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PROPOSAL

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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Subject:	Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the protection of the Union's budget in case of generalised deficiencies as regards the rule of law in the Member States

Delegations will find attached document COM(2018) 324 final.

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2018/0136 (COD)

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

**on the protection of the Union's budget in case of generalised deficiencies as regards the
rule of law in the Member States**

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

• Reasons and objectives

As explained in the Communication from the Commission from February 2018 "A new, modern Multiannual Financial Framework for a European Union that delivers efficiently on its priorities post-2020"¹, the Union is a community of law and its values constitute the very basis of its existence. They permeate its entire legal and institutional structure and all its policies and programmes. Respect for these values must therefore be ensured throughout all Union policies. This includes the EU budget, where respect for fundamental values is an essential precondition for sound financial management and effective EU funding. Respect for the rule of law is important for European citizens, as well as for business initiatives, innovation and investment. The European economy flourishes most where the legal and institutional framework adheres fully to the common values of the Union.

The potential of the EU budget can only be fully unleashed if the economic, regulatory and administrative environment in the Member States is supportive. Under the current Multiannual Financial Framework, all Member States and beneficiaries are already required to show that the regulatory framework for financial management is robust, that the relevant EU regulation is being implemented correctly, and that the necessary administrative and institutional capacity exists to make EU funding a success. In addition, policy conditionality can foster the cooperation between Member States in areas where economies of scale or externalities are significant. New provisions were also introduced under the Multiannual Financial Framework 2014 – 2020 to avoid situations where the effectiveness of EU funding is undermined by unsound economic and fiscal policies.

Effective respect for the rule of law is a prerequisite for confidence that EU spending in Member States is sufficiently protected. As explained in the Communication from the Commission from 2014 "A new EU Framework to strengthen the Rule of Law",² the rule of law is the backbone of any modern constitutional democracy. It is one of the founding principles stemming from the common constitutional traditions of all the Member States of the European Union. As such, it is one of the main values upon which the Union is based, as recalled by Article 2 of the Treaty on European Union, as well as by the Preambles to the Treaty and to the Charter of Fundamental Rights. It ensures that actions by the state take place under an effective and reliable legal framework, that they can be scrutinised and challenged if needed, and that effective redress can follow.

The different constitutions and judicial systems of the EU Member States are in principle well designed to ensure the rule of law and equipped with in-built safeguards to protect citizens against any threat to the rule of law. However, a number of recent events have demonstrated generalised weaknesses in national checks and balances and have shown how a lack of respect for the rule of law can become a matter of serious and common concern within the European Union. The result has been a clear request from institutions such as the European Parliament as well as from the public at large for the EU to take actions to protect the rule of law.

¹ COM(2018) 98 final.

² COM(2014) 158 final.

Such action has been taken with the available tools and results have been achieved. However, considering the link between the respect for the rule of law and mutual trust and financial solidarity amongst Member States of the European Union, and that control mechanisms cannot be effective unless supported by an effective application of administrative and legal control and remedies in the case of wrongdoing, existing obligations to ensure effective control systems should be supplemented by measures to ensure respect of the rule of law.

In order to protect the Union's financial interests from the risk of financial loss caused by generalised deficiencies as regards the rule of law in a Member State, the European Union should be granted the possibility to adopt appropriate measures in such cases. This should be on the basis on a Council decision following a proposal from the Commission. The decision shall be deemed to have been adopted by the Council, unless it decides, by qualified majority, to reject the Commission proposal within one month of its adoption by the Commission. The European Parliament should also be fully involved at all stages.

Measures need to be adopted in full respect of the principles of transparency and proportionality. It is also important to ensure that the consequences of measures have a sufficient connection with the aim of the funding. This also points to the need to ensure that the consequences fall on those responsible for identified shortcomings. It should therefore reflect the fact the individual beneficiaries of EU funding, such as Erasmus students, researchers or civil society organisations, cannot be considered responsible for such breaches.

This proposal establishes the rules necessary for the protection of the Union's budget in case of generalised deficiencies as regards the rule of law in the Member States. It could be [integrated into the Financial Regulation, which is based on the same legal basis, at the occasion of its future revision.](#)

- **Consistency with existing policy provisions**

The proposal will contribute to ensuring the respect for the rule of law in all Member States in accordance with Article 2 TEU and to protecting the budget of the Union.

