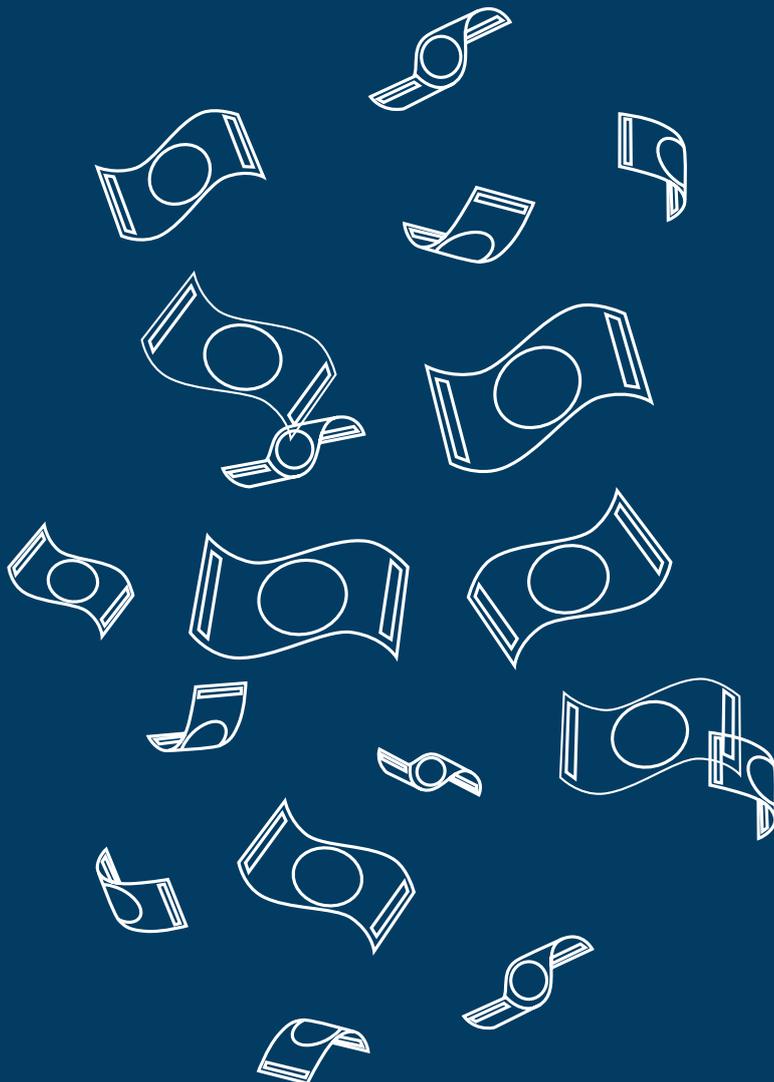


The EU Commission has to Cut Funding to Hungary: The Legal Case



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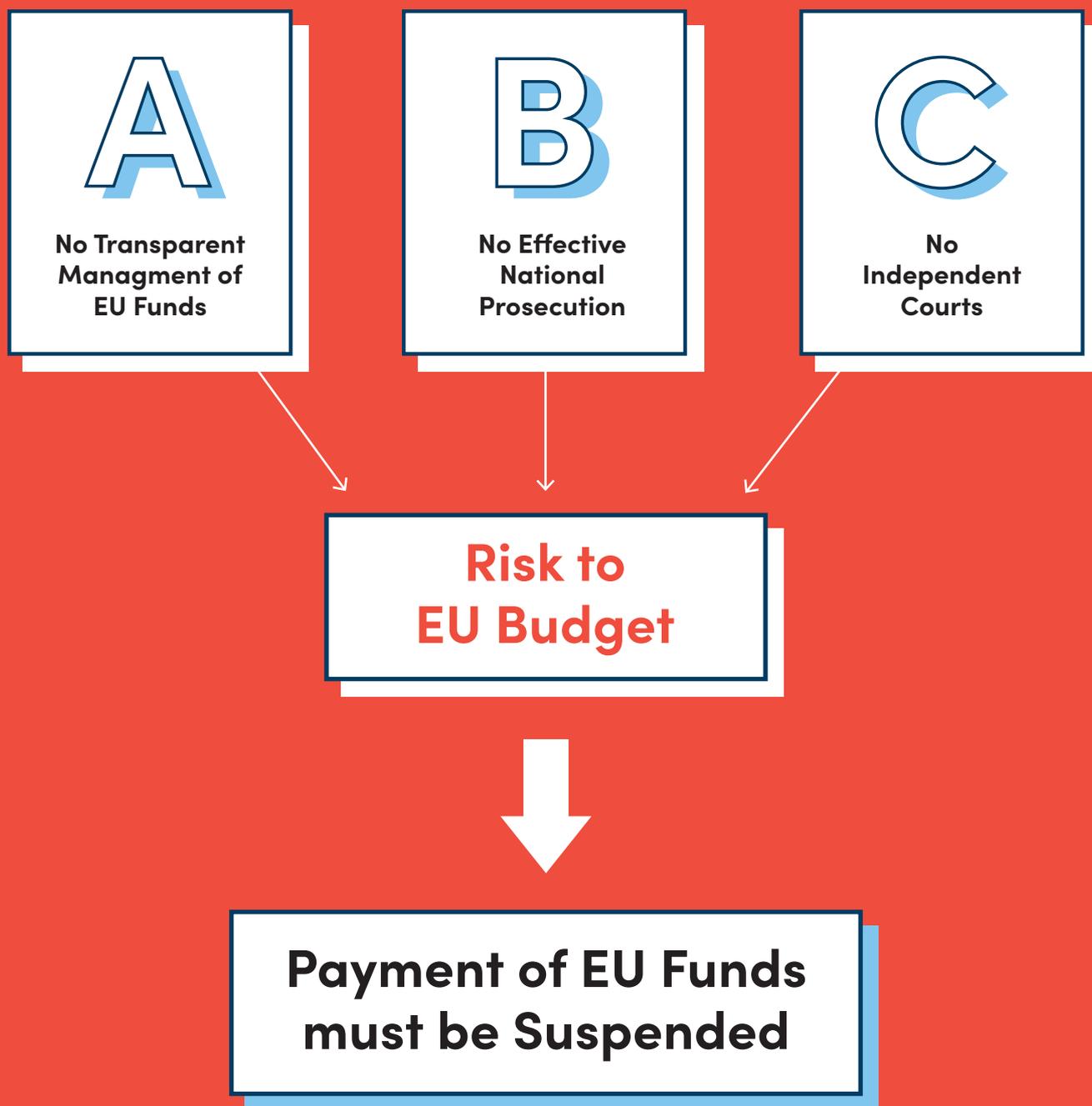
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The Legal Case for Activating the Rule of Law Conditionality Regulation Against Hungary



Today, we are calling for the European Commission to trigger the new Rule of Law Conditionality Regulation (EU, Euratom) 2020/2092 with respect to Hungary. Specifically, we are calling on the Commission to issue a written notification to the government of Hungary pursuant to Article 6(1) of the Regulation, the first step in a process that that could eventually lead to the suspension of EU funds.

In its resolution of 25 March 2021¹, the Parliament gave the Commission a deadline of 1st June 2021 to respond to our call for immediate application of the Regulation, which entered into force on 1 January 2021. We maintain that no guidelines are necessary for application of the Regulation because the Regulation itself does not require any. We also maintain that the Commission need not wait for the Court of Justice to rule on the actions for annulment lodged by Hungary and Poland challenging the legality of the Conditionality Regulation. An EU regulation does not cease to be applicable simply because it is subject to a pending annulment action; it ceases to be applicable only if and when the Court of Justice finds the action to be well founded and declares the nullity of the contested act. We now call upon the Commission to fulfil its duty as the Guardian of the Treaties and to apply the regulation against Hungary immediately.

To facilitate this process, we have done the Commission's work for it. We have prepared a model of the written notification under the Conditionality Regulation that the Commission should send to the Hungarian government immediately, documenting A) the lack of transparent management of EU funds, B) the lack of an effective national prosecution service to investigate and prosecute fraud, and C) the lack of guarantee of independent courts to ensure that EU law is reliably enforced, including measures affecting the Union's budget and financial interest.

We have also performed an analysis of the various EU legal instruments designed to ensure the proper spending of EU funds and have determined that the problematic stewardship of EU funds in Hungary is best addressed through the immediate application of the Conditionality Regulation.

Because the Rule of Law Conditionality Regulation applies only to EU funds awarded after 1 January 2021, some observers have assumed that it cannot be triggered until and unless specific instances of fraud against these new EU funds are detected. This is plainly incorrect. Rather, the *Regulation explicitly* demands the Commission take a proactive, risk-based approach to protect the EU budget. This does not require the Commission to wait until specific instances of fraud or abuse of EU funds under the new budget can be documented, but instead requires the Commission to act to address serious risk of such fraud or abuse created by existing breaches of rule of law principles enumerated in the Regulation.

The model notification we are publishing today demonstrates that this serious risk already exists in Hungary because Hungary has already engaged in grave breaches of the rule of law as defined in the Regulation, which requires that Member States ensure:

... 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 rule of law shall be understood having regard to the other Union values and principles enshrined in Article 2 TEU.²

Risks generated by a failure to honour the rule of law constitute a threat to the sound financial management of the Union budget, and these are risks that the Commission must confront and insist on being remedied by Hungary before it can responsibly release funds to it. Indeed: remedy first, release later.

While some of the rule of law breaches we identify in the model notification are of recent origin, many of them are long-standing violations that have not been addressed, despite repeated criticisms from many European Union institutions, international organisations, as well as civil society actors. The fact that some breaches are longstanding and persistent does not make them any less threatening to the responsible management of EU funds. Indeed, they may be even more threatening because they are more entrenched.

New streams of EU funds will soon be released to Member States under the Multi-Annual Financial Framework (MFF) and through the Recovery Fund, based on plans currently being submitted to the Commission. Now is the time for the Conditionality Regulation to be activated to ensure that proper accountability mechanisms are in place before funds allocated to Hungary are authorized and committed.

The European Commission frequently tells both the Parliament and the European public that it is serious about protecting the rule of law. Now is the time to show it.

How Breaches of Rule of Law in Hungary Put the EU Budget & Financial Interests at Risk

Background, Context & Illustrations

The Model Notification we are publishing today sets out in strictly legal terms the systemic rule of law breaches that justify the Commission’s immediate application of the Rule of Law Regulation. Below, we offer a more contextual description—including concrete illustrations—of how these rule of law breaches have posed—and continue to pose—grave risks to the EU budget and to the financial interests of the Union more generally.



The Lack of Transparent Management of EU Funds

Hungary’s problems with the proper stewardship of EU funds are not new. In the last MFF from 2014–2020, Hungary was at the top of list of countries for which the EU’s anti-fraud agency OLAF made financial recommendations to recover EU funds.

In 2019, the Commission imposed about €1 billion in financial corrections after having found “systemic irregularities, in particular related to discriminatory or restrictive exclusion, selection or award criteria, and unequal treatment of bidders.”³

This correction was the highest in the EU in the 2014–2020 period. The Group of States against Corruption, GRECO (a monitoring body based at the Council of Europe), has subjected Hungary to its special “non-compliance procedure” since 2017 because the Hungarian government has repeatedly failed to take the steps GRECO has recommended in order to prevent corruption. In its most recent report in November 2020, GRECO labelled the Hungarian government’s compliance with its recommendations as “globally unsatisfactory.”⁴

In its 2020 country-specific recommendations as part of the European Semester, the Council pointed to serious problems with Hungary’s procurement system, in particular a lack of competition in tenders. Nearly half of all public tenders generated only a single bid.⁵ In 2019, the European Semester country-specific recommendations had flagged the same problems, indicating “systemic irregularities in the tendering processes.”⁶ Indeed, the European Parliament’s own think tank assessed the Hungarian government’s compliance with European Semester recommendations in the field of public procurement and anti-corruption efforts as showing only “limited progress.”⁷

Going into the 2021–2027 funding cycle, Hungary’s management of EU funds has not improved, and in fact the European Parliament’s Think Tank noted changes in the wrong direction as “an amendment to the Public Procurement Act adopted in 2019 abolished a type of procedure used in the national regime for tenders below EU thresholds, which the Commission considered to be non-transparent and a barrier to competition.”⁸



Some specific cases illustrate the problems that the Commission has already identified. During the last MFF, a program for modernizing science education, the *Öveges* program, was adopted under the European Social Fund, providing new laboratory classrooms in each of 43 Hungarian high schools at the cost of €1 million euros per classroom. The audit reports soon showed “the existence of significant deficiencies in the management and control system ... concerning procedures for selecting operations, the first level of management verifications and the audit trail.”⁹ The Commission’s investigation found, for one example among many, that each classroom was charged separately and additionally for the development of textbooks even though the textbook for each of the classrooms was the same.¹⁰ The Commission concluded that the managing authority was not uncovering fraud effectively, not least because the audit trail was found to be defective.¹¹ Despite much dialogue with the Hungarian government over the matter, the Commission ultimately found that the Hungarian authorities did not correct the irregularities.¹² Funding to this project was therefore suspended and a financial correction applied. The following year, the Hungarian government corrected the deficiencies sufficiently on this particular project for the Commission to lift the suspension.

But corrections on a single project (and for that matter, Commission oversight over individual projects) do not correct the serious structural deficiencies in the management of EU funds more generally. After the corrections to the *Öveges* program, OLAF investigated thirty-five contracts worth €40 million that were awarded to a single company, *Elios Zrt.*, to modernize street lighting systems in twenty-eight municipalities using EU funds.

Though OLAF files remain secret, the Hungarian investigative reporting outlet *Atlatszo.hu* was able to use the Hungarian freedom of information act to uncover the correspondence between OLAF and a number of these municipalities in early 2018¹³ to show precisely how



Istvan Tiborcz, Viktor Orbán's son-in-law, whose company won tenders worth 40 million Euro of EU funds to modernize street lights. OLAF found serious irregularities and conflicts of interests in relation to the awarded contracts but the national investigation was closed finding no crime. (Credit: Daniel Nemeth)

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businessmen together won nearly €6.5 billion between 2010 and 2018 from state contracts

particular municipalities were able to channel the contracts to the son-in-law of the Prime Minister, who in fact won the tenders for all twenty-eight of the municipalities.

The auditor on the project was a company owned by a friend of the Prime Minister's son-in-law. Though Hungarian authorities launched an investigation into *Elios* after OLAF had indicated that serious irregularities and conflicts of interest plagued its projects, the Hungarian investigation was quietly closed after finding that there was no crime.¹⁴

Investigative reporting has shown that the public contracts have massively benefited PM Viktor Orbán's family and friends. An investigation by the *Financial Times* documented the rise of a new set of Hungarian oligarchs close to PM Orbán who have made most of their money through state contracts.¹⁵ An analysis by *Reuters* of Hungarian public procurement data showed that just ten businessmen—including both PM Orbán's close childhood friend and his son-in-law—together won nearly €6.5 billion between 2010 and 2018 from state contracts.¹⁶ Development projects at Lake Balaton have proceeded with a budget of about €2.5 billion, 40% of which was earmarked to come from EU funds for underdeveloped regions. But just six men close to PM Orbán won tenders worth more than 25% of the funds committed to the project.¹⁷

An analysis by the Corruption Research Center Budapest of nearly 250,000 public contracts issued from 2005 to 2020 showed that, though the intensity of competition (as measured by number of bids) increased after OLAF's investigations into Hungarian procurement started in 2016, the share of public procurements won by crony companies nonetheless increased nearly every year since 2011.¹⁸

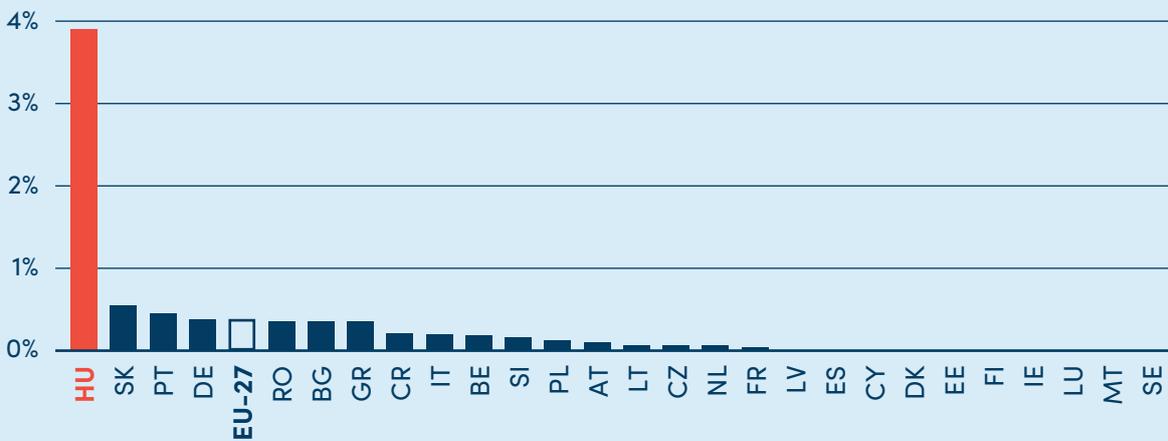
In 2019, companies close to the government won 21% of the value of all public tenders, and in the early months of the pandemic in 2020, closely connected companies won fully 27% of the value of all public tenders.¹⁹

Repeated investigations into Hungary’s public procurement system have indicated that the problems with the deficiencies in the rule of law have not been corrected and remain systemic. EU institutions are well aware of this. OLAF’s 2019 report showed that Hungary had by far the largest percentage of its payments flagged for financial irregularities of any Member State.²⁰ The Commission’s history of attempting to monitor corruption project by project in Hungary demonstrates that the Hungarian government will often make specific corrections to specific projects in order to keep the funds flowing, but systemic changes to the management and control systems for spending EU funds have not been forthcoming. Indeed, due to some recent legislation passed in Hungary in anticipation of the new funding cycle which the Hungarian government knew would be accompanied by the Rule of Law Conditionality Regulation, the problem has gotten worse.

Starting in 2019, the Hungarian government has repurposed an existing legal form, the *közérdekű vagyonkezelő alapítványok* or, literally, public interest asset management foundation. These foundations (“public interest foundations”) are structured in such a way that they can escape oversight in the way they spend public funds. Public interest foundations are regulated under the Hungarian Civil Code²¹ and are thus private institutions. Through the Ninth Amendment to the constitution in December 2020, the law creating the public interest foundations was designated “cardinal” (that is, the law now requires a two-thirds vote of the Parliament for any modification). The Ninth Amendment at the same time defined “public funds” in Hungarian law to exclude all assets of these public interest foundations because they are now held in “private” hands under Hungarian law.

Financial irregularities found by the EU’s anti-fraud office (% of payments)

The EU’s Anti-Fraud Office found that in Hungary, the ratio of irregular payments is around ten times the EU average



Source: OLAF Report 2019, p. 39

Public interest foundations are therefore, legally speaking, private actors whose financial operation is no more subject to public audit than that of a private business. But they are established for a “public purpose.” The founding boards of these foundations are appointed by the Hungarian government. Indeed, in a radio interview on 30 April 2021, PM Orbán openly admitted that the boards were to be filled only with politically like-minded people excluding those with “internationalist” or “globalist” views.²² Already the current justice minister chairs one board and the current foreign minister sits on another. After the initial appointment of board members, any vacancy that arises thereafter is filled by the existing board, so the governance of these foundations is self-sustaining. The board also appoints the auditor to check the books of these foundations; no public audit can reach them, nor can freedom of information requests. Public interest foundations are run more like private businesses than like state agencies even if their boards are full of cabinet ministers and other public figures associated with the governing party.