- **Consistency with other Union policies**

By contributing to ensuring respect for the rule of law and proper implementation of the budget of the Union the proposal will come in support of all other Union policies, notably when the use of Union funds is concerned.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

- **Legal basis**

The proposal is based on Article 322(1)(a) of the Treaty on the Functioning of the European Union and Article 106a of the Treaty establishing the European Atomic Energy Community.

- **Subsidiarity (for non-exclusive competence)**

Financial rules governing the Union budget under Article 322 of the Treaty on the Functioning of the EU could not be adopted at the level of the Member States.

- **Proportionality**

The proposal envisages measures proportionate to the generalised deficiencies as regards the rule of law, including the suspension, and reduction of funding under existing commitments, or the prohibition to conclude new commitments with specific categories of recipients.

Proportionality will be ensured in particular by taking into account the seriousness of the situation, the time which has elapsed since the relevant conduct, its duration and its recurrence, the intention and the degree of collaboration of the Member State in putting an end to the violation of the rule of law and the effects of that deficiency on the respective Union funds.

- **Choice of the instrument**

Considering that the objective is to contribute to the proper implementation of the general budget of the Union; the proposal takes the form of a self-standing Regulation based on Article 322 TFEU, the same legal base as the Financial Regulation.³

3. RESULTS OF RETROSPECTIVE EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

- **Retrospective evaluations/fitness checks of existing legislation**

There is no comparable current programme. There is however experience gathered from addressing at European Union level issues concerning the rule of law in Member States. This has demonstrated that, whilst some tools exist, they are not specifically designed to address situations where the implementation of Union funds could be put at risk by deficiencies as regards the rule of law.

- **Stakeholder consultations**

No specific stakeholder consultation has taken place, but the subject matter has been widely debated, including at the European Parliament and the Council.

- **External expertise**

External sources, in particular the Council of Europe, have been considered when designing the current rules. The use of external expertise from the Council of Europe is also envisaged, where appropriate, when implementing the proposed measures.

- **Impact assessment**

No impact assessment has been carried out as the measure has as its sole objective to avoid that the Union budget is harmed by situations where a generalised deficiency as regards the rule of law in a Member State affects or risks affecting the sound financial management and the protection of the financial interests of the Union. The options were therefore to either maintain the status quo, with no specific financial procedure in case of problems relating to the rule of law and potentially affecting the sound management of Union funds, or to develop such a procedure.

- **Fundamental rights**

By increasing the current level of protection against deficiencies as regards the rule of law, the proposal will have a positive impact on fundamental rights

³ Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002, OJ L 298, 26.10.2012, p. 1–96.

4. BUDGETARY IMPLICATIONS

By increasing the protection against possible practices, omissions or measures of public authorities which affect the rule of law in that Member State and which affect or risk affecting its capacity to implement its budgetary obligations, the proposal will have a positive impact on the sound financial management of the general budget of the Union.

5. OTHER ELEMENTS

- **Implementation plans and monitoring, evaluation and reporting arrangements**

The Commission will assess the situation in the Member State concerned in order to decide whether a lifting of measures can be proposed.

- **Detailed explanation of the specific provisions of the proposal**

The proposal draws upon the Communication from the Commission from 2014 "A new European Union Framework to strengthen the Rule of Law",⁴ and the Communication from the Commission from February 2018 "A new, modern Multiannual Financial Framework for a European Union that delivers efficiently on its priorities post-2020"⁵ as well as standards and principles developed by the Council of Europe.

Article 1 explains the subject matter and the need to protect the Union budget against generalised deficiencies as regards the rule of law in a Member State, which could affect or risk affecting the sound financial management and the protection of the financial interests of the Union.

Article 2 sets out the definitions.

Article 3 details the measures to be taken to address a situation of generalised deficiencies as regards the rule of law. It explains what particular functions of the state might be affected and negatively impact the sound financial management of Union funds.

Article 4 lists the type of measure that can be taken and clarifies that these should be addressed to Member States as recipients of the Union funds.

Article 5 sets out the procedures that should be followed by the Commission when proposing measures to the Council, who should decide in accordance with a reversed qualified majority vote.

Article 6 sets out the procedure to lift measures when the situation it targeted has been addressed in a given Member State, and the consequences of the lifting in terms of budgetary terms.

Article 7 concerns the information provided to the European Parliament.

Article 8 contains the final provisions.

⁴ COM(2014) 158 final.

⁵ COM(2018) 98 final

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on the protection of the Union's budget in case of generalised deficiencies as regards the rule of law in the Member States

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,
 Having regard to the Treaty on the Functioning of the European Union, and in particular Article 322(1)(a) thereof,
 Having regard to the Treaty establishing the European Atomic Energy Community, and in particular Article 106a thereof,
 Having regard to the proposal from the European Commission,
 After transmission of the draft legislative act to the national parliaments,
 Having regard to the opinion of the Court of Auditors⁶,
 Acting in accordance with the ordinary legislative procedure

Whereas:

- (1) The rule of law is one of the essential values upon which the Union is founded. As recalled by Article 2 of the Treaty on European Union, these values are common to the Member States.
- (2) The rule of law requires that all public powers act within the constraints set out by law, in accordance with the values of democracy and fundamental rights, and under the control of independent and impartial courts. It requires, in particular, that the principles of legality⁷, legal certainty⁸, prohibition of arbitrariness of the executive powers⁹, separation of powers¹⁰, and effective judicial protection by independent courts¹¹ are respected¹².

⁶ [...]

⁷ Judgment of the Court of Justice of 29 April 2004, CAS Succhi di Frutta, C-496/99 PECLI:EU:C:2004:236, paragraph 63.

⁸ Judgment of the Court of Justice of 12 November 1981, Amministrazione delle finanze dello Stato v Srl Meridionale Industria Salumi and others Ditta Italo Orlandi & Figlio and Ditta Vincenzo Divella v Amministrazione delle finanze dello Stato. Joined cases 212 to 217/80, ECLI:EU:C:1981:270, paragraph 10.

⁹ Judgment of the Court of Justice of 21 September 1989, Hoechst, Joined cases 46/87 and 227/88, ECLI:EU:C:1989:337, paragraph 19.

¹⁰ Judgment of the Court of Justice of 10 November 2016, Kovalkovas, C-477/16, ECLI:EU:C:2016:861, paragraph 36; Judgment of the Court of Justice of 10 November 2016, PPU Poltorak, C-452/16, ECLI:EU:C:2016:858, paragraph 35; and Judgment of the Court of Justice of 22 December 2010, DEB, C-279/09, ECLI:EU:C:2010:811, paragraph 58.

¹¹ Judgment of the Court of Justice of 27 February 2018, Associação Sindical dos Juizes Portugueses v Tribunal de Contas C-64/16, ECLI:EU:C:2018:117, paragraphs 31, 40-41.

- (3) The rule of law is a prerequisite for the protection of the other fundamental values on which the Union is founded, such as freedom, democracy, equality and respect for human rights. Respect for the rule of law is intrinsically linked to respect for democracy and for fundamental rights: there can be no democracy and respect for fundamental rights without respect for the rule of law and vice versa.
- (4) Whenever the Member States implement the Union's budget, and whatever method of implementation they use, respect for the rule of law is an essential precondition to comply with the principles of sound financial management enshrined in Article 317 of the Treaty on the Functioning of the European Union.
- (5) Sound financial management can only be ensured by the Member States if public authorities act in accordance with the law, and if breaches thereof are effectively pursued by investigative and prosecution services, and if decisions of public authorities can be subject to effective judicial review by independent courts and by the Court of Justice of the European Union.
- (6) Judicial bodies should act independently and impartially and investigation and prosecution services should be able to properly execute their function. They should be endowed with sufficient resources and procedures to act effectively and in full respect of the right to a fair trial. These conditions are required as a minimum guarantee against unlawful and arbitrary decisions by public authorities that could harm the financial interests of the Union.
- (7) The independence of the judiciary presupposes, in particular, that the body concerned is able to exercise its judicial functions wholly autonomously, without being subject to any hierarchical constraint or subordinated to any other body, and without taking orders or instructions from any source whatsoever, and that it is thus protected against external interventions or pressure liable to impair the independent judgment of its members and to influence their decisions. The guarantees of independence and impartiality require rules, particularly as regards the composition of the body and the appointment, length of service and the grounds for rejection and dismissal of its members, in order to dismiss any reasonable doubt in the minds of individuals as to the imperviousness of that body to external factors and its neutrality with respect to the interests before it.
- (8) Respect for the rule of law is not only important for citizens of the Union, but also for business initiatives, innovation, investment and the proper functioning of the internal market, which will flourish most where a solid legal and institutional framework is in place.
- (9) Article 19 TEU, which gives concrete expression to the value of the rule of law stated in Article 2 TEU, requires the Member States to provide effective judicial protection in the fields covered by Union law, including those relating to the implementation of the Union's budget. The very existence of effective judicial review designed to ensure compliance with Union law is the essence of the rule of law and requires independent courts¹³. Maintaining the independence of the courts is essential, as confirmed by the second subparagraph of Article 47 of the Charter of Fundamental Rights of the European Union¹⁴. This is true, in particular, for the judicial review of the validity of