The purpose of these foundations became clear through the transfer of massive amounts of public property into these public interest foundations in April 2021²³, effectively insulating all management and disposition of this property from public view. Many of these foundations will be recipients of EU funds but once public contracts are awarded to them, public management and accountability ceases. In particular, most of Hungary’s universities, along with a number of other cultural institutions, have now been converted from public institutions into private foundations. Of the thirty-one public interest foundations currently regulated by this law, fully twenty-one are universities that have now been transferred—most within the last month—into this new legal form whose assets can no longer be publicly scrutinized. New public interest foundations may be added to this list with the government’s reliable two-thirds majority in the Parliament.



Hungarian art students and professors protest the government take-over of their university (Credits: Gyula Bujdosó/ Shutterstock.com)

The EU's goals in the next funding cycle rely heavily on supporting innovation and technology.²⁴ Hungary has been persistently criticized by the European Commission in its European Semester reports for having a lower-than-average percentage of university graduates in the population and for falling behind in ensuring that its population has skills for the new economy.²⁵ The combination of policy areas that the Commission has set out for funding, combined with the European Semester recommendations for Hungary will practically necessitate putting a great deal of EU money into the higher education sector. In its initial public plan for spending the Recovery Fund, the Hungarian government indicated that it would spend fully 20% of the Recovery Funds through universities.²⁶ While the Commission seems to have rejected this plan and Prime Minister Orbán has responded by saying that Hungary will take only the grant part of the Recovery Fund and not the loans²⁷, Hungary's new plan of action will still require much of the influx of EU funds to go through universities.

Let us consider concretely what that would mean: Contracts to increase the number of university graduates, or to encourage basic university research to be brought to market, or to develop new green technologies will be bid on by universities. But twenty-one of Hungary's universities are now governed by boards whose members have been named precisely for their connection to the governing party. Once public money—including EU money—is awarded to the public interest foundations, it leaves the realm of the state audit and public management.

Any public funds distributed to these twenty-one universities disappear into pockets that cannot be probed by EU auditors because they will not be able to get the relevant data from Hungarian auditors to see what happened to the money.

Even if universities produce competitive bids, these bids will be like tines of a fork—appearing separate at the end, but linked by a common handle behind them. Universities may be incorporated and managed separately, but the members of the governing boards are linked through their association with the governing party. Bids generated by different universities managed by the same circle of political friends may look competitive, but they will not necessarily be so.

Given abundant evidence of corruption in the use of EU funds in Hungary, the risks to the EU budget clearly have increased in recent months, even above and beyond the initially very high background risk. The Conditionality Regulation should be triggered where rule of law breaches affect, or risk affecting the authorities implementing the EU budget and the functioning of those who control, monitor and audit EU funds.²⁸ The Hungarian track record and new developments provide ample evidence that EU funds are not well managed, monitored or controlled.

B The Lack of an Effective National Prosecution Service to Investigate and Prosecute Fraud

The lush landscape of corruption and cronyism we have sketched above presents a stark contrast with the desert of high-level public prosecutions for fraud. In its 2019 country-specific recommendations as part of the European Semester, the Council expressed continuing concern about weaknesses in the Hungarian prosecution service in which there were “still no signs of determined action to prosecute corruption involving high-level officials or their immediate circle when serious allegations arise.”²⁹

The 2020 European Semester country-specific recommendations noted even more bluntly that “[d]etermined systematic action to prosecute high-level corruption is lacking.”³⁰

The European Parliament Think Tank report assessing progress in compliance with European Semester recommendations concluded there was:

No Progress. There is no determined systematic action to prosecute high-level corruption. According to the Prosecutor General’s Office, most corruption-related cases involve public officials, typical cases involving tax and customs officials. While some high-level cases have been prosecuted, there is a general perception of impunity among the business community. Hungary reports relatively few cases, while OLAF finds much more in Hungary than in other countries. Restrictions on access to information hinder corruption prevention and the application of fees for accessing public information has a deterrent effect on citizens and NGOs exercising their constitutional right. While the Freedom of Information Act has not been touched, piecemeal changes to other sectoral laws have continued, corroding the overall transparency and access to information framework.

The Prosecutor General in Hungary is Péter Polt, a long-time ally of the Prime Minister and a founding Fidesz member who ran for a parliamentary seat on the Fidesz list in 1994. He was elected Prosecutor General during the first Orbán government in 2000 and was returned to that office by the second Orbán government in 2010. Despite the fact that his tenure has been repeatedly criticized by European institutions for failing to come to grips with corruption, Polt was re-elected by the Fidesz two-thirds majority in Parliament in 2019 for another nine-year term. We cannot realistically expect the Hungarian strategy for public prosecutions to change without a change of leadership in that office.

Although the hierarchical arrangement of the prosecution service created through a pair of laws in 2011 has been criticized since the Venice Commission report of 2012³¹, the public prosecutor's office still retains a rigid structure in which each prosecutor can be disciplined by those higher up in the office rather than by an independent authority. At the top of this pyramid, the Public Prosecutor has been granted by law the same immunity as members of Parliament, a general immunity that applies to all of his actions and can only be lifted by a two-thirds vote of the Parliament. The structure of the prosecution service in Hungary thus lends itself to tight control *from* the top without any accountability *at* the top.

Under EU law as it presently stands, national governments are responsible for taking action on files referred to the Member States by OLAF as well as for conducting their own investigations of corruption. If national governments fail to investigate and prosecute the misuse of EU funds, the EU cannot take over and do the job. Of course, this was one important reason for creating the European Public Prosecutor's Office (EPPO). However, Hungary remains one of only five EU Member State that has not joined the EPPO.

The lack of determination of the prosecution services in Hungary to effectively investigate and prosecute high-level fraud in the use of EU funds provides another reason for triggering the Conditionality Regulation.³²



The Lack of Guarantee of Independent Courts to Ensure that EU Law is Reliably Enforced

Enforcing procurement rules, ensuring prosecution of fraud, adjudicating challenges to tender procedures and being able to make references to the European Court of Justice, among other actions related to the EU budget, demand independent courts. While many judges in the ordinary courts in Hungary remain independent, they have been increasingly subjected over the last ten years to growing political pressures, as evidenced by the fact that

Hungary now has the lowest score in the World Justice Project's Rule of Law Index of any EU Member State³³ and was the first EU Member State to be categorized as an autocratic regime by the Varieties of Democracy (V-Dem) Institute³⁴ and by Freedom House.³⁵ Attacks on judicial independence have been central to all of these indicators.

The Hungarian government's strategy for compromising the independence of courts has not in general involved wholesale firing of judges (at least not since about 15% of Hungarian judges were removed by suddenly lowering the judicial retirement age in 2012)³⁶.

Instead, the appointment of judges has been politicized and dominated exclusively by the ruling party, and court procedures have been adjusted so that judges aligned with the ruling party have been steadily appointed to the bench and so that specific cases can always be assigned to these friendly judges.

The power to appoint judges was strongly centralized after 2012 in the hands of a politically elected former judge, Tünde Handó, who had been a friend since college days with Prime Minister Orbán. Handó was elected by a two-thirds vote of the Fidesz Parliament into the newly created position of president of the National Judicial Office (NJO) in 2012 with the power to hire, fire, reassign, promote, demote and discipline all judges in the ordinary Hungarian judiciary without any substantial checks on her power.

15%

of Hungarian judges were removed by suddenly lowering the judicial retirement age in 2012



Tünde Handó, judge at the Constitutional Court and college friend of Prime Minister Orbán. The power to appoint judges has been centralized in her hands after 2012. (Credits: posztos/Depositphotos.com)

International criticism of this arrangement eventually forced the Hungarian government to compromise by giving a minor role in the selection process to the National Judicial Council (NJC), a body of judges elected by the judiciary itself. The NJC was given the power to rank the candidates for a judgeship and, if the president of the NJO disagreed with the ranking, she could fail to choose the first person on the list, as long as she provided reasons for her choice and didn't stray in her selection too far down the list that the NJC had ranked.

In practice, this arrangement has not worked well. In cases where the NJC and the president of the NJO have disagreed—cases that have been quite frequent—the president of the NJO has used her legal authority to simply cancel the search and install a temporary appointee into the open judgeship. In both 2018 and 2019, the NJC issued reports accusing Handó of abuse of power for increasingly bypassing the NJC; she retaliated by subjecting the judges on the NJC to administrative pressure, including initiating disciplinary actions against some of the judges who had criticized her and publishing defamatory articles about these judges' personal lives.³⁷ She then refused to work with the NJC at all. The European Association of Judges sent an assessment team and released a report on the matter, concluding that the judiciary faced “a very grievous situation which in some aspects comes close to a ‘constitutional crisis’ due to the activity of the President of the [NJO].”³⁸ The NJC rebelled against Handó's actions and recommended to the Parliament that Handó be impeached. Without even holding a debate on the issue, the Parliament refused to remove her. Instead, shortly thereafter, the Parliament elected Handó as a judge on the Constitutional Court. But Handó's replacement, also elected by the Fidesz two-thirds majority in the Parliament, still has all of the same powers that Handó did.

The end result is that the Hungarian judiciary is filled with judges appointed over the last eleven years in an openly political process controlled exclusively by the ruling Fidesz party that was only slightly tamed by the interventions of judges. As a result, there are government-friendly judges on every court in the country and all of the court presidents have been appointed through this process.

In addition to control of judges through the appointment process, there is also control of judges through the disciplinary process. One of the judges on the NJC who had voted to impeach Handó was then threatened with a disciplinary procedure himself.³⁹ He took a criminal case before him involving a non-Hungarian EU national and referred it to the Court of Justice asking, among other things, whether the pressure brought to bear on him affected his independence. The Prosecutor General appealed the case to the Supreme Court, which ruled that the reference to the Court of Justice was unlawful because the questions it raised were unrelated to the case before the referring judge.⁴⁰ The interim president of the referring judge's court (who had been appointed by Handó over the objection of the NJC after the search for the permanent president was cancelled) then initiated disciplinary proceedings against the referring judge, proceedings that were eventually dropped but that surely had a chilling effect on other judges thinking of referring issues related to the independence of the Hungarian judiciary to the ECJ. As the Commission noted in its 2020 Rule of Law report:

The fact that the Kúria can, in the context of an extraordinary judicial remedy, review the necessity of preliminary references could interfere with the possibility of national courts to refer questions of interpretation of Union law to the Court of Justice and that disciplinary proceedings could be initiated, could discourage individual judges from making requests for a preliminary ruling.⁴¹

This episode illustrates that judges who try to enforce EU law in cases where the government objects can be subject to politically motivated disciplinary procedures. The mere existence of this situation will have a chilling effect, discouraging judges from ruling against the government or powerful actors connected to the government in any case, including those involving the EU budget and the financial interests of the Union.

In Hungary, court presidents have the power to determine how cases are assigned to judges—and how judges are assigned to panels to decide these cases. The Omnibus Act of 2019⁴² has made it much easier for court presidents to direct cases to specific judges. Prior to this law, the process of assigning cases to judges in Hungary was not automated or strictly rule-governed; instead, court presidents designated a general assignment system once each year to send cases to specific judges or panels of judges. Under the new law, however, the remaining legal constraints the prevented court presidents from simply assigning particular cases to particular judges as the cases came along have been lifted. Now, a court president can decide that for case A, judges 1, 2, and 7 should decide the case, but for case B, judge 7 should be replaced with judge 4.

This has given rise to the concern that cases affecting the government's interests can always be channelled to friendly judges by court presidents, all of whom have now been appointed through a politicized process.

Two other new features of the Omnibus Act of 2019⁴³ intensify concern about the independence of the judiciary: a) a new form of appeal to the Constitutional Court and b) new powers of constitutional judges. The Omnibus Act has also provided an opportunity for the government to capture the presidency of Supreme Court.

Should any public authority object to a decision of any court, the Omnibus Act permits a novel form of appeal directly to the Constitutional Court, bypassing the normal appeals process through the ordinary courts. So, for example, if the government loses an administrative law case in the central court in Budapest, the Budapest Metropolitan Court, it can either appeal through the normal judicial channels up to the Supreme Court or it can now appeal directly to the Constitutional Court.

Since 2013, the Constitutional Court has been staffed with a majority of judges elected by the Fidesz supermajority in the Parliament; at present, almost every member of the Court has been elected by the Fidesz supermajority. It virtually always rules in favour of the government's position on any contested matter.

For any public authority to have the possibility of a quick appeal directly to the Constitutional Court practically ensures favourable decisions in cases of high salience to the government. If the audit office, prosecutor's office or any ministry loses a case in the ordinary courts, this new appeals procedure gives that body a friendly forum to review the case. This includes, of course, cases that involve the expenditure of EU funds.

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new judges could be appointed in 2019, increasing the size of the court by nearly one quarter and giving rise to accusations of court-packing

The Omnibus Act of 2019 also creates the legal possibility for constitutional judges to be transferred to sit on ordinary courts without going through an additional vetting process.⁴⁴ This power was used in late 2020 to appoint one of the constitutional judges directly into the position of president of the Supreme Court (*Kúria*). The prior president, Péter Darák, had been one of the first judges chosen by Handó, but he turned out to be surprisingly independent. When Darák's term ended, he was not renewed in the position, though he was eligible. Instead, the President of the Republic nominated one of the Constitutional Court judges, András Zsolt Varga (a former deputy to the current public prosecutor), to succeed Darák. The National Council of the Judiciary objected because Varga had never sat on an ordinary court and therefore had neither trial nor appeals experience. But this objection was ignored and as of 1 January 2021, a judge who had originally been elected to the Constitutional Court in a purely political procedure by the Parliament has now been installed as the president of the Supreme Court.

The Omnibus Act of 2019 gives President Varga 21 new judges to appoint to his own court, increasing the size of the court by nearly one quarter and giving rise to accusations of court-packing by Fidesz.

The Omnibus Act of 2019 also gives the Supreme Court a power similar to that wielded by the Soviet-era Supreme Court. The new president of the Supreme Court may constitute a panel of judges of his own choosing to issue a ruling on the unification of jurisprudence, or leading judgment, establishing the authoritative interpretation of any law, binding on all courts.⁴⁵ If a lower-level court deviates from this understanding, its decisions may be subject to review by the Supreme Court.⁴⁶ This establishes a heavy-handed control by the Supreme Court over the lower courts and lower court judges depart from this interpretation at their peril, knowing that the same hands that have chosen the president of the Supreme Court also control the disciplinary procedures.

The judiciary in Hungary has been subjected to a decade of political pressure and political shaping. While many individual judges still hold out and can be relied upon to be independent, the judicial system has been designed so that cases of high salience to the government can always be channeled to judges who will reliably side with the government. Cases involving the spending of EU funds are likely to be highly salient to the government, not because it wants to ensure the proper spending of EU funds but instead because well-documented corruption investigations have shown that those close to the government have disproportionately benefited from EU funds.

The government's ability to always find a friendly judge can and, in a society as full of corruption and cronyism as Hungary, surely will compromise the independence of the judiciary and will almost surely include cases where public contracts and the distribution of EU funds will be at issue.

The systematic availability of channels for politically sensitive cases to always reach friendly judges provides another reason why the Conditionality Regulation⁴⁷ should be triggered.

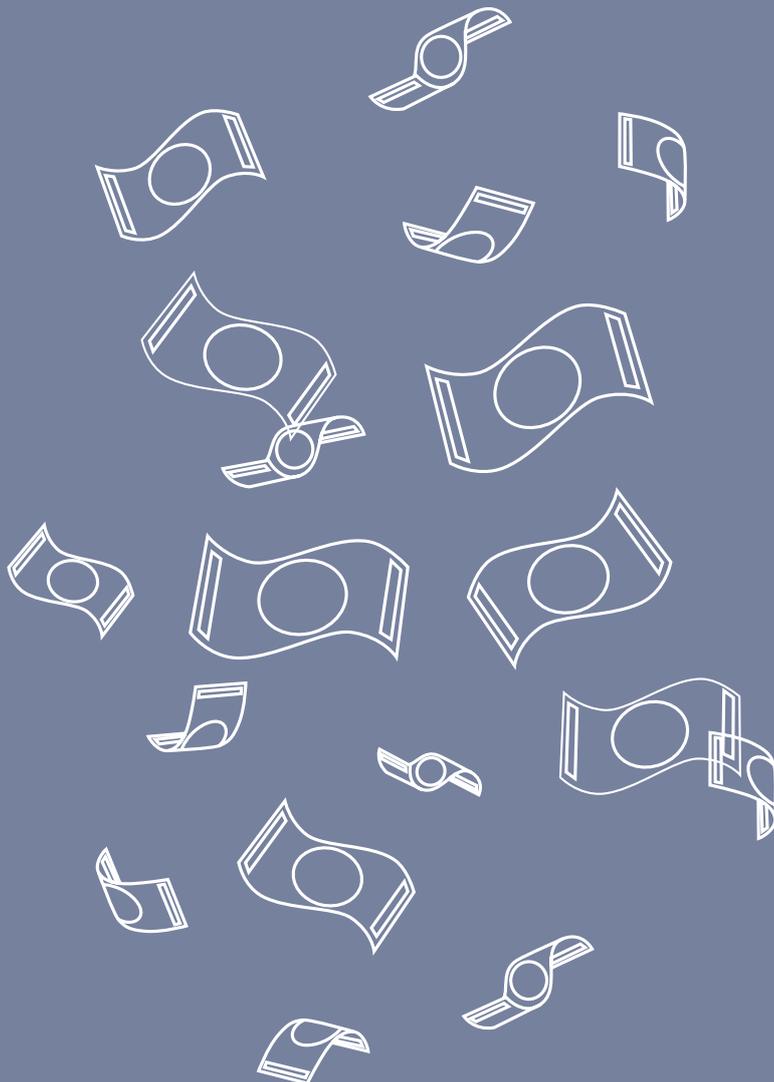
These three areas taken together—the lack of transparent management of EU funds, the lack of an effective national prosecution service and the lack of guarantees of judicial independence—show that Hungary has already egregiously violated basic rule of law principles as laid out in the Conditionality Regulation. The government of Hungary cannot be a reliable steward of EU funds until these problems are corrected. The Commission should therefore immediately trigger the Conditionality Regulation with regard to Hungary.