¹² Communication from the Commission "A new EU Framework to strengthen the Rule of Law", COM(2014) 158 final, Annex I.

¹³ Case C-64/16, para 32-36.

¹⁴ Case C-64/16, para 40-41.

the measures, contracts or other instruments giving rise to public expenditure or debts, inter alia in the context of public procurement procedures which may also be brought before the courts.

- (10) There is hence a clear relationship between respect for the rule of law and an efficient implementation of the Union budget in accordance with the principles of sound financial management.
- (11) Generalised deficiencies in the Member States as regards the rule of law which affect in particular the proper functioning of public authorities and effective judicial review, can seriously harm the financial interests of the Union.
- (12) The identification of a generalised deficiency requires a qualitative assessment by the Commission. That assessment could be based on the information from all available sources and recognized institutions, including judgments of the Court of Justice of the European Union, reports of the Court of Auditors, and conclusions and recommendations of relevant international organisations and networks, such as the bodies of the Council of Europe and the European networks of supreme courts and councils for the judiciary.
- (13) The possible measures to be adopted in the event of generalised deficiencies and the procedure to be followed to adopt them should be determined. Those measures should include the suspension of payments and of commitments, a reduction of funding under existing commitments, and a prohibition to conclude new commitments with recipients.
- (14) The principle of proportionality should apply when determining the measures to be adopted, in particular taking into account the seriousness of the situation, the time which has elapsed since the relevant conduct started, its duration and its recurrence, the intention, and the degree of cooperation of the Member State concerned in putting an end to the generalised deficiency as regards the rule of law, and the effects of that deficiency on the respective Union funds.
- (15) In order to ensure uniform implementation of this Regulation and in view of the importance of the financial effects of measures being imposed pursuant to this Regulation, implementing powers should be conferred on the Council which should act on the basis of a Commission proposal. To facilitate the adoption of decisions which are required to protect the financial interests of the Union, reversed qualified majority voting should be used.
- (16) Before proposing the adoption of any measure pursuant to this Regulation, the Commission should inform the Member State concerned why it considers that a generalised deficiency regarding the rule of law might exist in that Member State. The Member State should be allowed to submit its observations. The Commission and the Council should take those observations into account.
- (17) The Council should lift measures with suspensive effect on a proposal from the Commission, if the situation leading to the imposition of those measures has been sufficiently remedied.
- (18) The Commission should keep the European Parliament informed of any measures proposed and adopted pursuant to this Regulation,

HAVE ADOPTED THIS REGULATION:

Article 1
Subject matter

This Regulation establishes the rules necessary for the protection of the Union's budget in the case of generalised deficiencies as regards the rule of law in the Member States.