- 1 European Parliament Resolution of 25 March 2021 on the Application of Regulation (EU, Euratom) 2020/2092, the Rule of Law Conditionality Mechanism (2021/2582/(RSP), P9_TA(2021)0103, at www.europarl.europa.eu/doceo/document/TA-9-2021-0103_EN.html.
- 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, Article 2(1).
- 3 Commission Staff Working Document Country Report, Hungary 2020. Accompanying the Document: Communication From The Commission to the European Parliament, The European Council, The Council, The European Central Bank and the Eurogroup 2020 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011 at p. 43, available at eur-lex.europa.eu/legal-content/EN/TXT/?qid=1584543810241&uri=CELEX%3A52020SC0516.
- 4 Group of States Against Corruption (GRECO), Council of Europe. Fourth Evaluation Round, Corruption Prevention in Respect Of Members Of Parliament, Judges And Prosecutors, Second Interim Compliance Report, 17.11.2020, Greco RC4(2020)10.
- 5 Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Hungary and Delivering a Council opinion on the 2020 Convergence Programme of Hungary (2020/C 282/17), available at eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32020H0826%2817%29&qid=1620472484834.
- 6 Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Hungary and Delivering a Council Opinion on the 2019 Convergence Programme of Hungary (2019/C 301/17), available at op.europa.eu/en/publication-detail/-/publication/421552eb-cffd-11e9-b4bf-01aa75ed71a1/language-en/format-PDFA2A.
- 7 European Parliament Think Tank, Country-Specific Recommendations for 2019 and 2020: A Tabular Comparison and Overview of Implementation, May 2021 pp. 102-104 at [www.europarl.europa.eu/RegData/etudes/STUD/2021/651389/IPOL_STU\(2021\)651389_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2021/651389/IPOL_STU(2021)651389_EN.pdf).
- 8 Id. at 102.
- 9 European Commission, Commission Decision of XXX on the Suspension of Interim Payments for the Operational Programme for Social Renewal for Community Assistance from the European Social Fund under the Convergence and Regional Competitiveness and Employment Objectives In Hungary (CCI No 2007HU05UPO001) at para. 8 available at ec.europa.eu/transparency/regdoc/rep/3/2015/EN/3-2015-5839-EN-F1-1.PDF (For the official Hungarian version, see ec.europa.eu/transparency/regdoc/rep/3/2015/HU/3-2015-5839-HU-F1-1.PDF).
- 10 European Commission, Commission Decision of XXX on the Suspension of Interim Payments for the Operational Programme for Social Renewal for Community Assistance from the European Social Fund under the Convergence and Regional Competitiveness and Employment Objectives In Hungary (CCI No 2007HU05UPO001) at para. 26 available at ec.europa.eu/transparency/regdoc/rep/3/2015/EN/3-2015-5839-EN-F1-1.PDF (For the official Hungarian version, see ec.europa.eu/transparency/regdoc/rep/3/2015/HU/3-2015-5839-HU-F1-1.PDF).
- 11 Id. at para. 28 ff.
- 12 Id. at para. 28 ff.
- 13 Katalin Erdélyi, "LED Lamps by Orbán's Son-In-Law: This is How EU Funds Were Stolen in the Town of Vác." 26 August 2018, [atlatzso.hu](http://atlatzso.hu/en/2018/08/26/led-lamps-by-orbans-son-in-law-this-is-how-eu-funds-were-stolen-in-the-town-of-vac/) at english.atlatzso.hu/2018/08/26/led-lamps-by-orbans-son-in-law-this-is-how-eu-funds-were-stolen-in-the-town-of-vac/.
- 14 Reuters, "Hungarian Police Find No Crime in Projects Disputed by EU Anti-Fraud Office." 7 November 2018 at www.reuters.com/article/uk-hungary-eu-funds-probe/hungarian-police-find-no-crime-in-projects-disputed-by-eu-anti-fraud-office-idUKKCN1NC12N.
- 15 Neil Buckley and Andrew Byrne, "Viktor Orbán's Oligarchs: A New Elite Emerges in Hungary." Financial Times, 21 December 2018 at www.ft.com/content/ecf6fb4e-d900-11e7-a039-c64b1c09b482.
- 16 Márton Dunai, "Exclusive: Hungary's Premier's Friends and Family Win More and More Public Business." Reuters, 15 March 2018 at www.reuters.com/article/us-hungary-orban-balaton-procurement-exc/exclusive-hungary-premiers-friends-and-family-win-more-and-more-public-business-idUSKCN1GR213.
- 17 Márton Dunai, "How Viktor Orbán Will Tap Europe's Taxpayers and Bankroll his Friends and Family." Reuters, 15 March 2018 at www.reuters.com/investigates/special-report/hungary-orban-balaton/.
- 18 Corruption Research Center Budapest, New Trends in Corruption Risk and Intensity of Competition in the Hungarian Public Procurement from January 2005 to April 2020, available at www.crcb.eu/wp-content/uploads/2020/05/2020_hpp_0520_flash_report_1_200526_.pdf.
- 19 Id. at p. 10.
- 20 The OLAF Report 2019, available at ec.europa.eu/anti-fraud/sites/antifraud/files/olaf_report_2019_en.pdf; See also, European Parliament, Report on a Proposal Calling on the Council to Determine, Pursuant to Article 7(1) of the Treaty on European Union, the Existence of a Clear Risk of a Serious Breach by Hungary of the Values on which the Union is Founded (2017/2131(INL), A8-0250/2018, 4.7.2018, (hereafter, 'the Sargentini Report.') available at www.europarl.europa.eu/doceo/document/A-8-2018-0250_EN.html.
- 20 The OLAF Report 2019, available at ec.europa.eu/anti-fraud/sites/antifraud/files/olaf_report_2019_en.pdf; See also, European Parliament, Report on a Proposal Calling on the Council to Determine, Pursuant to Article 7(1) of the Treaty on European Union, the Existence of a Clear Risk of a Serious Breach by Hungary of the Values on which the Union is Founded (2017/2131(INL), A8-0250/2018, 4.7.2018, (hereafter, 'the Sargentini Report.') available at www.europarl.europa.eu/doceo/document/A-8-2018-0250_EN.html.
- 21 Act V of 2013, the Hungarian Civil Code. After the Hungarian government understood that the Conditionality Regulation would be enacted, it has actively repurposed this existing civil law institution so that it can hide public assets under private management. The government has done so through the 2019 Act on Public Interest Asset Management Foundations (Act XIII of 2019), and the 2021 Act on Public Interest Asset Management Foundations (Act IX of 2021).
- 22 Deutsche Welle, "Hungary's Viktor Orbán Seeks to Control Universities," 6 May 2021 at www.dw.com/en/hungarys-viktor-orban-seeks-to-control-universities/a-57444869.
- 23 Act IX of 2021.
- 24 European Commission, EU's Next Long-Term Budget and Next-GenerationEU: Key Facts and Figures at ec.europa.eu/info/sites/default/files/about_the_european_commission/eu_budget/mff_factsheet_agreement_en_web_20.11.pdf.

- 25 Commission Staff Working Document Country Report Hungary 2020, Accompanying The Document Communication From The Commission To The European Parliament, The European Council, The Council, The European Central Bank And The Eurogroup 2020 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011, available at eur-lex.europa.eu/legal-content/EN/TXT/?qid=1584543810241&uri=CELEX%3A52020SC0516.
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- 28 Conditionality Regulation, Article 4(2) (a) (b) and (g).
- 29 Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Hungary and Delivering a Council Opinion on the 2019 Convergence Programme of Hungary (2019/C 301/17), at para. 16.
- 30 Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Hungary and Delivering a Council opinion on the 2020 Convergence Programme of Hungary (2020/C 282/17) at para. 33.
- 31 Venice Commission, Opinion on Act CLXIII of 2011 on the Prosecution Service and Act CLXIV of 2011 on the Status of the Prosecutor General, Prosecutors and Other Prosecution Employees and the Prosecution Career, Hungary, 19 June 2012, CDL-AD(2012)008 at [www.venice.coe.int/webforms/documents/?pdf=CDL-AD\(2012\)008-e](http://www.venice.coe.int/webforms/documents/?pdf=CDL-AD(2012)008-e).
- 32 Conditionality Regulation, Articles 4(2) (c) and (e).
- 33 World Justice Project Rule of Law Index 2020, World Justice Project, Washington, DC. Available at worldjusticeproject.org/sites/default/files/documents/WJP-ROLI-2020-Online_0.pdf.
- 34 V-Dem downgraded Hungary from a democracy to the category of "electoral autocracy" in 2019, explaining, "Hungary is no longer a democracy, leaving the EU with its first non-democratic Member State." See Varieties of Democracy Institute, Democracy Report 2020. Autocratization Surges – Resistance Grows, available at www.v-dem.net/media/filer_public/de/39/de39af54-0bc5-4421-89ae-fb20dcc53dba/democracy_report.pdf, at p.4. Hungary remained in the "electoral autocracy" category in 2020, see Varieties of Democracy Institute, Democracy Report 2021. Autocratization Turns Viral, available at www.v-dem.net/media/filer_public/c9/3f/c93f8e74-a3fd-4bac-adfd-ee2cfbc0a375/dr_2021.pdf.
- 35 Freedom House, Nations in Transit 2020: Dropping the Democratic Façade, available at freedomhouse.org/sites/default/files/2020-04/05062020_FH_NIT2020_vfinal.pdf. Freedom House down-graded Hungary from a democracy to a "transitional/hybrid regime" in 2020, explaining (p.2) that, Hungary's decline has been the most precipitous ever tracked in Nations in Transit; it was one of the three democratic frontrunners as of 2005, but in 2020 it became the first country to descend by two regime categories and leave the group of democracies entirely.
- 36 The European Commission brought a successful infringement action against Hungary on grounds of age discrimination. *Commission v Hungary* (Case C-286/12). But the Hungarian government merely compensated most of the prematurely retired judges and reinstated very few of them. In the end, the Hungarian government was able to install its preferred judges into key leadership positions as if the case had never been brought.
- 37 US Department of State, Annual Human Rights Report: Hungary, 2019 p. 6 at www.state.gov/wp-content/uploads/2020/03/HUNGARY-2019-HUMAN-RIGHTS-REPORT.pdf.
- 38 European Association of Judges, Report on the Fact-Finding Mission of the EAJ to Hungary, available at www.iaj-uim.org/iuw/wp-content/uploads/2019/05/Report-on-the-fact-finding-mission-of-a-delegation-of-the-EAJ-to-Hungary.pdf.
- 36 The European Commission brought a successful infringement action against Hungary on grounds of age discrimination. *Commission v Hungary* (Case C-286/12). But the Hungarian government merely compensated most of the prematurely retired judges and reinstated very few of them. In the end, the Hungarian government was able to install its preferred judges into key leadership positions as if the case had never been brought.
- 37 US Department of State, Annual Human Rights Report: Hungary, 2019 p. 6 at www.state.gov/wp-content/uploads/2020/03/HUNGARY-2019-HUMAN-RIGHTS-REPORT.pdf.
- 38 European Association of Judges, Report on the Fact-Finding Mission of the EAJ to Hungary, available at www.iaj-uim.org/iuw/wp-content/uploads/2019/05/Report-on-the-fact-finding-mission-of-a-delegation-of-the-EAJ-to-Hungary.pdf.
- 39 Hungarian Helsinki Committee, "Disciplinary Action Threatens Judge for Turning to EU Court of Justice." Available at helsinki.hu/en/disciplinary-action-threatens-judge-for-turning-to-cjeu/.
- 40 Commission Staff Working Document, 2020 Rule of Law Report, Country Chapter on the Rule of Law Situation in Hungary Country Report, SWD(2020) 316 final, Brussels 30.9. 2020, p. 4.
- 41 *Id.* p. 4.
- 42 Act CXXVII of 2019 (the "2019 Omnibus Act"), Article 45
- 43 Act CXXVII of 2019, Article 55.
- 44 Act CXXVII of 2019, Art. 44 and 91.
- 45 Act CXXVII of 2019, Articles 67-74.
- 46 Hungarian Helsinki Committee, "New Law Threatens Judicial Independence in Hungary – Again." Available at helsinki.hu/wp-content/uploads/HHC_Act_CXXVII_of_2019_on_judiciary_analysis_2020Jan.pdf.
- 47 Conditionality Regulation, Article 4(2) (d) and (h).

Written Notification to Hungary

under REGULATION (EU, Euratom) 2020/2092
on a general regime of conditionality for the
protection of the Union budget



Written Notification to the Government of Hungary pursuant to REGULATION (EU, Euratom) 2020/2092 on a general regime of conditionality for the protection of the Union budget

Article 6(1) of REGULATION (EU, Euratom) 2020/2092 on a general regime of conditionality for the protection of the Union budget (hereafter “the Conditionality Regulation”) establishes that:

Where the Commission finds that it has reasonable grounds to consider that the conditions set out in Article 4 are fulfilled, it shall, unless it considers that other procedures set out in Union legislation would allow it to protect the Union budget more effectively, send a written notification to the Member State concerned, setting out the factual elements and specific grounds on which it based its findings. The Commission shall inform the European Parliament and the Council without delay of such notification and its contents.

Recital 14 clarifies that the Regulation complements a variety of instruments and processes that promote the rule of law and its application, including infringement proceedings (Article 258 TFEU), the procedure provided for in Article 7 TEU, financial support for civil society organisations, the European Rule of Law Mechanism, and the EU Justice Scoreboard. Recital 17, first sentence, adds that measures under this Regulation are necessary in particular where other procedures set out in Union legislation would not allow the Union budget to be protected more effectively. Recital 17, second sentence, clarifies in this regard that Union financial legislation and applicable sector-specific and financial rules provide for various possibilities to protect the Union budget, including interruptions, suspensions or financial corrections linked to irregularities or serious deficiencies in management and control systems. These other procedures include, *inter alia*, checks and monitoring of Member States’ budgetary management and control systems and individual beneficiaries, including through the Early Detection and Exclusion System, under the Financial Regulation¹ (recital 90, Article 63(2) and Articles 135-144), the enabling condition that refers to the need to design and implement in line with the Charter of Fundamental Rights the funds covered by the Common Provisions Regulation² and the European Social Fund Plus Regulation³ as well as the possibility to act on the notion of ‘systemic irregularities’ in spending by economic operators under the Common Provision Regulation (Articles 2(36), 2(38) and 7). These tools also include more detailed Commission policy guidance to implement European Structural and Investment funds in line with the Charter of Fundamental Rights.⁴ The Commission points out that, in its assessment in the current case, the Regulation provides more effective protection than these other procedures for different reasons. Firstly, the main origin and cause of problems with sound financial management in Hungary are breaches of the principles of the rule of law. Problems are best confronted by directly addressing their source. Moreover, the Regulation authorises a pro-active risk-based assessment that is generalised rather than one that is tailored to specific EU funds or targeted at specific final beneficiaries. A comprehensive approach based on a single legal instrument facilitates coordinated targeting of the issues at hand. Finally, the Regulation provides for a clear and transparent procedure with short deadlines for triggering

1 Regulation 2018/1046 of 18 July 2018 on the financial rules applicable to the general budget of the Union [...], OJ L193/1, 30 July 2018.

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

3 Council document 6182/21, European Social Fund Plus (ESF+) Regulation – Analysis of the final compromise text with a view to agreement, 25 February 2021.

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

it and react to the notification, which is best tailored to the urgency of the problems in Hungary and the risks these cause for the sound financial management of the EU budget. The Commission therefore concludes that, in this particular case, other procedures set out in Union legislation would not allow for the Union budget to be protected more effectively. It will, however, assess how the other instruments mentioned and referred to in recitals 14 and 17 can also be put to use without delay.

Pursuant to Article 6(1), we therefore hereby notify the government of Hungary that we have determined that there are reasonable grounds to consider that the conditions set out in Article 4 of the Conditionality Regulation are fulfilled in the case of Hungary and that other available procedures would not allow the Commission to protect the Union budget more effectively than would the triggering of the Conditionality Regulation.⁵ In assessing whether the conditions set out in Article 4 are fulfilled, the Commission followed the procedure set out in Article 6 of Regulation 2020/2092, taking into account relevant information from available sources including decisions, conclusions and recommendations of Union institutions, other relevant international organisations and other recognised institutions. Moreover, we will demonstrate that due to the systematic and severe character of the relevant breaches of rule of law in Hungary, no other procedures set out in Union legislation would allow it to protect the Union budget more effectively.

We have identified a series of interconnected breaches of the principles of the rule of law in Hungary. Some of these are long-standing breaches that have not been remedied while others are only recently enacted. Alone and taken together, these breaches seriously risk affecting the sound financial management of the Union or the protection of the financial interests of the Union as of 1 January 2021 in a sufficiently direct way. The relevant breaches of the principles of the rule of law the Commission has identified concern multiple issues enumerated in Article 4(2) (a-h). Though the breaches of the rule of law in Hungary are interconnected and must be understood in a holistic manner, we can divide them into three broad headings:

1. **Transparent Financial Management: Breaches of principles of the rule of law that seriously risk affecting the proper functioning of the authorities implementing the Union budget, in particular in the context of public procurement or grant procedures, as well as the proper functioning of the authorities carrying out financial control, monitoring and audits and effective and transparent financial management (Articles 4(2)(a) and 4(2)(b) Regulation 2020/2092).**
2. **Investigation and Prosecution of Fraud: Breaches of principles of the rule of law that seriously risk affecting the proper functioning of investigation and public prosecution services in relation to the investigation and prosecution of fraud, including tax fraud, corruption or other breaches of Union law, as well as the prevention and sanctioning of fraud, including tax fraud, corruption and other breaches of Union law relating to the implementation of the Union budget or to the protection of the financial interests of the Union, and the imposition of effective and dissuasive penalties on recipients by national courts or by administrative authorities (Articles 4(2)(c) and 4(2)(e) Regulation 2020/2092).**

5 For a full discussion of the complementarity and subsidiarity aspects of the Regulation as they relate to other available procedures, please refer to Appendix 1.

3 Judicial Review by Independent Courts: Breaches of principles of the rule of law that seriously risk affecting the effective judicial review by independent courts of actions or omissions by the authorities dealing with public procurement or grant procedures, carrying out financial control, monitoring and audit and investigations and public prosecution and other situations or conduct of authorities that are relevant, including lack of implementation of Court of Justice judgments (Articles 4(2)(d) and 4(2)(h) Regulation 2020/2092).

Below we set out the factual elements and specific grounds on which the Commission based its findings, as required under Article 6(1). Pursuant to Article 6(5), the government of Hungary may make observations on the findings set out in this notification and may propose the adoption of remedial measures to address the findings set out herein. If the government of Hungary chooses to make such observations, it shall provide them to the Commission within one month of the date of this notification.

1. Serious breaches of rule of law affecting transparent financial management (Article 4(2)(a), Article 4(2)(b) and Article 4(2)(g))

Background: A number of breaches of principles of the rule of law in Hungary - involving issues ranging from the operation of so-called “public interest asset management foundations”⁶ (hereinafter, “public interest foundations”) to frequent derogation from public procurement rules – seriously risk affecting the transparency of financial management and directly put at risk the protection of the financial interests of the Union. The Commission has recently opted to act with regard to one such instance regarding alleged irregularity with public procurement in Hungary.⁷ These breaches interact with and amplify one another such that their cumulative, systemic effect creates even greater risks for the Union budget and the financial interests of the Union. Despite being called on to address these issues by the Council in the context of the European Semester process⁸, by the European Parliament in the context of the Sargentini Report⁹ and the Article 7 process, by respected watchdog organisations

6 Public interest asset management foundations (*közérdekű vagyongazdálkodási alapítványok*) are private law institutions operating with a public purpose, regulated under the Hungarian Civil Code (Act V of 2013) as modified by the Act on Public Trust Funds (Act XIII of 2019). Under a December 2020 constitutional amendment adding Art 38(6) to the Fundamental Law, the statute regulating these foundations can now only be changed by a two-thirds vote of the Parliament. These foundations are governed by boards of trustees initially appointed by the government. Once a board is constituted, all subsequent appointments to the board are made by the board itself. The funds of public interest foundations are audited by a supervisory board or property administrator appointed by the board. Under Fundamental Law Art. 39(3) (also added to the Constitution in December 2020), public funds are defined narrowly to include only “revenues, expenditures and receivables” of the State.” Public funds awarded to the public interest foundations will now lose their public character because the foundations are regulated under private law. Such funds therefore leave the jurisdiction of the State Audit Office.

7 See December 2020 infringement package, available at: https://ec.europa.eu/commission/presscorner/detail/en/inf_20_2142 explaining that the Commission has sent a letter of formal notice to Hungary regarding the non-conformity of a provision in the Hungarian Asylum Act (Hungarian law (Article 80/E(c)), together with the implementing Government Decree) with the EU public procurement rules (Directive 2014/24/EU).

8 Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Hungary and delivering a Council opinion on the 2020 Convergence Programme of Hungary 2020/C 282/17, OJ C 284, 26 August 2020, p. 107-115.

9 European Parliament, Report on a proposal calling on the Council to determine, pursuant to Article 7(1) of the Treaty on European Union, the existence of a clear risk of a serious breach by Hungary of the values on which the Union is founded (2017/2131(INL), A8-0250/2018, 4.7.2018, hereafter, ‘the Sargentini Report.’

such as Transparency International, Amnesty International, and the Helsinki Committee,¹⁰ and by the Council of Europe's Group of States Against Corruption,¹¹ the government of Hungary has failed to address adequately these breaches of rule of law. Hungary has in fact been subject to GRECO's special "non-compliance procedure" since 2017 due to its failure to take sufficient measures to prevent corruption.¹² This was confirmed again in November 2020 in GRECO's Second Interim Compliance Report, when GRECO concluded that Hungary's overall low level of compliance with its recommendations remained "globally unsatisfactory."¹³ As discussed below, in recent years Hungary continues to have the highest percentage of financial recommendations from OLAF of any member state. In the 2014-2020 EU budget cycle, after a Commission audit identified serious deficiencies in the functioning of the management and control system in relation to public procurement procedures, Hungary was made to apply a 10% flat rate financial correction on all contracts awarded under the deficient system.¹⁴ The fact that Hungary has chosen not to participate in the European Public Prosecutors Office raises additional concerns given that, according to Transparency International, Hungary is tied for having the highest level of corruption of any member state of the EU.¹⁵ Against this background, the Hungarian government's failure to comply with recommendations from the Commission and external watchdogs provides a particular reason for concern about the transparent and accountable management of EU funds:

1.1. Breaches of rule of law concerning public procurement (Article 4(2)(a)).

Many indicators suggest that the public procurement process in Hungary is highly prone to irregularities and corruption.¹⁶ As the Commission noted in a 2019 country report on Hungary in the context of the European Semester process, despite some improvements in aspects of the public procurement process, serious rule of law breaches persist. The Commission explained, "Available indicators point to notable corruption risks. Determined action to prosecute corruption in high-level cases is missing. Weak accountability and obstacles in access to public information hinder the anti-corruption framework. The effectiveness of the justice system increasingly raises concerns, in particular as regards judicial independence. Corruption risks and favouritism distort the

- 10 See, for instance, Contributions of Hungarian NGOs to the European Commission's Rule of Law Report, March 2021. Testimony submitted to the European Commission in the framework of the targeted stakeholder consultation the European Commission launched in relation to its 2021 Annual Rule of Law Report, available at https://transparency.hu/wp-content/uploads/2021/03/HUN_NGO_contribution_EC_RoL_Report_2021.pdf; Contributions of Hungarian NGOs to the European Commission's Rule of Law Report, May 2020. Testimony submitted to the European Commission in the framework of the targeted stakeholder consultation the European Commission launched in relation to its 2020 Annual Rule of Law Report, available at https://www.helsinki.hu/wp-content/uploads/HUN_NGO_contribution_EC_RoL_Report_2020.pdf; Amnesty International Hungary, "Fearing the Unknown: How rising control is undermining judicial independence in Hungary," EUR 27/2051/2020, (2020), p. 7. Available at: https://www.amnesty.eu/wp-content/uploads/2020/04/FINAL_Fearing-the-Unknown_report_Amnesty-Hungary_E1.pdf
- 11 Group of States Against Corruption (GRECO), Council of Europe. Fourth Evaluation Round, Corruption prevention in respect of members of parliament, judges and prosecutors, Evaluation Report Hungary, Greco Eval IV Rep (2014) 10E, 22 July 2015.
- 12 GRECO Press Release, "Hungary: Insufficient progress and lack of transparency hamper fight against corruption, say Council of Europe anti-corruption experts," 1.3.2019, Ref. DC 034(2019).
- 13 Group of States Against Corruption (GRECO), Council of Europe. Fourth Evaluation Round, Corruption prevention in respect of members of parliament, judges and prosecutors, Second Interim Compliance Report, 17.11.2020, Greco RC4(2020)10.
- 14 "Miscellaneous - Questionnaire to Commissioner Hahn.doc - Replies of Commissioner Hahn to the CONT written questionnaire," Presented at Hearing on 11 November 2019, Available at https://emeeting.europarl.europa.eu/emeeting/committee/en/agenda/201911/CONT?meeting=CONT-2019-1111_1&session=11-11-09-00, pp.63-64.
- 15 Transparency International, Corruption Perceptions Index 2020, available at: [CPI2020_Report_EN_0802-WEB-1_2021-02-08-103053.pdf](https://www.transparency.org/cpi2020)
- 16 For summaries, see for instance, Contributions of Hungarian NGOs to the European Commission's Rule of Law Report, March 2021. Testimony submitted to the European Commission in the framework of the targeted stakeholder consultation the European Commission launched in relation to its 2021 Annual Rule of Law Report, at pages 25-27, Available at https://transparency.hu/wp-content/uploads/2021/03/HUN_NGO_contribution_EC_RoL_Report_2021.pdf; Corruption Research Center Budapest. 2018. Cronyism in Hungary: Empirical Analysis of Public Tenders 2010-2016, Report Available at: <https://www.crcb.eu/?p=1679>

allocation of resources.¹⁷ Corruption risk and political favouritism in the allocation of public contracts in Hungary are well documented.¹⁸ The impact of systemic breaches of rule of law principles regarding public procurement in Hungary are evidenced in the high level of financial irregularities involving European Structural and Investment Funds detected in Hungary. OLAF's 2019 report showed that Hungary had by far the highest percent of its payments impacted by OLAF financial recommendations concerning financial irregularities. Hungary had such financial recommendations concerning 3.93% of its payments, more than ten times the EU average.¹⁹ Previous OLAF investigations have detected, "very serious irregularities as well as possible fraud and corruption" in projects in Hungary involving EU funds,²⁰ and "Commission audits on public procurement related to projects co-funded by the Union and carried out in recent years identified systemic deficiencies and showed weaknesses in the public procurement control system."²¹ European Semester Reports show that the share of single bid public tenders "remained stably high over the last years and increased in 2018 to 39% for tenders above the EU threshold".²²

1.2. Measures that provide for discretionary suspension of public procurement rules (Article 4(2)(a)).

The financial interests of the Union are further put at risk by the Hungarian government's longstanding and ongoing invocation of emergency measures that allow for the suspension of public procurement rules that are designed to ensure the proper functioning of authorities involved in public procurement – inter alia those involved in implementing the Union budget. In its December 2020 package of infringements, the Commission sent a letter of formal notice to Hungary stemming from its 2015 suspension of procurement rules in the continually renewed state of migration emergency that continues to the present day.²³ The new state of medical emergency in force since June 2020 and renewed in February 2021, however, contains a similar suspension of normal procurement procedures at the discretion of the Prime Minister or his designate.²⁴ Under the state of medical emergency, the Prime Minister has the discretion to exempt procurement processes from following the normal rules, including inviting

- 17 Country Report Hungary 2019 Brussels, 27.2.2019 SWD (2019) 1016 final. Accompanying the Communication from the Commission, 2019 European Semester, COM (2019)150 final, available at https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-hungary_en.pdf, at p.6.
- 18 Corruption Research Center Budapest. 2018. Cronyism in Hungary: Empirical Analysis of Public Tenders 2010-2016, Report Available at: <https://www.crcb.eu/?p=1679>; Tóth, I. J. and Hajdu, M. 2020. *Factors Affecting the Corruption Risk and Intensity of Competition in Public Procurement at the Level of Local Government*. Working Paper Series: CRCB-WP/2020:1. Budapest: Corruption Research Centre Budapest, Report Available at, <https://www.crcb.eu/?p=2638>
- 19 The OLAF Report 2019, Available at https://ec.europa.eu/anti-fraud/sites/antifraud/files/olaf_report_2019_en.pdf; See also "The Sargentini Report", at pages 38-40, available at https://www.europarl.europa.eu/doceo/document/A-8-2018-0250_EN.html
- 20 "The Sargentini Report" (supra note 6), at page 11. Available at https://www.europarl.europa.eu/doceo/document/A-8-2018-0250_EN.html
- 21 Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Hungary and delivering a Council opinion on the 2020 Convergence Programme of Hungary 2020/C 282/17, OJ C 282, 26.8.2020, p. 107-15.
- 22 Country Report Hungary 2019 Brussels, 27.2.2019 SWD (2019) 1016 final. Accompanying the Communication from the Commission, 2019 European Semester, COM (2019)150 final, available at https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-hungary_en.pdf at p.43.
- 23 See December 2020 infringement package: https://ec.europa.eu/commission/presscorner/detail/en/inf_20_2142 explaining that the Commission has sent a letter of formal notice to Hungary regarding the non-conformity of a provision in the Hungarian Asylum Act (Hungarian law (Article 80/E(c)), together with the implementing Government Decree) with the EU public procurement rules (Directive 2014/24/EU).
- 24 Health Care Act of 1997, Section 232, amended by Section 319 of the Transitional Act LVIII of 2020 which now provides as follows: (1) In the event of a health crisis situation, ... [those authorised to supervise public procurements may follow procedures for] a health crisis different from public procurement and procurement rules. (2) The Prime Minister shall decide on a request for exemption from procurement. The Prime Minister may delegate to another member of the Government the power to decide on a request for exemption from procurement. (3) Pursuant to the derogation provided for in paragraph (1), the contracting authority may award the procurement without conducting a public procurement procedure or other procurement procedure in accordance with [Act CXLIII of 2015 on Public Procurement]. (7) In cases of extreme urgency, an economic operator may be invited to tender directly in the absence of the above procedural rules.

specific contractors to submit bids directly without competition. The new statutory provision also permits the Prime Minister to delegate this discretionary competence to any member of government. While the ability of the Prime Minister to suspend procurement rules during the state of medical emergency nominally excludes “EU development funds” (*Európai uniós fejlesztési források*), risks to the financial interest of the Union remain.²⁵ First, the language of this provision leaves it unclear whether the exclusion of the suspension of public procurement rules would apply to all EU funds or only a subset of those funds. Second, even if all EU funds must be allocated under normal procurement rules under this particular state of medical emergency, the regularity with which states of emergency are accompanied by suspensions of public procurement rules in Hungary, and recent amendments to the procedures governing the declaration of emergencies that make it easier for such suspensions to be declared pose grave risks to the financial interests of the Union. The Ninth Amendment to the Fundamental Law adopted in December 2020, comprehensively rewrote Articles 48-54 regulating states of emergency. Previously government decrees issued in a state of emergency required parliamentary ratification if they were to remain in force for longer than 15 days.²⁶ However, under the December 2020 amendments to the Fundamental Law, once Parliament declares an emergency, government decrees may override any existing law – including laws on Public Procurement – without any parliamentary approval and they may remain in force until the emergency ends.²⁷

1.3. Measures that impede scrutiny of spending of Union funds (Article 4(2)(b)):

The Ninth Amendment to the Fundamental Law of Hungary, adopted in December 2020, introduced measures that will have the effect of further impeding scrutiny of public funds, including EU funds. An amendment to Article 39(3) of the Fundamental Law entrenches a new, narrower definition of public funds as, “the revenues, expenditures and receivables of the State.” According to this new definition, public funds (including funds originating from the EU budget) would lose their ‘public’ character and no longer be subject to various disclosure and transparency requirements, such as freedom of information act requests and monitoring by the state audit office, once they are transferred into the hands of a legal form known as “public interest asset management foundations”²⁸ (hereinafter, “public interest foundations”). In recent years, the government of Hungary has been transferring state assets, including nearly all state universities, into the hands of such public interest foundations. Of the thirty-one institutions presently listed in the statute as public interest foundations, twenty-one are universities, most transformed into this status within the last six months.²⁹ Given that Hungarian universities are regularly recipients of EU funds, EU funds going to them will be shielded from public scrutiny under this new legal status. Moreover, the Ninth Amendment to the Fundamental Law passed in December 2020 also provided (in amendments to Fundamental Law Article 38) that henceforth the establishment and control of such public interest foundations would be regulated by a so-called ‘cardinal law’ that can be passed only with a two-thirds majority of MPs in the Hungarian Parliament. As a result, these public interest foundations - and the funds that they receive, including funds originating from the EU budget - would be further insulated from scrutiny and control by future governments. The December 2020 amendments to the Fundamental Law thus create new barriers to the public scrutiny of spending of Union funds that are awarded to such entities, because public audits and freedom of information requirements no longer apply to these entities. Finally, it must be emphasised that neither the redefinition of public funds nor the private-law character of public interest foundations under Hungarian law can have any

25 Act LVIII of 2020, Section 232 (9) states that, “The rules referred to in paragraphs 1 through 8 shall not apply to the use of European Union development funds (*Európai uniós fejlesztési források*).”

26 Fundamental Law 2011, Article 53(3).

27 Fundamental Law 2011 as amended by the Ninth Amendment 2020, Article 51.

28 See Hungarian Helsinki Committee, What Just Happened in the Last 48 Hours? at p. 5, https://www.helsinki.hu/wp-content/uploads/HHC_RoL_flash_report_Hungary_12112020.pdf; The Hungarian Constitutional Court had held previously, in Decision 3/18, that freedom of information act requests could reach money spent by public foundations, such that final beneficiaries were disclosed. However, such disclosure will no longer be possible in light of the redefinition of public funds in the constitutional amendment to Article 39(3).

29 2019. évi XIII. törvény a vagyonkezelő alapítványokról (Law 13/2019 on Trusts). (http://njt.hu/cgi_bin/njt_doc.cgi?docid=213302.416863 as amended by 2021. évi IX. törvény a közfeladatot ellátó közérdekű vagyonkezelő alapítványokról (Law 9/2021 <https://magyarkozlony.hu/dokumentumok/c53d1cad7ddda39a2f4abe45bb8ce011da4413c1/letoltes>).

bearing on the application of Regulation 2020/2092. The fact that domestic legislation defines funds originating from the EU as no longer constituting public funds once they are transferred into a public interest foundation cannot shield them from scrutiny by the Union or from the application of this Regulation.

1.4. Measures that permit discretionary changes in the management and prioritization of particular public projects (Article 4(2)(b)).

Act LIII of 2006³⁰ provides for the expedited completion of publicly funded projects, including those with EU funding, and Section 12(5) authorises the government to declare by means of a decree that a particular project has “national economic significance.” Under a 2012 amendment to this law, this designation permits the government to appoint a special commissioner (“*kormány megbízott*”) to manage the project in detail and allows the projects so designated to be granted exemptions from otherwise compulsory requirements (e.g. obtaining certain permits, meeting environmental standards, bypassing local municipality regulations). Given that a discretionary government decree issued after a project has been approved can change the authorities responsible for managing the grant and/or can waive otherwise compulsory rules involving EU funds, the proper functioning of effective and transparent financial management and accountability systems is put at risk. Thus, declaring particular projects to be of “national economic significance” can be used in an effort to circumvent EU rules concerning the management of those projects.

2. Serious breaches of rule of law affecting investigation and prosecution of fraud (Article 4(2)(c) and 4(2)(e))

Background: Limiting the effective investigation and prosecution of fraud is indicative of a breach of rule of law principles under the Conditionality Regulation. Today, the investigation and prosecution of fraud, including investigation and prosecution of fraud against the EU budget committed by high level officials in Hungary and/or contractors closely associated with them, is almost non-existent. This is true even in instances where OLAF has identified such fraud against the EU budget and recommended that the Prosecutor General of Hungary act on the matters.³¹ As the 2020 Rule of Law Report on Hungary states, “When serious allegations arise, there is a systematic lack of determined action to investigate and prosecute corruption cases involving high-level officials or their immediate circle,” and, “there has been no prosecution of high-level government officials in recent years” [on corruption related charges].³² Likewise, a 2021 European Parliament Study on country specific recommendations in the context of the European Semester process found that in Hungary, “There is no determined systematic action to prosecute high-level corruption,” and that no progress had been made on the issue in the past two years.³³ The very low level of investigation and prosecution of fraud by high level officials or those closely connected to them is all the more striking given that evidence from organisations such as Transparency International suggests that Hungary is among the most corrupt member states in the European Union, and that some of the largest

30 Section 12(5) of Act LIII of 2006 on the simplification and acceleration of the realisation of developments with national economic significance. The inclusion of EU-funded projects in the scope of this law is authorised by Section 1(a).

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

32 Commission Staff Working Document, 2020 Rule of Law Report, Country Chapter on the Rule of Law Situation in Hungary Country Report, SWD(2020) 316 final, Brussels 30.9. 2020, p. 10.

33 European Parliament, Economic Governance Support Unit, “Country Specific Recommendations for 2019 and 2020,” PE 651.389 - May 2021, p. 103.

beneficiaries of public contracts are closely connected to high level officials.³⁴ The lack of investigation and prosecution of fraud is clearly systemic, in that it is rooted in organisational deficiencies in the Hungarian prosecution service, which the Hungarian government has refused to address despite calls to do so from the Council of Europe and the European Council.

2.1. Organisation of the Prosecution Service (Article 4(2)(c).

Key aspects of the organisation of the Prosecution Service raise doubts about the political independence of this office. The Council of Europe's GRECO (Group of States Against Corruption) made a series of recommendations to the Hungarian government to address this concern, recommendations that the Hungarian government has not fully acted upon. In particular, GRECO recommended that the possibility of reelecting the Prosecutor General be reconsidered to improve the independence of the office³⁵ but the public prosecutor who has systematically failed to bring actions involving corruption against senior officials of the current government was re-elected in November 2019 by the Parliament for another nine-year term. In addition, GRECO recommended that disciplinary procedures against prosecutors be handled by an independent body and not by the immediate superior of the prosecutor in question. While the Hungarian government added a separate "disciplinary commissioner"³⁶ to the disciplinary process, the ultimate decisions about disciplining prosecutors still rests with the directly superior prosecutor which, in GRECO's assessment, limits the transparency and accountability of the procedure.³⁷ GRECO recommended that "the removal of cases from subordinate prosecutors be guided by strict criteria and ... justified in writing" but GRECO concluded that this recommendation had not been followed.³⁸ GRECO also recommended that "the immunity of public prosecutors be limited to activities relating to their participation in the administration of justice."³⁹ But this recommendation was also not acted upon. The failure of the government of Hungary to act fully on the recommendations regarding the organisation of the prosecution services indicates the persistence of breaches of rule of law principles that undermine the proper functioning of investigation and public prosecution services in Hungary - including in relation to the potential investigation and prosecution of fraud or other breaches of Union law relating to the implementation of the Union budget or to the protection of the financial interests of the Union. In short, the organisation of the prosecution services continues to breach rule of law principles by undermining the independence of line prosecutors who are subject to hierarchically organized disciplinary procedures within the prosecution service under a chief public prosecutor who himself has general immunity that can only be lifted by a two-thirds vote of the Parliament, and this creates an ongoing situation in which there is a serious risk that fraud against the EU budget perpetrated by high ranking government officials or private actors closely connected to them will not be prosecuted.

34 See Mikola, Bálint, "Hungary's Rule of Law Backsliding Continues Amidst the Covid-19 Crisis," Transparency International, 18 February 2021, available at https://www.transparency.org/en/blog/hungarys-rule-of-law-backsliding-continues-amidst-the-covid-19-crisis?fbclid=IwAR1HAXhOFqawI0luffMllmkBHQKv9wmgTfNl_W3BmI33lUXxZ-gaZ_R9rE#; and Transparency International, Corruption Perceptions Index 2020, in which Hungary ranks (along with two other states) last in the European Union and is singled out as a "significant decliner" inter alia because of "corruption scandals involving EU funds." Available at <https://www.transparency.org/en/news/cpi-2020-western-europe-eu>

35 Group of States Against Corruption (GRECO), Council of Europe. Fourth Evaluation Round, Corruption prevention in respect of members of parliament, judges and prosecutors, Second Interim Compliance Report, 17.11.2020, Greco RC4(2020)10 at <https://rm.coe.int/fourth-evaluation-round-corruption-prevention-in-respect-of-members-of/1680a062e9> at para. 34.

36 This modification to the Section 88 of the law on the public prosecution service (*2011. évi CLXIV. törvény a legfőbb ügyész, az ügyészek és más ügyészségalkalmazottak jogállásáról és az ügyési életpályáról*) was made by *2018. évi CXXII. törvény*, Section 10 (4). Effective from 1 January 2019.

37 Group of States Against Corruption (GRECO), Council of Europe. Fourth Evaluation Round, Corruption prevention in respect of members of parliament, judges and prosecutors, Second Interim Compliance Report, 17.11.2020, Greco RC4(2020)10 <https://rm.coe.int/fourth-evaluation-round-corruption-prevention-in-respect-of-members-of/1680a062e9> at para. 49-53.

38 Id at para.39-43. Section 85 of the law on the public prosecution service (*2011. évi CLXIV. törvény*) still designates as the disciplinary authority the line prosecutor above the rank of the prosecutor who is subject to disciplinary authority.

39 Id. at para. 44-48. Section 3 of the law on the public prosecutor (*2011. évi CLXIII. Törvény az ügyészségről*) still gives the public prosecutor the same general immunity granted to Members of Parliament, which can only be lifted by a two-thirds vote of the Parliament.

2.2. Functioning of Prosecution Services and Sanctioning of Fraud. (Article 4(2)(c) and 4(2)(e)).

In the context of the “European Semester” national reform programme process, the Council of the European Union has repeatedly noted Hungary’s failure to address concerns over the prevention and prosecution of corruption. For instance, in its 2019 Recommendation on the Convergence Programme of Hungary, the Council noted, “there are still no signs of determined action to prosecute corruption involving high-level officials or their immediate circle when serious allegations arise. Accountability for decisions to close investigations is a matter of concern, as there are no effective remedies to contest such decisions.”⁴⁰ As noted above, there have been no cases of prosecution of high-level corruption in recent years, and there have been instances in which OLAF recommended that Hungarian authorities bring prosecutions targeting corruption by involving EU funds by individuals with connections to senior government officials but in which the authorities declined to bring any legal action.⁴¹ Since OLAF itself cannot bring prosecutions, there is no further recourse in such cases where Hungary’s prosecution service refuses to act. The Council reiterated the same concerns in its 2020 Recommendation, further underlining that, “Investigation and prosecution appears less effective in Hungary than in other Member States,” and noting that, “Restrictions on access to information continue to hinder the fight against corruption.”⁴² Likewise in its latest Country Report on Hungary as part of the European Semester Process, the European Commission noted that “No progress has been made to reinforce the anti-corruption framework,” including by improving prosecutorial efforts and access to public information.”⁴³

3. Serious breaches of rule of law affecting effective judicial review by independent courts (Article 4(2)(d) and 4(2)(h)).

Background: Recital 8 of the Regulation reminds us that, “Sound financial management can only be ensured by Member States if ... arbitrary or unlawful decisions of public authorities, including law-enforcement authorities, can be subject to effective judicial review by independent courts and by the Court of Justice of the European Union.” Indeed, the Court of Justice has made it clear that Article 19(1) second subparagraph TEU requires that national courts be independent when they are called upon to rule on issues linked to the interpretation and application of EU law.⁴⁴ This entails, firstly, that the court concerned exercises its functions wholly autonomously, without being subject to any hierarchical constraint or being subordinated to any other body and without taking orders or instructions from any source whatsoever, thus being protected against external interventions or pressure liable to impair the independent judgement of its members and to influence their decisions.⁴⁵ Second, judicial independence requires impartiality which, among other things, requires that an equal distance is maintained by national courts from the parties to the proceedings and their respective interests with regard to the subject matter of those proceedings. Third, judicial independence demands objectivity of judgment and the absence of any interest on the part of the judges in the outcome of the proceedings apart from the strict application of the rule of law.⁴⁶ Judicial independence thus requires autonomy, impartiality and objectivity, but these qualities can

40 Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Hungary and delivering a Council opinion on the 2019 Convergence Programme of Hungary, ST/10170/2019/REV/2, OJ C 301, 5.9.2019, p.105.

41 See supra notes 38–41 and accompanying text.

42 Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Hungary and delivering a Council opinion on the 2020 Convergence Programme of Hungary, 2020/C 282/17, OJ C 282, 26.8.2020, p. 114.

43 Country Report Hungary 2020, COM(2020) 150 final.

44 Court of Justice, Case C-619/18, Commission v. Poland, 24 June 2019, par. 71–74.

45 Court of Justice, C-64/16, Associação Sindical dos Juizes Portugueses, 27 February 2018, par. 44.

46 Court of Justice, C-216/18 PPU, 25 July 2018, Minister of Justice and Equality (Deficiencies in the system of justice), par. 65.

no longer be assured in Hungary. Breaches of numerous rule of law principles in Hungary concerning judicial review by independent courts seriously risk affecting the implementation of the Union budget and the protection of the financial interests of the Union. The breaches of rule of law principles are systemic in nature and affect the independence of the judiciary as a whole.

Generally, individual judges in Hungary hearing specific cases can still reach judgments not subject to direct outside influence. However, a variety of new structures erected in the past 10 years have subjected the judiciary as a whole to excessive political control by the government – on issues ranging from the appointment and promotion of judges to the allocation of cases. Moreover, recent changes to the judiciary make it more likely that the government can find judges inclined to rule in its favor. As a result, effective judicial review by independent courts in Hungary, including in cases affecting the implementation of the Union budget and the financial interests of the Union, can no longer be guaranteed. Moreover, the absence of this effective judicial review by independent courts has enabled the government of Hungary to defy CJEU rulings, and to do so in ways that affect the financial interests of the Union.

Effective judicial review by independent courts in Hungary has been compromised in several ways, some dating back years and some very recent in origin. As detailed below, Union institutions including the European Parliament, the European Commission, Parliament and Council, and numerous international organisations specializing in rule of law including the Council of Europe's Venice Commission, the Council of Europe's GRECO Group, the Council of Europe's Commissioner for Human Rights, the UN Human Rights Committee, the UN Special Rapporteur on the situation of human rights defenders on his mission to Hungary, the European Association of Judges, the Hungarian Helsinki Committee, and Amnesty International Hungary among others have all have criticised the mounting threats to judicial independence in Hungary and called for specific reforms to address areas of concern. However, rather than undertake such reforms, the government of Hungary has instead put in place additional measures that breach rule of law principles and further endanger the independence of the judiciary. The cumulative effect of these is evident in the fact that Hungary has the lowest rating of any EU member state in the World Justice Project's Rule of Law Index⁴⁷ and was the first EU member state to be categorised as an autocratic regime by the Varieties of Democracy (V-Dem) Institute⁴⁸ and by Freedom House.⁴⁹

Relevant breaches under the Regulation (Article 4(2)) of principles of the rule of law that seriously risk affecting the effective judicial review by independent courts of the proper functioning of authorities implementing the Union budget and authorities carrying out financial control management and audit include the following:

- 47 World Justice Project Rule of Law Index 2020, World Justice Project, Washington, DC. Available at https://worldjusticeproject.org/sites/default/files/documents/WJP-ROLI-2020-Online_0.pdf, see especially pages 19. Not only does Hungary have the lowest overall Rule of Law score of any EU member state measured, its ranking on the "constraints on government powers" score, which measures "the extent to which those who govern are bound by law", is particularly low – 108th of 128 countries ranked, a ranking closer to that of Iran, Russia, and China than to that of any other EU member state.
- 48 V-Dem downgraded Hungary from democracy to the category of "electoral autocracy" in 2019, explaining, "Hungary is no longer a democracy, leaving the EU with its first non-democratic Member State." See Varieties of Democracy Institute, Democracy Report 2020. Autocratization Surges – Resistance Grows, available at https://www.v-dem.net/media/filer_public/de/39/de39af54-0bc5-4421-89ae-fb20dcc53dba/democracy_report.pdf, at p.4. Hungary remained in the "electoral autocracy" category in 2020, see Varieties of Democracy Institute, Democracy Report 2021. Autocratization Turns Viral, available at https://www.v-dem.net/media/filer_public/c9/3f/c93f8e74-a3fd-4bac-adfd-ee2cfbc0a375/dr_2021.pdf
- 49 Freedom House, Nations in Transit 2020: Dropping the Democratic Façade, available at https://freedomhouse.org/sites/default/files/2020-04/05062020_FH_NIT2020_vfinal.pdf. Freedom House downgraded Hungary from a democracy to a "transitional/hybrid regime" in 2020, explaining (p.2) that, Hungary's decline has been the most precipitous ever tracked in Nations in Transit; it was one of the three democratic frontrunners as of 2005, but in 2020 it became the first country to descend by two regime categories and leave the group of democracies entirely."

3.1. Excessive concentration of power in hands of politically appointed President of the National Judicial Office (NJO) and the sidelining judicial self-governance (Article 4(2)(d)).

As the result of changes introduced already in 2012, institutions of judicial self-governance were sidelined and excessive control of the entire judicial system was concentrated in the hands of a political appointee occupying the newly created position of President of the National Judicial Office (NJO). By exercising control over appointments to judgeships, to leadership positions in the courts, to the promotion and career advancement of judges, and to disciplinary procedures for judges, the NJO President exercises political control over the judiciary in ways that undermine the guarantee of effective judicial review by independent courts – including courts like the Budapest Metropolitan Court (*Fővárosi Törvényszék*) which, due to the concentration of government agencies in the capital, are likely to hear many of the cases involving EU funds. Some of the powers wielded by this political appointee that undermine judicial independence include that:

I. The NJO President can appoint court presidents in Hungary with very little input from the National Judicial Council (which is composed of judges elected by their fellow judges) despite a strong recommendation from the Venice Commission that the position of sitting judges be strengthened in this process.⁵⁰ In principle, the NJO President should only appoint court Presidents that enjoy the support of a majority of judges on the court in question, and if the NJO President wants to appoint an applicant that does not enjoy such majority support, he must seek the consent of the National Judicial Council. However, the NJO President can circumvent this entire process and prevent judges from participating in the appointment of court Presidents: the NJO President can simply declare the call for applicants unsuccessful and appoint an interim court President without any judicial input. This loophole has been exploited by the NJO President, such that court Presidents have been installed without support from judges or the National Judicial Council.⁵¹ This is significant in particular because these court presidents control the allocation of cases – including cases that could involve EU funds - to specific judges, which creates the possibility for political considerations to play a role in the selection of judges who will hear a particular case. Court president can also initiate disciplinary procedures against judges on their courts.⁵²

II. The NJO President can invalidate applications for judgeships even when they are approved by National Judicial Council.⁵³ The previous NJO President used this power so frequently that the National Judicial Council called for her impeachment in 2019.⁵⁴ Above and beyond these specific instances in which this authority was used, the mere existence of this authority can have a chilling effect – discouraging qualified judges from taking the time and effort to apply for positions that they know the NJO President could in the end simply invalidate their applications.

50 Venice Commission, Opinion on the Cardinal Act on the Judiciary that were amended following the adoption of Opinion CLD-AD (2012)001 on Hungary (12-13 October 2012) CDL-AD(2012)020 at [https://www.venice.coe.int/webforms/documents/?pdf=CDL-AD\(2012\)020-e](https://www.venice.coe.int/webforms/documents/?pdf=CDL-AD(2012)020-e) at para. 46-47 p. 1p.

51 See Hungarian Helsinki Committee, Observations and recommendations submitted to Council of Europe, Directorate General of Human Rights and Rule of Law Department for the Execution of Judgments of the ECHR under Rule 9(2) of the “Rules of the Committee of Ministers for the supervision of the execution of judgments and of the terms of friendly settlements” regarding the execution of the judgment of the European Court of Human Rights in the *Baka v. Hungary* case (Application no. 20261/12, Judgment of 23 June 2016). Available at https://www.helsinki.hu/wp-content/uploads/HHC_Rule_9_Baka_v_Hungary_201908.pdf, pages 2-4.

52 Indeed, the president of the Budapest Metropolitan Court, who was appointed by the president of the NJO over the objection of the National Judicial Council and was serving on an interim basis, initiated disciplinary proceedings in 2019 against a judge on that court for referring a case to the Court of Justice of the European Union. The Commission noted this case in its 2020 Rule of Law Report. Commission Staff Working Document, 2020 Rule of Law Report, Country Chapter on the Rule of Law Situation in Hungary Country Report, SWD(2020) 316 final, Brussels 30.9. 2020, p. 4.

53 Venice Commission, Opinion on the Cardinal Act on the Judiciary that were amended following the adoption of Opinion CLD-AD (2012)001 on Hungary (12-13 October 2012) CDL-AD(2012)020 at [https://www.venice.coe.int/webforms/documents/?pdf=CDL-AD\(2012\)020-e](https://www.venice.coe.int/webforms/documents/?pdf=CDL-AD(2012)020-e) para 44 at p. 10.

54 See United States Department of State. 2020. Hungary 2019 Human Rights Report, p.6. Available at <https://www.state.gov/wp-content/uploads/2020/03/HUNGARY-2019-HUMAN-RIGHTS-REPORT.pdf>

III. The NJO President can reassign judges to new posts (including demotions and transfers to remote locations) without their consent, which might be experienced by some judges as punishment or a threat of punishment for decisions they have made.⁵⁵ Similarly, the NJO President can transfer any judge outside the judiciary and into an administrative body.⁵⁶ Judges thus transferred typically receive significantly higher remuneration⁵⁷ and can later be returned to the judiciary as the head of a panel (*tanácselnök*) without going through the regular application procedure.⁵⁸ Using these tools, the NJO president can easily reward judges for decisions they have made. The fact that the NJO President – a political appointee – has the authority to reward or punish judges at his or her discretion subjects the judiciary as a whole to an excessive degree of political control.

Union institutions including the European Commission⁵⁹ and Parliament⁶⁰, as well as international organisations and other recognised institutions such as UN Human Rights Committee,⁶¹ UN Special Rapporteur,⁶² Venice Commission,⁶³ Council of the European Union,⁶⁴ Commissioner for Human Rights of the Council of Europe,⁶⁵ Council of Europe's GRECO group,⁶⁶ the European Association of Judges,⁶⁷ the International Bar Association,⁶⁸ the Hungarian Helsinki Committee and Amnesty International Hungary,⁶⁹ have all expressed concerns over the NJO, but the government of Hungary has not addressed their central concerns. Along with the concentration of

- 55 Venice Commission, Opinion in the Cardinal Act on the Judiciary at para. 54–57 at pp. 11–12.
- 56 Act CLXII of 2011 on the Legal Status and Remuneration of Judges, Article 62/A (2). For discussion see, Contributions of Hungarian NGOs to the European Commission's Rule of Law Report, March 2021. Testimony submitted to the European Commission in the framework of the targeted stakeholder consultation the European Commission launched in relation to its 2021 Annual Rule of Law Report. Available at https://transparency.hu/wp-content/uploads/2021/03/HUN_NGO_contribution_EC_RoL_Report_2021.pdf, at p. 5.
- 57 Act CLXII of 2011 on the Legal Status and Remuneration of Judges, Article 195 (5).
- 58 Act CLXII of 2011 on the Legal Status and Remuneration of Judges, Article 62/C (3).
- 59 Commission Staff Working Document, 2020 Rule of Law Report, Country Chapter on the Rule of Law Situation in Hungary Country Report, SWD(2020) 316 final, Brussels 30.9. 2020, pp. 2–5.
- 60 See supra, note 6, "The Sargentini Report."
- 61 Concluding observations on the sixth periodic report of Hungary, CCPR/C/HUN/CO/6, 9 May 2018, §§ 11–12, available at <https://docstore.ohchr.org/SelfServices/FilesHandler.ashx?enc=6QkG1d%2fPPRiCAqhKb7yhnm97%2bRfSonZvQyDICMC7to7kIHViwiffCrjxVJVYr7AYGd1bD3LqpWwx7fjwdowpOXO09j1KeHx2S0%2be4%2fGUZf4WEtz0X6rsDTNt6FAcrQ>
- 62 18 Para. 18 and 72 of the Report of the Special Rapporteur on the situation of human rights defenders on his mission to Hungary (A/HRC/34/52/Add.2) ("SRD Special Rapporteur Report") https://ap.ohchr.org/documents/dpage_e.aspx?si=A/HRC/34/52/Add.2 <https://hudoc.echr.coe.int/eng#%7B%22itemid%22%3A%22001-163113%22%7D>
- 63 European Commission for Democracy through Law (Venice Commission), Opinion on the Cardinal Acts on the Judiciary that were amended following the adoption of Opinion CDL-AD(2012)001 on Hungary, CDL-AD(2012)020-e, 15 October 2012, available at [https://www.venice.coe.int/webforms/documents/?pdf=CDL-AD\(2012\)020-e](https://www.venice.coe.int/webforms/documents/?pdf=CDL-AD(2012)020-e)
- 64 Council Recommendation 2019/C 301/17, and Council Recommendation 2020/C 282/17.
- 65 Hungary: Legislative changes threaten democracy and human rights, 12 January 2012, <https://www.coe.int/en/web/commissioner/-/hungary-legislative-changes-threaten-democracy-and-human-rights>
- 66 Group of States against Corruption, Fourth Evaluation Round – Corruption prevention in respect of members of parliament, judges and prosecutors. Evaluation Report – Hungary, Greco Eval IV Rep (2014) 10E, <https://rm.coe.int/CoERMPublicCommonSearchServices/DisplayDCTMContent?documentId=09000016806c6b9e>; Group of States against Corruption, Fourth Evaluation Round – Corruption prevention in respect of members of parliament, judges and prosecutors. Second Interim Compliance Report – Hungary, GrecoRC4(2020)10, §§ 18–28, <https://rm.coe.int/fourth-evaluation-round-corruption-prevention-in-respect-of-members-of-1680a062e9>
- 67 Report on the fact-finding mission of the EAJ to Hungary, 2019, <https://www.iaj-uim.org/iuw/wp-content/uploads/2019/05/Report-on-the-fact-finding-mission-of-a-delegation-of-the-EAJ-to-Hungary.pdf>
- 68 International Bar Association Human Rights Institute, "Still Under Threat: The Independence of the Judiciary and the Rule of Law in Hungary," October 2015. Available at <https://www.ibanet.org/Article/NewDetail.aspx?ArticleUid=93e2c33c-71e5-4ab5-89a7-299f5c5752ce>
- 69 Amnesty International Hungary. 2020. Fearing the Unknown: How rising control is undermining judicial independence in Hungary, Index: EUR 27/2051/2020, p. 7 Available at: https://www.amnesty.eu/wp-content/uploads/2020/04/FINAL_Fearing-the-Unknown_report_Amnesty-Hungary_E1.pdf

power in the hands of the NJO President, institutions of judicial self-governance in Hungary such as the National Judicial Council (NJC) have been sidelined. The statutes in place since 2011 have allowed the political appointee at the NJO to circumvent the NJC's recommendations for appointments to judgeships and court leadership positions.⁷⁰ In 2020, the NJC vigorously opposed the candidate for the new president of the Supreme Court (*Kúria*) put forward by the President of Hungary. The Parliament nonetheless elected this candidate over the objections of the NJC.

3.2. Avoiding judicial review by independent courts (Article 4(2)(d)).

Act CXXVII of 2019 (the "2019 Omnibus Act"), Article 55 enables public authorities, including the tax authority, state audit office, prime minister's office, and public prosecutor's office, each of which is involved in implementing the Union budget, carrying out financial control, management and audit, and/or investigating fraud, to overrule judicial review by independent courts by asking for a special review of the Constitutional Court in cases public authorities have lost in the ordinary courts. The 2019 Omnibus Act established this new legal action, which enables public authorities to bring appeals against unfavourable court decisions in the ordinary courts directly to the Constitutional Court,⁷¹ a court that has already been subject to substantial control by the governing party.⁷² While the Constitutional Court has not been active in cases involving the EU budget before this time, the new appeals mechanism could put that court in the middle of controversies over the use of EU funds. The Commissioner for Human Rights of the Council of Europe also noted that the Omnibus Act would have negative effects on fair trial guarantees in Hungary.⁷³ Likewise, analyses from Amnesty International and the Hungarian Helsinki Committee conclude Act CXXVII of 2019 was designed to guarantee judicial decisions favourable to the government in politically sensitive cases.⁷⁴ Because public authorities can appeal cases involving the expenditure of EU funds and/or the collection of EU revenue in Hungary through this new procedure, this situation seriously risks affecting the effective judicial review by independent courts of actions or omissions by the authorities dealing with the financial interests of the Union.

71 Act CXXVII of 2019 (the 2019 Omnibus Act), Article 55.

72 The party that has ruled Hungary since 2010 has maintained substantial political control over the Hungarian Constitutional Court since a series of actions it took between 2010 and 2013. First, in 2010 the ruling party eliminated a previous rule that had required the ruling majority to appoint constitutional court judges together with the opposition. This was amended to allow the majority to appoint new members on its own. Then in 2011, the number of the judges on the Court was expanded from 11 to 15, allowing the ruling party to install four additional judges. In 2012 and 2013, the term of Constitutional Court Judges was increased from 9 to 12 years and the retirement age limit was eliminated. Gaining a working majority in 2013 and replacing all of the other judges since that time, these changes have resulted in a situation in which every single judge on the Constitutional Court has been elected by a two-thirds vote of the governing party in Parliament with little to no support from opposition parties. See Hungarian Helsinki Committee, "Hungary's Government Has Taken Control of the Constitutional Court," 25 March 2015, available at <https://helsinki.hu/en/hungarys-government-has-taken-control-of-the-constitutional-court/>

73 Report of the Special Rapporteur on the situation of human rights defenders on his mission to Hungary (A/HRC/34/52/Add.2) ("SRD Special Rapporteur Report"), available at https://ap.ohchr.org/documents/dpage_e.aspx?si=A/HRC/34/52/Add.2

74 "New Law threatens judicial independence in Hungary," Hungarian Helsinki Committee, January 2020, available at https://helsinki.hu/wp-content/uploads/HHC_Act_CXXVII_of_2019_on_judiciary_analysis_2020Jan.pdf; Amnesty International Hungary, 2020. Fearing the Unknown: How rising control is undermining judicial independence in Hungary, Index: EUR 27/2051/2020, p. 7 Available at: https://www.amnesty.eu/wp-content/uploads/2020/04/FINAL_Fearing-the-Unknown_report_Amnesty-Hungary_E1.pdf

3.3. Political capture of the Kúria (Supreme Court) and its growing control over the ordinary judiciary (Article 4(2)(d)).

Though the Constitutional Court in Hungary has had since 2013 a working majority of judges been elected by the governing party's two-thirds parliamentary majority and presently features a bench in which every judge has been elected in this way, the Supreme Court (*Kúria*) has on balance maintained greater independence over the last decade. However, the independence of the *Kúria* has come under substantial new pressures:

I. As the result of changes introduced in the 2019 Omnibus Act, politically appointed judges to the Constitutional Court can now be transferred without an additional appointment procedure to become judges at the *Kúria*.⁷⁵ Whereas previously only judges with extensive experience sitting as judges in the Hungarian ordinary court system could qualify for positions on the *Kúria*,⁷⁶ the new transfer mechanism introduced in the 2019 Omnibus Act allows political appointees to the Constitutional Court with no prior experience as judges in the ordinary courts to be installed as *Kúria* judges. Because the judges at the Constitutional Court are elected by the Parliament without vetting by professional judges in the process, reappointing them to the *Kúria* without going through the ordinary judicial appointments process thus compromises the independence of the *Kúria*.⁷⁷ In January 2021, a new president of the *Kúria* was installed using this procedure after being transferred from a judgeship at the Constitutional Court without fulfilling the normal statutory conditions for holding his present position (namely, at least five years of prior experience as a judge in an ordinary court). This new President was appointed despite having been rejected by an overwhelming (but non-binding) vote of the National Judicial Council, a vote which – among other things – registered judicial disapproval of having at the top of the system of ordinary courts a judge who had never served on any ordinary court before.

II. This new, politically appointed *Kúria* President will oversee an extraordinary expansion of the number of judges on the *Kúria*. In 2020, the number of judgeships on the *Kúria* was increased by 23% with the addition of 21 new vacant positions.⁷⁸ The number of judges on the *Kúria* is not set by statute but determined by the President of the National Judicial Office.⁷⁹ Vacancies at the *Kúria* can be filled by appointment by the President of the *Kúria*, who has powers identical to those of the President of the National Judicial Office when it comes to appointing judges on his court. As of 1 January 2021, the President of the *Kúria* was also given the power to increase the number of judges on each adjudicating panel from three to five, with his appointments to these panels constituting the expanded group. Leading non-governmental organisations have expressed concern that this extraordinary expansion of judgeships as well as the expansion of judicial panels, which is occurring at the moment when a new *Kúria* President has been installed over the objections of the National Judicial Council, creates a risk of politically motivated 'court packing' that would undermine judicial review by independent courts.⁸⁰

75 Contributions of Hungarian NGOs to the European Commission's Rule of Law Report, March 2021. Available at https://transparency.hu/wp-content/uploads/2021/03/HUN_NGO_contribution_EC_RoL_Report_2021.pdf; Act CXXVII of 2019 on the changes made to certain laws with regard to introducing a one-level procedure by local government offices; <https://www.amnesty.hu/wp-content/uploads/2020/10/ANALYSIS.pdf>, p. 3.; Amnesty International Hungary. 2020. Fearing the Unknown. (supra note 5), at p. 8.

76 Notably, the requirement to have at least five years of experience as a judge in the ordinary courts before a candidate could become a judge on the *Kúria* had previously been used by the government of Hungary as a basis for removing a previous President of the Hungarian Supreme Court (*Kúria*) from his position, an action that the European Court of Human Rights later found to have violated the judge's rights under the Convention. See *Baka v. Hungary*, Grand Chamber 23 June 2016, Application 20261/12 at <https://hudoc.echr.coe.int/eng#%7B%22appno%3A20261%2F12%22%22%26%22itemid%3A202001-163113%22%7D>

77 "New Law Threatens Judicial Independence in Hungary – Again," Hungarian Helsinki Committee, January 2020.

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

79 Act CLXI of 2011, Section 76(4)(a).

80 Contributions of Hungarian NGOs to the European Commission's Rule of Law Report, March 2021. Testimony submitted to the European Commission in the framework of the targeted stakeholder consultation the European Commission launched in relation to its 2021 Annual Rule of Law Report. Available at https://transparency.hu/wp-content/uploads/2021/03/HUN_NGO_contribution_EC_RoL_Report_2021.pdf, at p. 4.

III. The new President of the *Kúria* – along with the presidents of all other courts – has also been given expanded powers over case allocation in the Omnibus Act of 2019. In general, in the Hungarian courts, cases are allocated by the court president to standing panels of judges on each court. There is no automatic system of allocation; rather, cases are assigned to panels of known judicial composition under a case allocation scheme designed by the court president. Before the Omnibus Law of 2019, these case allocation schemes could only be revised once per year, which limited the strategic use of case management so that particular cases could not be arbitrarily directed to particular judges. The Omnibus Act of 2019 now lifts this one-year limit so that all court presidents, including the President of the *Kúria*, may revise the case allocation scheme at will.⁸¹ When the president of a court has the power to ensure that particular cases can be assigned to particular judges, particularly where the president of a court has the power to assign judges to particular panels, essential elements of judicial independence – the requirements of impartiality and objectivity – can be called into question.

IV. The Omnibus Act of 2019 gave new powers to the *Kúria* to exercise control over the rest of the system of ordinary courts. Under a new review procedure, called a “complaint for the unification of jurisprudence,” that went into effect on 1 July 2020, the *Kúria* now has the power to issue interpretations of law that are binding on all courts.⁸² This procedure allows the *Kúria* to quash any final and binding court judgment that it deems deviates from prior decisions published by the *Kúria* and to issue an opinion of general applicability to all future cases on related matters. The panels that issue such binding interpretations are composed solely at the discretion of the President of the *Kúria*.⁸³ Given the new political pressures being placed on the *Kúria* and the fact that its new President was elected by the Parliament over the objections of the independent National Council of the Judiciary, the introduction of this procedure seriously risks affecting the effective judicial review by independent courts of actions or omissions by the authorities dealing with the financial interests of the Union.

3.4. Serious breaches of rule of law affecting the effectiveness of legal remedies (including through lack of implementation of CJEU judgments) (Article 4(2)(h)).

The enforcement of Union law in Hungary has been called into doubt by recent developments.

I. Breaches of rule of law principles in Hungary seriously risk undermining the effectiveness of legal remedies for violations of EU law, including in cases involving the financial interests of the Union. These breaches affect both the functioning of the preliminary reference procedure under Article 267 TFEU and the functioning of the infringement procedure under Article 258 TFEU. With regard to preliminary references, the Hungarian Supreme Court (*Kúria*) declared that a judge acted illegally by sending a request for a preliminary ruling to the CJEU,⁸⁴ and as a result disciplinary proceedings were later initiated against that judge.⁸⁵ The judge in question then added to his reference to the CJEU the question of whether the commencement of disciplinary proceedings against a judge for having requested a preliminary ruling constituted a violation of the principle of judicial independence.⁸⁶ The Commission’s 2020 Rule of Law Report on Hungary noted this case with concern:

81 Act CXXVII of 2019 (the 2019 Omnibus Act), Article 45.

82 Act CXXVII of 2019 (the 2019 Omnibus Act), Articles 66–74.

83 Contributions of Hungarian NGOs to the European Commission’s Rule of Law Report, March 2021. Testimony submitted to the European Commission in the framework of the targeted stakeholder consultation the European Commission launched in relation to its 2021 Annual Rule of Law Report. Available at https://transparency.hu/wp-content/uploads/2021/03/HUN_NGO_contribution_EC_RoL_Report_2021.pdf, at p. 4.

84 Judgment No. Bt.838/2019. Press release in original language is available at https://kuriabirosag.hu/hu/sajto/buntetoeljaras-menetenek-megakaszttasa-jogszeru-es-alapos-erdemi-dontes-meghozatalanak?fbclid=IwAR1DEoefrVZp2vgufIZ-AB_l2p9AKcUW_h2cHGRHeShkmv6tO1OmMWafIBM.

85 File number: 2019.II.IV.K.15/2.

86 The case, C-564/19 Criminal Proceedings against IS, is currently pending before the CJEU. Available at CURIA – Documents. (europa.eu).

The fact that the *Kúria* can, in the context of an extraordinary judicial remedy, review the necessity of preliminary references could interfere with the possibility of national courts to refer questions of interpretation of Union Law to the Court of Justice and that disciplinary proceedings could be initiated, could discourage individual judges from making requests for a preliminary ruling.⁸⁷

Though the case in question involved a weapons related charge and not judicial independence outright, the prospect of judges being subject to disciplinary proceedings for sending preliminary references to the CJEU undermines judicial independence and the effectiveness of remedies for breaches of EU law in all areas of law, including those directly affecting the financial interests of the Union.⁸⁸

II. With regard to infringement proceedings, the Hungarian government has failed to implement several recent judgments by the CJEU in Article 258 TFEU cases. Taken together, these cases amount to a pattern of non-implementation that undermines the effectiveness of legal remedies for violations of Union law, including in cases that risk affecting the financial interests of the Union.

Law on NGOs – In its judgment in Case C-78/18, *Commission v Hungary* (Transparency of Associations), delivered on 18 June 2020, the Court of Justice found that the Hungarian Law on NGOs (“Transparency Act”) was in breach of EU rules on free movement of capital, fundamental rights to protection of personal data and freedom of association as protected by the EU Charter of Fundamental Rights. The Commission determined that the government of Hungary has failed to comply with the judgment, despite repeated calls from the Commission for it to do so.⁸⁹ As a result, the Commission has sent Hungary a Letter of Formal Notice under Article 260(2) for its failure to comply with the CJEU ruling in C-78/18. The government of Hungary recently announced that it would repeal the offending Law on NGOs. However, the draft bill it has proposed to replace the existing Law appears designed to serve as an alternative means for the government to breach fundamental rights to freedom of association by harnessing the State Audit Office (*Állami Számvevőszék*) to obstruct the work of independent NGOs.⁹⁰

Higher Education Law – In its judgment in Case C-66/18 *Commission v Hungary* (Higher education), delivered on 6 October 2020, the Court of Justice held that aspects of Hungary’s higher education law violated provisions of the Charter of Fundamental Rights of the European Union (‘the Charter’) relating to academic freedom, the freedom to found higher education institutions and the freedom to conduct a business, along with other requirements of EU law and of the General Agreement on Trade in Services. To date, Hungary has failed to comply with the judgment of the Court of Justice.

Pushbacks of Migrants and Asylum Seekers – In its judgment in Case C-808/18, *Commission v Hungary* (Reception of Applicants for International Protection) delivered on 17 December 2020, the Court of Justice ruled that Hungarian legislation on pushbacks of migrants and asylum seekers breaches EU law. To date, Hungary has failed to comply with the judgment of the Court of Justice, and, according to the Hungarian police themselves, thousands of pushbacks have taken place at the borders with

87 Commission Staff Working Document, 2020 Rule of Law Report, Country Chapter on the Rule of Law Situation in Hungary Country Report, SWD(2020) 316 final, Brussels 30.9. 2020, p. 4.

88 Indeed, the Case Law of the CJEU has already established the direct relevance criminal law can have for the protection of the financial interests of the Union. See for instance Case C42/17, *M.A.S., M.B.* EUR-Lex - 62017CJ0042 - EN - EUR-Lex (europa.eu).

89 For example, in 2020 the government established Tempus Public Foundation, which handles the EU funded Erasmus+ programme in Hungary, continued to apply the Hungarian Law on NGOs (and rejected the grant application of an NGO on that basis) in direct defiance of the ECJ judgment. See Amnesty International. 2021. Hungary: Living under the Sword of Damocles. Report, Index EUR 27/3968/2021. Available at: <https://www.amnesty.org/en/documents/eur27/3968/2021/en/>

90 Draft Law T/15991, introduced in Parliament on 20 April 2021. The draft law amends the Law on the State Audit office and now requires the State Audit Office to audit each year the accounts of all NGOs that have a budget of more than €14 million. See Lydia Gall, “Hungary’s Scrapping of NGO Law Insufficient to Protect Civil Society,” Human Rights Watch, 23 April 2021, available at <https://www.hrw.org/news/2021/04/23/hungarys-scrapping-ngo-law-insufficient-protect-civil-society#>

Croatia and Serbia. As a result of this noncompliance, Frontex – an EU funded agency – has suspended operations in Hungary, thus demonstrating directly the effect that lack of implementation with CJEU judgments can have on the financial interests of the Union. Moreover, the government of Hungary itself receives EU funds in connection with its border management activities, and will continue to do so in the context of the new Multi-Annual Financial Framework (2021-2027) through the Integrated Border Management Fund.

Conclusions

Any one of the breaches of rule of law principles detailed above seriously risks affecting the sound financial management of the Union budget and/or the protection of the financial interests of the Union in a sufficiently direct way. Taken as a whole, they reflect serious and interconnected breaches of rule of law principles affecting transparent financial management, the prosecution of fraud and judicial review by independent courts (as enumerated in Article 4(2), under headings a, b, c, d, e, g and h of Regulation 2020/2092). Hungary must adopt remedial measures to stop and reverse these breaches of rule of law principles with immediate effect so as to restore conditions enabling sound financial management.

In accordance with Article 6(5) of Regulation 2020/2092, and in light of the gravity and urgency of the situation, the Commission now provides Hungary the opportunity to provide the required information, make any observations and put in place remedial measures to stop and reverse the breaches of rule of law principles affecting the sound financial management of the Union budget and/or the protection of the financial interests of the Union within one month from this written notification.

To the extent that the Commission will not have received appropriate, comprehensive and satisfactory information and evidence of remedial measures having been put in place by that date it will, in accordance with Article 6(6) of Regulation 2020/2092 formulate a proposal for a Council implementing decision to take appropriate measures for the protection of the Union budget within one month. In accordance with Article 6(7) of Regulation 2020/2092 Hungary would then have a further period of one month to submit its observations on the proposed Council implementing measure, in particular on the proportionality of the envisaged measures.

Appendix 1

An analysis of Regulation 2020/2092 on a general regime of conditionality for the protection of the Union budget and its legal context

1. Introduction

As per its Article 10, Regulation 2020/2092⁹¹ entered into force on 1 January 2021. Adopted through the ordinary legislative procedure (majority EP, QMV in Council), it is now a fully binding and a fully applicable instrument of secondary Union law that can and should be applied instantly to fulfil its stated aim: facilitating the sound financial management of the 2021-2027 EU Budget and EU Recovery Fund and protecting the EU's financial interests from the start.

The legal context of the Regulation is complex due to the unanimity-based political deal struck in the European Council to unblock its adoption. The non-legally binding December 2020 European Council Conclusions contain language that appears aimed at conditioning or adding to the substantive agreement. It mentions Guidelines to be developed and adopted by the Commission, including a methodology for carrying out its assessment. These Guidelines, according to the European Council Conclusions, will be finalised after the Court has announced on its legality after an action for annulment.⁹² Parliament has twice replied politically.⁹³ It did not opt to pursue legal routes over the European Council Conclusions. Nonetheless, Parliament insisted Guidelines were not necessary, and if they would be developed, they should be finished by 1 June 2021 with prior consultation of Parliament.⁹⁴ It also announced that if the Commission does not act on the Regulation before 1 June 2021, Parliament could act under Article 265 TFEU for failure to act.⁹⁵

Hungary and Poland have both challenged the legality of the Regulation on 11 March 2021. These cases are now registered under Case C-156/21 and C-157/21. The Parliament and Council will have to defend the instrument as co-legislators. Parliament has announced it will request an expedited procedure.⁹⁶ The Commission will also intervene as Guardian of the Treaties, as will at least some Member States in support of the legality of the instrument. Under an expedited procedure it is possible that the Court will still rule in 2021.

The Regulation itself, for the first time expressly and comprehensively links implementation of the Union budget to compliance with elements of the rule of law. It defines the rule of law (Article 2(a)) – a first for secondary Union legislation. The key-phrase is that Member State level breaches of principles of the rule of law that *affect* or *seriously risk affecting* the sound financial management of the Union budget or the protection of the financial interest of the Union *in a sufficiently direct way* will result in appropriate measures. This means that threats can be both potential (“risk affecting”) and actual (“affect”) but need to have a strong causal link to the Union budget.

91 Regulation 2020/2092 of 16 December 2020 on a general regime for the protection of the Union budget, OJ L 433 I/1, 22 December 2020.

92 European Council Conclusions, 10-11 December 2020, point 2c).

93 European Parliament, Motion for a Resolution on the MFF 2021-2027, the IIA, the EU Recovery Instrument and the Rule of Law Regulation (2020/2923(RSP)), Doc. B9-0428/2020, 17 December 2020, par 4-9. European Parliament, Resolution of 25 March 2021 on the application of Regulation (EU, Euratom) 2020/2092, the rule-of-law conditionality mechanism (2021/2582(RSP)).

94 Resolution 25 March 2021, par. 13.

95 Resolution 17 December 2020, par. 9. Resolution 25 March 2021, par. 14.

96 Resolution 25 March 2021, par. 12. The Article 265 TFEU option was mentioned previously in Resolution 17 December 2020, par. 9.

The Regulation now exists in parallel to other tools and procedures that are equally aimed at upholding the rule of law. There are tools in Union financial legislation and more generally Treaty based legal remedies such as infringements, many of which have not been previously used, or insufficiently so with regard to Hungary. Given that the Regulation explicitly states it is to be used in a complementary and supplementary manner (Article 6(1) and recitals 14 and 17), it is of significant political, legal and practical importance to establish the legal relationship between the different instruments, particularly to assess whether and to what extent these instruments could be operationalised in parallel so as to ensure a (more) comprehensive and (more) robust defense of rule of law principles in the Union legal order.

This background paper will first look at some key terms of the Regulation, including in the light of recent legislative developments in Hungary that may have the purpose or effect of complicating the Regulation's immediate application in Hungary. In order to demonstrate the logic of the instrument, it will also visualise how the breaches of the principles of the rule of law (Article 3) relate to the specific scenarios for the conditions for the adoption of measures for the protection of the Union budget (Article 4) (section 2). Next, it will identify the most relevant other legal avenues to uphold the rule of law and assess how the Regulation relates to these, particularly in the light of the notion that it should be complementary and subsidiary to other tools. The analysis of the Regulation and its context serves as a background for a draft Commission written notification under Article 6(1) Regulation vis-à-vis Hungary.

2. Regulation: some key terms with a view to putting it to use (vis-à-vis Hungary)

2.1. Some key terms

The legal base of the Regulation is Article 322(1)(a) TFEU, which reads: "The European Parliament and the Council, acting in accordance with the ordinary legislative procedure ... shall adopt by means of regulations: (a) the financial rules which determine in particular the procedure to be adopted for establishing and implementing the budget and for presenting and auditing accounts." Article 317 TFEU refers to Article 322 TFEU and states that "the Commission shall implement the budget in cooperation with the Member States ... having regard to the principles of sound financial management. Member States shall cooperate with the Commission to ensure that the appropriations are used in accordance with the principles of sound financial management". The second sentence is repeated, verbatim, in Article 310(5) TFEU too.

The purpose of the Regulation is to establish rules necessary for the protection of the Union budget in the case of breaches of the principles of the rule of law in the Member States (Article 1). Given the legal basis, said breaches need to affect or seriously risk affecting in a sufficiently direct way **the sound financial management** of the Union budget (Article 4(1) Regulation). This should be understood in the light of recital 8, that makes clear that:

Sound financial management can only be ensured by Member States if public authorities act in accordance with the law, if cases of fraud, including tax fraud, tax evasion, corruption, conflict of interest or other breaches of the law are effectively pursued by investigative and prosecution services, and if arbitrary or unlawful decisions of public authorities, including law-enforcement authorities, can be subject to effective judicial review by independent courts and by the Court of Justice of the European Union.

What does this sound financial management concept, of which rule of law is a *sine qua non* according to the Regulation's wording but that is often simultaneously presented as an inherent limitation to the Regulation's reach, signify for budget specialists? It is defined in greater detail in the Financial Regulation⁹⁷, particularly⁹⁸ in Article 33(1):

Appropriations shall be used in accordance with the principle of sound financial management, and thus be implemented respecting the following principles:

- (a) the principle of economy which requires that the resources used by the Union institution concerned in the pursuit of its activities shall be made available in due time, in appropriate quantity and quality, and at the best price;
- (b) the principle of efficiency which concerns the best relationship between the resources employed, the activities undertaken and the achievement of objectives;
- (c) the principle of effectiveness which concerns the extent to which the objectives pursued are achieved through the activities undertaken.

It has been widely debated whether and to what extent the requirement of affecting the Union budget in a "sufficiently direct way" would limit the reach of the Regulation. Indeed, this was deemed by some a major limitation to the Regulation's scope and effectiveness. However, given the above definition of sound financial management, and the very wording of the Regulation ("only" - recital 8), arguably many if not all grave and systemic breaches of the rule of the law in a Member State will have a direct impact on how Union budget is spent. For example, fraudulent and corrupt practices by definition violate economy/efficiency (after all, this is directly at odds with assuring the best quantity, quality at the best price, and with achieving the optimal relationship between resources employed and objectives achieved). Moreover, practices undermining prosecutorial or judicial independence potentially violate the effectiveness of how the Union budget can be spent given that independent control over it that is required to correct any irregularity is severely limited.

Crucially, none of these types of rule of law breaches tends to exist in isolation as they are part of the same "strategy" or "playbook". Moreover, each of these rule of law breaches will very likely have an impact on how a Member State handles financial resources originating from the EU, or how it collects financial resources for the EU simply as a matter of basic logic. Courts or prosecutors whose independence has been compromised cannot and will not be independent on a part-time basis when they deal with EU funds. Likewise, fraudulent and corrupt practices are unlikely to be neatly compartmentalised, in the sense of being limited to purely national resources and not applying when it comes to the Union budget. Indeed, rule of law principles underlie *any* field of activity, so that problems with them will by definition impact upon any specific policy field in a sufficiently direct way. Member State level implementation of the Union budget will be no exception.

For rule of law specialists expressing themselves in terms of economy, efficiency and effectiveness may appear unnatural, and perhaps overly instrumental. But from a substantive rule of law protection viewpoint, it may make little difference in practice. If sound financial management, according to the Regulation, can *only* be ensured if principles of the rule of law are complied with, then not complying with the rule of law by definition will be at odds with one or more of the principles of economy, efficiency and effectiveness. Conversely, not acting when rule of law principles are breached by definition threatens the protection of the Union budget. Sound financial management over EU monies is impossible without complying with principles of the rule of law.

The challenge with regard to applying the Regulation, therefore, legally, politically and strategically, may be to start the reasoning not from the viewpoint of rule of law arguments *per se* but from the budgetary/sound financial management side of the argument. The starting point should be how one or more of the three aspects of sound financial management are impacted as a result of breaches of principles of the rule of law, rather than the rule of law breaches themselves. This may require categorizing the way in which each of the breaches of the principles of

97 Regulation 2018/1046 of 18 July 2018 on the financial rules applicable to the general budget of the Union [...], OJ L193/1, 30 July 2018. See recital 9 and article 2(59).

98 But see also recital 9 and article 2(59).

the rule of law mentioned in Article 3 and 4 Regulation are at odds with the sound financial management principle of economy, efficiency or effectiveness – and to use that as a starting-point. Changing the lingo and the approach of the argument is the implication of the legal base, links better to the primary know-how of EU services that will apply it. But, most importantly, it will drive home that budget and rule of law specialists often talk about the same problems but just use different words.

Crucially, the reasoning for triggering the Regulation’s mechanism swiftly in order to protect EU sound financial management will hinge on the Article 4(1)-wording, “**seriously risk** affecting the [EU budget or the Union’s financial interests] in a sufficiently direct way”. Indeed, the crucial addition and added value of this Regulation is that it authorises a *comprehensive, proactive, risk-based approach* that facilitates EU-intervention to safeguard sound financial management even *before* disbursement of EU funds. In short, given that in practice no or very little EU monies under the new EU budget have been disbursed to any Member States as yet, this means that the Commission need not wait for new documented instances of fraud or mismanagement of EU funds under the new EU budget to occur, but must instead act on the basis of the existence of serious risks to the EU budget or the Union’s financial interests. This means, on the one hand, that past breaches of the principles of the rule of law remain relevant if and when they result in a continuing undermining of the rule of law that affects the way in which the EU budget can be implemented.⁹⁹ On the other hand, this logically requires the Commission to take an anticipatory approach – including by giving weight in its risk assessments to well-documented patterns of past behaviour and by being immediately proactive in assessing new information.

Yet, there is nothing innovative or even especially progressive about this. The risk-based approach that both gives significance to the past and requires proactive monitoring and acting on the present is simply inherent in the logic of this wording, and is also in line with the logic of other already existing and partial *ex ante* tools, such as laid down in the Financial Regulation.¹⁰⁰ In other words, the only reason why this may be portrayed as innovative is that the Commission has so far been lacking behind in applying similar tools it already had at its disposal to more effectively deal with occurrences that link to breaches of the rule of law too. Nothing prevents the Commission from using all of the other tools at its disposal quickly too. In fact, that is necessary to ensure a comprehensive protection of both the EU budget and the rule of law.

2.2. Rule of law definition, breaches of rule of law principles and triggering factors

The Regulation contains both a definition of the rule of law (Article 2(a)) – the first of its kind in Union secondary law – and two different descriptions of breaches of the principles of the rule of law (Article 3 and 4(2)). Article 3 seems to set out a specific sub-set of rule of law concerns, apparently thought to be of particular relevance to the implementation of the budget or the protection of the Union’s financial interests. Article 4(2) lays down specific triggering factors that can justify measures to be adopted. The way the various Regulation clauses relate is complex. The triggering factors laid down in Article 4(2) are not listed in the same order as the way their underlying considerations are laid out in Article 3.

Other elements of the wording of Article 4(2) scenarios are noteworthy too. The wording of 4(2)(c), (e) and particularly 4(2)(h) are formulated in a deliberately open-ended way (“or other breaches” and “other situations or conduct of authorities”). This underlines that the phrase in the European Council Conclusions of December 2020 (point 2f) that “the triggering factors set out in the Regulation are to be read and applied as a closed list of homogeneous elements and not to be open to factors or events of a different nature” rings hollow. Open wording never

99 Resolution 25 March 2021, para 2: “Notes that the breaches which occurred before the entry into force of the Regulation may also trigger the adoption of measures under the Regulation as long as they continue to exist and to 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”.

100 Article 63(2) and recital 90. See for further analysis below section 3.

constitutes a truly closed list, as its very intention is to allow for flexibility to address situations that violate the spirit of the Regulation. It is also noteworthy that some grounds use the wording “relevant to” and others “relating to”, the latter requiring a less tight chain of causality.

Article 4(2)(d) clarifies that effective judicial review is only to be considered vis-à-vis specific scenarios with regard to the functioning of authorities implementing the budget, carrying out financial control or conducting investigation. It is not entirely clear whether the wording of “implementation of judgments” (Article 3(c)) and “effective judicial review by independent courts” in Article 4(2)(d) also relates to judgments of the Court of Justice and the European Court of Human Rights, or only to national judicial bodies. In case of the latter, Article 4(2)(h) could be used instead, on the reasoning that non-implementation of a judgment by a European Court constitutes conduct of authorities relevant to the sound financial management of the Union budget.

Finally, with regard to Hungary specifically, it should be pointed out with regard to 4(2)(g) that it does not participate in EPPO.

Below are two tables to visualise how Articles 3 and 4 relate, distinguishing rule of law breaches relating to the implementation of the Union budget and the protecting of the financial interests of the Union, standards of causality (relevant to and relating to) and drawing attention specifically to clauses that are formulated in an open-ended fashion.

Visualization 1: Obligation to ensure sound financial management of the Union budget

There is an obligation to take appropriate measures in the following circumstances (4(1))

Where one or more of the following types of breaches of the principles of the rule of law occurs (3)	Which concern/ relate to one or more of the following concrete scenarios 4(2)		With the consequence that breach(es) 4(1)	Impact 4(1)
<p>(b-1) failing to prevent, correct or sanction arbitrary or unlawful decisions by public authorities, including by law enforcement authorities</p> <p>(b-2) [...] withholding financial and human resources affecting the [...] proper functioning [of public authorities tasked with preventing, correcting or sanctioning]</p> <p>(b-3) [...] failing to ensure the absence of conflicts of interests</p>	vis à vis	<p>(a) the proper functioning of the authorities implementing the Union budget, including loans and other instruments guaranteed by the Union budget, in particular in the context of public procurement or grant procedures</p> <p>(b-1) the proper functioning of the authorities carrying out financial control, monitoring and audit [...]</p> <p>(b-2) the proper functioning of effective and transparent financial management and accountability systems</p> <p>(c) the proper functioning of investigation and public prosecution services in relation to the investigation and prosecution of fraud, including tax fraud, corruption or other breaches of Union law <u>relating to the implementation of the Union budget</u> [...]</p> <p>(e-1) the prevention and sanctioning of fraud, including tax fraud, corruption or other breaches of Union law <u>relating to the implementation of the Union budget</u> [...]</p> <p>(h) other situations or conduct of authorities that are relevant to the sound financial management of the Union budget [...]</p>	Affect(s), or risk(s) affecting in a sufficiently direct way	The sound financial management of the Union budget
<p>(a) endangering the independence of the judiciary</p>		<p>(d) the effective judicial review by independent courts of actions or omissions by the authorities referred to in points (a), (b), and (c).</p>		
<p>(c-1) limiting the availability and effectiveness of legal remedies, including through restrictive procedural rules and lack of implementation of judgments [...]</p> <p>(c-2) limiting the availability and effectiveness of legal remedies, including through [...] limiting the effective investigation, prosecution or sanctioning of breaches</p>	vis à vis	<p>(c) <i>the proper functioning of investigation and public prosecution services in relation to the investigation and prosecution of fraud, including tax fraud, corruption or other breaches of Union law <u>relating to the implementation of the Union budget</u> [...]</i></p> <p>(e-2) the imposition of effective and dissuasive penalties on recipients by national courts or by administrative authorities,</p> <p>(f) the recovery of funds unduly paid,</p> <p>(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,</p> <p>(h) other situations or conduct of authorities that are relevant to the sound financial management of the Union budget [...].</p>		

There is an obligation to take appropriate measures in the following circumstances (4(1))

Where one or more of the following types of breaches of the principles of the rule of law occurs (3)	Which concern/ relate to one or more of the following concrete scenarios 4(2)		With the consequence that breach(es) 4(1)	Impact 4(1)
<p>(b-1) failing to prevent, correct or sanction arbitrary or unlawful decisions by public authorities, including by law enforcement authorities</p> <p>(b-2) [...] withholding financial and human resources affecting the [...] proper functioning [of public authorities tasked with preventing, correcting or sanctioning]</p> <p>(b-3) [...] failing to ensure the absence of conflicts of interests</p>	vis à vis	<p>(a) the proper functioning of the authorities implementing the Union budget, including loans and other instruments guaranteed by the Union budget, in particular in the context of public procurement or grant procedures</p> <p>(b-1) the proper functioning of the authorities carrying out financial control, monitoring and audit [...]</p> <p>(b-2) the proper functioning of effective and transparent financial management and accountability systems</p> <p>(c) the proper functioning of investigation and public prosecution services in relation to the investigation and prosecution of fraud, including tax fraud, corruption or other breaches of Union law relating to [...] the financial interests of the Union</p> <p>(e-1) the prevention and sanctioning of fraud, including tax fraud, corruption or other breaches of Union law relating [...] to the protection of the financial interests of the Union [...]</p> <p>(h) other situations or conduct of authorities that are relevant [...] to the protection of the financial interests of the Union</p>	Affect(s), or risk(s) affecting in a sufficiently direct way	The protection of the financial interests of the Union
<p>(a) endangering the independence of the judiciary</p>		<p>(d) the effective judicial review by independent courts of actions or omissions by the authorities referred to in points (a), (b), and (c).</p>		
<p>(c-1) limiting the availability and effectiveness of legal remedies, including through restrictive procedural rules and lack of implementation of judgments [...]</p> <p>(c-2) limiting the availability and effectiveness of legal remedies, including through [...] limiting the effective investigation, prosecution or sanctioning of breaches</p>	vis à vis	<p>(c) the proper functioning of investigation and public prosecution services in relation to the investigation and prosecution of fraud, including tax fraud, corruption or other breaches of Union law relating to [...] the financial interests of the Union</p> <p>(e-2) the imposition of effective and dissuasive penalties on recipients by national courts or by administrative authorities,</p> <p>(f) the recovery of funds unduly paid,</p> <p>(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,</p> <p>(h) other situations or conduct of authorities that are relevant [...] <u>to the protection of the financial interests of the Union</u></p>		

2.3. Government entity, Member State organisation, public authorities and –expenditure

The Regulation's focus is on "government entity" and "Member State organisation"¹⁰¹ as a recipient, on the behaviour of "public" authorities, and on expenditure that is "public".¹⁰² Recent legislative changes in Hungary create entities under Hungarian law that can be formally attached to the final destination of EU-money: public interest asset management foundations.¹⁰³ Under Hungarian law they are formally private foundations with the primary goal of governing public activities, such as universities. Their primary purpose appears to be to install political control over public functions that, in principle, should be largely independent from politics (e.g. universities). In practice, however, political control can be exercised through the way that the public interest foundations are governed. Once established, the governing board of each foundation is appointed by the government; as openings arise, they are filled by the existing board. The apparent intention is to bring more public institutions under the control of these nominally civil law governed public interest foundations. The law setting up this legal form has an annex listing all entities that qualify as public interest foundations. Currently, there are thirty-one such entities, of which twenty-one are universities, and the list is now being continually updated. But these public interest foundations are designed in such a way that a future government can only change the law that regulates them if that government possesses a 2/3 majority in Parliament. As a result, between the governing structure of the foundations and the difficulty of changing the law that regulates them, these foundations would remain under the functional control of the present governing party even if it were to be voted out of office. Finally, because these public interest foundations are governed by civil law, the audit rules that normally apply to *public* organisations dealing with *public* functions – and that have an important role in protecting the Union budget – do not apply. Under the statute regulating these foundations, their funds are audited by a supervisory board or property administrator appointed by the board. As a matter of Hungarian law this has to be appreciated in the light of the Ninth amendment of the Constitution tabled in late 2020 – right around the time of the political agreement on the Conditionality Regulation – that adopted a very narrow and restrictive definition of "public funds". Under this provision, once title to assets and money has been transferred to public interest foundations, and any other non-state entities, these monies, funds and assets are no longer public for purposes of Hungarian public law.

The legal construction of these so-called civil law based "public interest foundations", particularly their public/private hybrid nature, may affect the Regulation's application, though not its applicability. The legal nature of the civil-law-based "public interest foundations" or the type of supervision over what are clearly public tasks they put in place could serve to have the effect of limiting the practical reach of the Regulation in Hungary because the entities that received the money would not be "public" and therefore data that would be relevant for assessing how EU funds were spent would not be available to public authorities on whom the EU relies for its information. There are also legal arguments about the applicability of the Conditionality Regulation that we can expect the government of Hungary to make. For instance, an argument could be put forward based on Hungarian law that an arbitrary or unlawful decision made by an authority that is not "public", would not qualify as a breach of the principle of the rule of law as a matter of Article 3(b) of the Conditionality Regulation. Or that no measure for the protection of the Union budget can be put forward where the Commission implements the Union budget in direct or indirect management but where an entity is (partly or eventually) a recipient that is not (wholly) a government entity (Article 5(1)(a)) of the Conditionality Regulation.

101 Article 2(b) and 5(1)(a) Regulation, Article 2(42) Financial Regulation. 'Member State organisation' means an entity established in a Member State as a public law body, or as a body governed by private law entrusted with a public service mission and provided with adequate financial guarantees from the Member State.

102 Recitals 8, 9, 12, 15, and Article 3(b) Regulation.

103 Act XIII of 14 March 2019 on Trusts (special rules on trusts as a form of foundations in the Hungarian legal system). This law permits the formation of the public trust, the so called "public purpose asset manager foundation" (Hungarian name: "közérdekű vagyonkezelő alapítvány"). Within the category of "public purpose asset manager foundation" there is also a narrower public trust category that is referred to as "public service public trust" (Hungarian name: "közfeladatot ellátó közérdekű vagyonkezelő alapítvány"). Many universities and think tanks sponsored by the governing party currently already have that status.

Nonetheless, and this is a crucial point in reply to those who may be worried that the Hungarian government may have found or created a loophole through which it can channel away EU funds without this being checked, “government entity”, “public authority” and “Member State organisation” are terms used in the Regulation. They are therefore terms of Union law. As such they will need to be interpreted solely as a matter of Union law, of which the Court of Justice of the European Union is the final arbiter. Interpretation will have to occur in the context of the overall aim of the Regulation: ensuring protection of the Union budget in the case of breaches of the rule of law in the Member States. It should therefore be self-evident that *national legislative (re)definitions of activities* that are essentially public in nature or recipients that are in reality public in nature *are legally irrelevant*. Indeed, the Regulation being directly applicable law in Hungary requires any national legislation to be applied in such a way as to give it full effect. This domestic (re-)definitional ploy cannot be allowed to delay Commission investigations. Quite to the contrary, as the creation of these public interest foundations is such an overt attempt to sidestep the full effect of the Rule of Law Conditionality Regulation, it should in and of itself be a reason for the Commission to step up its investigations into the implementation of the Union budget in Hungary.

3. Complementary and subsidiary nature of the Regulation

The Regulation was developed in addition to existing rule of law instruments and processes, both related and unrelated to the Union budget, and contains indications as to how to relate to such other rules. In particular, the Regulation is both complementary to more general tools and subsidiary to other tools in Union financial legislation to protect the budget.

In focusing specifically on protecting the Union budget against breaches of the principles of the rule of law affecting its sound financial management or the protection of the financial interests of the Union, the Regulation **complements** other tools (recital 14). These concern political tools such as financial support for civil society organisations, the European Rule of Law Mechanism and the EU Justice Scoreboard. The Regulation also complements traditional Treaty-based legal remedies such as infringement proceedings and political-legal tools such as the procedure provided for in Article 7 TEU.

It is noteworthy that the text of recital 14 only mentions infringement proceedings as an effective response from *Union institutions*. This disregards that *also Member States* can bring infringement actions against other Member States (Article 259 TFEU). This is relevant given that the Dutch parliament recently instructed the Dutch government¹⁰⁴ to assess whether it could act to sue Poland for undermining judicial independence. The Dutch government reported back on 1 February¹⁰⁵ that it had not found allies amongst other member states to back an Article 259 TFEU action, and that in light of further action on Poland taken by the Commission, it was no longer necessary for the Dutch government to act alone on enforcement. Yet it also said Article 259 TFEU “enters the picture in case the Commission, in a certain case, does not act or does not act sufficiently”.¹⁰⁶

The Regulation’s mechanism is to be used as a **supplementary** tool. Article 6(1) states that the Commission shall use the Regulation’s mechanism “unless it considers that other procedures set out in Union legislation would allow it to protect the Union budget more effectively”. Recital 17 provides the following additions:

Measures under this Regulation are necessary in particular in cases where other procedures set out in Union legislation would not allow the Union budget to be protected more effectively.

104 Motie van het lid Groothuizen c.s., Kamerstukken II 2020–2021, 35 570 VI, nr. 58, 26 November 2020 (Assessing the possibility of an inter-state complaint about Polish judicial independence).

105 Kamerbrief uitvoering motie-Groothuizen c.s. over onderzoek om Polen voor het Europese Hof van Justitie te dagen, 1 February 2021.

106 Idem.

Union financial legislation and the applicable sector-specific and financial rules provide for various possibilities to protect the Union budget, including interruptions, suspensions or financial corrections linked to irregularities or serious deficiencies in management and control systems.

The wording mentions only (other) procedures in Union *legislation*, and then clarifies it (recital 17 – second sentence) as Union *financial* legislation. That specific formulation is instructive in two distinct ways.

Firstly, it suggests there is no need to compare the relative effectiveness of the Regulation to procedures laid down in the *Treaties*, e.g. infringement actions or other political or political-legal tools mentioned in recital 14, rather than legislation. After all this is a complementary tool, not one that replaces these. Put differently: arguments that will likely be made in this regard that the Regulation cannot be applied since Treaty-based or political tools are applied already, do not fly. Nothing prevents different tools from being applied simultaneously. In fact, the very fact that the Regulation repeats the importance of these other tools may be taken as an argument for how important it is to apply them (more) forcefully and (more) comprehensively.

Secondly, tools not laid down in *legislation* (and therefore tools that are not themselves binding, but may explain how norms of binding Union law are to be applied), e.g. Commission guidance on ensuring respect for the Charter when implementing ESI Funds¹⁰⁷, also do not enter the picture in the assessment of whether applying these could be more effective than the Regulation's mechanism. So again, of course, nothing prevents such tools being applied simultaneously. And again, the recent attention that the Union legislator has given to rule of law enforcement by way of adopting this Regulation may actually underline how important it finds it that all tools are applied. Arguably, findings based on these non-legislative financial tools should nonetheless be taken into account by the Commission when it considers activating the Regulation's mechanism as "relevant information from available sources" in the sense of Article 6(3) Regulation.

Existing Union financial legislation, to which the Regulation must be supplementary in its application, contains both *ex ante* and *ex post* budgetary control tools.

As regards *ex ante* checks, Member States, in implementing the budget, are under an obligation to take legislative, regulatory and administrative measures to protect the financial interests of the Union, including by ensuring that actions financed from the budget are implemented correctly and effectively and by ensuring prevention, detection and correction of irregularities and fraud. This also entails, while respecting the principle of proportionality, *ex ante* and *ex post* controls. The Commission, in turn, as part of its risk assessment shall monitor the Member State management and control system. In its audit work it shall take into account the level of risk assessed as well as – importantly – respect the principle of proportionality (Article 63(2) Financial Regulation). Recital 90 of the Financial Regulation further clarifies:

Sound financial management should require that the Commission protects itself by requesting guarantees at the time of paying pre-financing. The requirement for contractors and beneficiaries to lodge guarantees should not be automatic, but should be based on a risk analysis.

The Conditionality Regulation has stated *expressis verbis* that there is "a clear relationship between respect for the rule of law and the efficient implementation of the Union budget in accordance with the principles of sound financial management" (recital 13). That relationship evidently works both ways. Therefore, it seems a reasonable approach for the Commission to consider a Member State subject to the Article 7 TEU procedure, such as Hungary, as posing a risk by definition to sound financial management at the *ex ante* stage. Therefore, it would seem proportional by definition to openly require such a Member State to improve its efforts with regard to *ex ante* checks and for the Commission to do close(r) checks of the Member State's performance. In that way the Commission can act in the European public interest by protecting its financial interests through requesting guarantees at the time of pre-financing, and only actually move to issuing any funds once it is satisfied with such guarantees.

Indeed, there seems to be particular value in drawing attention to the importance of the Commission's *ex ante* checks to take a risk-based approach to Sound Financial Management (Financial Regulation, recital 90 and Article 63(2)) at this point in time when European Union funds are about to be disbursed again. In this way the Commission could act on the notion that sound financial management and the rule of law are mutually dependent, and give effect to rule of law considerations *before* EU funding gets disbursed, in line with Council approved European Semester recommendations that need to be leading for disbursement of NGEU funds¹⁰⁸ but without getting politically blocked by the EUCO Conclusions that effectively suspend acting on the Regulation until after the Court of Justice has ruled on its legality.

The Financial Regulation also contains *ex ante* and *ex post* checks specifically focused on individual beneficiaries (Articles 135-144). In particular, there are options to bar someone from participating in bids by entering them in EDES/Early Detection and Exclusion System. A high-level panel has been established to assess this in 2018.¹⁰⁹

There is insufficient awareness of and transparency around these procedures. But these are issues that are easily solved. For example, Parliament could insist on (more) open reporting about the use of this system. More generally, linking this to Regulation (Article 5(2)), it seems reasonable that someone disqualified through EDES could no longer be a final recipient or beneficiary to whom any payments are owed. After all, as clarified in recital 19, "it is essential that the legitimate interests of final recipients and beneficiaries are properly safeguarded". Once you are barred from entering bids after having gone through a fair procedure, your expectations should no longer be considered *legitimate* as a matter of the Regulation.

The current Common Provisions Regulation (CPR)¹¹⁰, originally from 2013 covers many EU Funds.¹¹¹ It will continue to guide most of the cohesion spending until 2023. The CPR also already contains language that could be put to use to protect against breaches of rule of law principles. The most obvious connection is that Article 4(8) mentions that the Commission and Member States are to respect the principle of Sound Financial Management. There is no reason why the logic now laid down in Regulation 2020/2092 (recital 8), that sound financial management can only be ensured by Member States if public authorities act in accordance with various rule of law principles, should, as an interpretative matter, not be immediately applied to the current CPR too. Another rule of law enforcement "hook" in the 2013 CPR is that there are various options to act upon the notion of "(systemic) irregularity" (Articles 2(36)¹¹² and 2(38))¹¹³. Such action entails the possibility of suspending funds (Article 142 CPR) and imposing financial corrections (Article 40(5)(a), third sentence, and Article 143 CPR).

108 For example, Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Hungary and delivering a Council opinion on the 2020 Convergence Programme of Hungary 2020/C 282/17, OJ C 284, 26 August 2020, p. 107-115.

109 Commission Decision (EU) 2018/1220 of 6 September 2018 on the rule of procedure of the panel referred to in Article 143 of [the Financial Regulation], OJ L 226/7, 7 September 2018.

110 Regulation (EU) 303/2013 of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (consolidated version November 2020).

111 The European Regional Development Fund, the Cohesion Fund, the just Transition Fund, the European Social Fund Plus, the European Maritime and Fisheries Fund, the Asylum and Migration Fund, the Internal Security Fund and the Border Management and Visa Instrument.

112 (36) 'irregularity' means any breach of Union law, or of national law relating to its application, resulting from an act or omission by an economic operator involved in the implementation of the ESI Funds, which has, or would have, the effect of prejudicing the budget of the Union by charging an unjustified item of expenditure to the budget of the Union. "Economic operator", in this context, is defined in Article 2(37), as follows: 'economic operator' means any natural or legal person or other entity taking part in the implementation of assistance from the ESI Funds, with the exception of a Member State exercising its prerogatives as a public authority

113 (38) 'systemic irregularity' means any irregularity, which may be of a recurring nature, with a high probability of occurrence in similar types of operations, which results from a serious deficiency in the effective functioning of a management and control system, including a failure to establish appropriate procedures in accordance with this Regulation and the Fund-specific rules.

Importantly, the notion of “(systemic) irregularity” directly refers to *any* breach of Union law, or of national law implementing it, by a natural or legal person or other entity taking part in the implementation of EU Funds. Arguably, since the rule of law clearly forms part of binding Union law (Article 2 TEU, Article 2(a) Regulation 2020/2092), any of the rule of law breaches listed in Articles 3 and 4 of Regulation 2020/2092 should also qualify as a (systemic) irregularity in the sense of the (2013) CPR. This arguably already enables the Commission to apply rule of law considerations already within the current context of the CPR too with regard to misconduct of economic operators.

It is important to note that the definition of economic operator explicitly *excludes a Member State exercising its prerogatives as a public authority*. Importantly, given the previous description about the potential for recent Hungarian legislative changes for potentially complication the reach of Regulation 2020/2092, this wording also enables the Commission to go after rule of law related (systemic) irregularity that, under Union law, would not be caused by a Member State body exercising public authority (that would in any event be covered by Regulation 2020/2092). In that sense, the CPR and the rule of law conditionality Regulation will remain complementary, and should also be applied complementarily. In this way it can be ensured that all aspects of rule of law compliance of sound financial management, irrespective of whether pressure on it is caused by public authorities directly or by economic operators effectively under their control.

Also, the future Common Provisions Regulation will add a base to act on rule of law related problems from a different angle. As the Commission reported in its recent report on the application of the Charter¹¹⁴, it committed to strengthening (and really using) a previously existing ‘enabling condition’¹¹⁵ by making it refer to the Charter of Fundamental Rights more generally. This would mean concretely that for all programmes supported by the CPR covered EU Funds there must be effective mechanisms in place to ensure their compliance with the Charter, from their inception to their implementation. The final compromise text confirms a political agreement on these terms contains this wording in the horizontal principles (Article 6a(1)): “Member States and the Commission shall ensure respect for fundamental rights and compliance with the Charter ... in the implementation of the Funds.”¹¹⁶ In its Communication the Commission commits to monitoring and ensuring that complaints related to the Charter in the implementation of EU funding are duly addressed and receive follow-up in a systematic way.¹¹⁷ Similar language, directly referring to Article 6a(1) CPR, was included in the final compromise text of the European Social Funds Plus Regulation (Article 6, first sentence).¹¹⁸

These are highly relevant additions for present purposes because the Charter has many elements that directly touch on the rule of law, like the right to freedom of expression, including the right to receive information without interference by public authority (Article 11), the active and passive right to vote in free and fair European Parliament and municipal elections (Article 39 and 40), and the right to an effective remedy (article 47). These rights touch on relevant issues for Hungary, like free media and judicial independence. In that way, by way of using the Charter wording in the CPR and ESF Plus Regulation in addition to the Commission’s simultaneous guidance on European Structural and Investment Funds¹¹⁹, the rule of law can be more strongly enforced through the route of the Charter too.

114 COM(2020)711, Strategy to strengthen the application of the Charter of Fundamental Rights in the EU, 2 December 2020, p. 9–10.

115 Regulation (EU) 303/2013, Article 7.

116 Council document 6180/21, Common Provisions Regulation – Analysis of the final compromise text with a view to agreement, 25 February 2021.

117 COM(2020)711, p. 10.

118 Council document 6182/21, European Social Fund Plus (ESF+) Regulation – Analysis of the final compromise text with a view to agreement, 25 February 2021.

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

4. Conclusions: main takeaways

Three key insights flow from a close reading of the Regulation in the wider context of Union and Hungarian law. They may facilitate the effort to promote the Commission's triggering of the Regulation in combination with the use of other tools to address the rule of law situation in that Member State:

I. In terms of putting the Regulation to swift use, the reasoning to trigger it will hinge on the Article 4(1)-wording “**seriously risk** affecting the [EU budget or the Union's financial interests] in a sufficiently direct way”. This wording implies that *past* breaches of the principles of the rule of law remain relevant if and when they result in a continuing weakening that affects the way in which the EU budget can be implemented now. This logically requires giving a certain predictive power to well-documented past behaviour. And that, in turn, requires being immediately proactive on assessing new information given that, in practice, no or very little EU monies have been disbursed to any Member States as yet. This approach is simply inherent in the wording, and is also in line with the logic of *ex ante* risk-based assessment that already existed in the Financial Regulation.

II. The Regulation's focus is on “government entity” and “Member State organisation” as a recipient of Union monies, on the behaviour of “public” authorities, and on expenditure that is “public”. Recent legislative changes in Hungary appear designed, or at least may be raised, as an argument to side-step the Regulation's reach. They create nominally private law governed entities under Hungarian law that can receive or serve as the final destination of EU-money, but that are in Hungarian law formally private foundations with the primary goal of governing public activities, such as universities. If the civil law nature of the “public interest foundations” or the type of supervision over public tasks they put in place would indeed be put forward in an effort to sidestep the Regulation, it should however be clear that national Hungarian legislative (re)definitions are legally irrelevant to how concepts such as “government entity”, “public authority” and “Member State organisation” are understood as a matter of Union law. As Union law terms they need to be interpreted solely as a matter of Union law. A Regulation is directly binding in the national legal order, so that any national law needs to be changed or interpreted in such a way so as to give it full effect. Domestic (re-)definitional ploys do not affect the reach of the Regulation, and therefore should in no way delay its application.

III. The (subsidiarity and complementarity) wording and overall logic of the Regulation in its wider context do not exclude its application in parallel to other specific and general legal procedures. To the contrary, the very reference to the relevance of all these different tools in recitals 14 and 17 should be taken as an encouragement to the Commission to start using all available tools. This is particularly so for the Commission's possibility to conduct *ex ante* checks to monitor disbursing EU monies as a risk-based approach to Sound Financial Management.¹²⁰ In this way, practically, the Commission would give effect to rule of law considerations *before* EU funding gets disbursed, which would be fully in line with Council approved European Semester recommendations that need to be leading for disbursement of NGEU funds.¹²¹ Application of different tools may even happen with regard to the same general subject matter of rule of law issues. For example, from a legal perspective nothing stands in the way of acting both preventively (*ex ante* checks) and reactively (checks of individual financial misconduct) under the Financial Regulation, structurally under the Common Provisions Regulation and European Social Fund Plus Regulation, and from the angle of rule of law protection under the Conditionality Regulation, in case these angles are simply different expressions of the same wider issue of rule of law backsliding. On the other hand, the Regulation's restriction of considering only those rule of law issues with a sufficiently direct link to budgetary matters underlines the significant remaining relevance of Treaty based tools such as infringement actions by either the Commission or Member States (Article 258 and 259 TFEU).

120 Financial Regulation, Article 63(2) and recital 90.

121 Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Hungary and delivering a Council opinion on the 2020 Convergence Programme of Hungary 2020/C 282/17, OJ C 284, 26 August 2020, p. 107-115. The European Council Conclusion of July 2020 clarify these need to be taken into account by the Commission in assessing NGEU plans that Member States table.