Article 2
Definitions

For the purposes of this Regulation, the following definitions apply:

- (a) 'the rule of law' refers to the Union value enshrined in Article 2 of the Treaty on European Union which includes the principles of legality, implying a transparent, accountable, democratic and pluralistic process for enacting laws; legal certainty; prohibition of arbitrariness of the executive powers; effective judicial protection by independent courts, including of fundamental rights; separation of powers and equality before the law;
- (b) 'generalised deficiency as regards the rule of law' means a widespread or recurrent practice or omission, or measure by public authorities which affects the rule of law;
- (c) 'government entity' means all public authorities at all levels of government, including national, regional and local authorities, as well as Member State organisations within the meaning of [point 42 of Article 2] of Regulation (EU, Euratom) No [...] (the 'Financial Regulation').

Article 3
Measures

1. Appropriate measures shall be taken where a generalised deficiency as regards the rule of law in a Member State affects or risks affecting the principles of sound financial management or the protection of the financial interests of the Union, in particular:
 - (a) the proper functioning of the authorities of that Member State implementing the Union budget, in particular in the context of public procurement or grant procedures, and when carrying out monitoring and controls;
 - (b) the proper functioning of investigation and public prosecution services in relation to the prosecution of fraud, corruption or other breaches of Union law relating to the implementation of the Union budget;
 - (c) the effective judicial review by independent courts of actions or omissions by the authorities referred to in points (a) and b);
 - (d) the prevention and sanctioning of fraud, corruption or other breaches of Union law relating to the implementation of the Union budget, and the imposition of effective and dissuasive penalties on recipients by national courts or by administrative authorities;
 - (e) the recovery of funds unduly paid;
 - (f) the effective and timely cooperation with the European Anti-fraud Office and with the European Public Prosecutor's Office in their investigations or

prosecutions pursuant to their respective legal acts and to the principle of loyal cooperation.

2. The following may, in particular, be considered generalised deficiencies as regards the rule of law,
 - (a) endangering the independence of judiciary;
 - (b) failing to prevent, correct and sanction arbitrary or unlawful decisions by public authorities, including by law enforcement authorities, withholding financial and human resources affecting their proper functioning or failing to ensure the absence of conflicts of interests;
 - (c) limiting the availability and effectiveness of legal remedies, including through restrictive procedural rules, lack of implementation of judgments, or limiting the effective investigation, prosecution or sanctioning of breaches of law.

Article 4 *Content of measures*

1. One or more of the following appropriate measures may be adopted
 - (a) where the Commission implements the Union's budget in direct or indirect management pursuant to points (a) and (c) of Article 62 of the Financial Regulation, and where a government entity is the recipient:
 - (1) a suspension of payments or of the implementation of the legal commitment or a termination of the legal commitment pursuant to Article [131(3)] of the Financial Regulation;
 - (2) a prohibition to enter into new legal commitments;
 - (b) where the Commission implements the Union's budget in shared management pursuant to [point (b) of Article 62] of the Financial Regulation:
 - (1) a suspension of the approval of one or more programmes or an amendment thereof;
 - (2) a suspension of commitments;
 - (3) a reduction of commitments, including through financial corrections or transfers to other spending programmes;
 - (4) a reduction of pre-financing;
 - (5) an interruption of payment deadlines;
 - (6) a suspension of payments.
2. Unless the decision adopting the measures provides otherwise, the imposition of appropriate measures shall not affect the obligation of government entities referred to in point (a) of paragraph 1 or of Member States referred to in point (b) of paragraph 1 to implement the programme or fund affected by the measure, and in particular the obligation to make payments to final recipients or beneficiaries.
3. The measures taken shall be proportionate to the nature, gravity and scope of the generalised deficiency as regards the rule of law. They shall, insofar as possible, target the Union actions affected or potentially affected by that deficiency.

Article 5
Procedure

1. Where the Commission finds that it has reasonable grounds to believe that the conditions of Article 3 are fulfilled, it shall send a written notification to that Member State, setting out the grounds on which it based its finding
2. The Commission may take into account all relevant information, including decisions of the Court of Justice of the European Union, reports of the Court of Auditors, and conclusions and recommendations of relevant international organisations.
3. The Commission may request any additional information required for its assessment, both before and after having made a finding pursuant to paragraph 1.
4. The Member State concerned shall provide all required information and may make observations within a time limit specified by the Commission, which shall not be less than 1 month from the date of notification of the finding. In its observations, the Member State may propose the adoption of remedial measures.
5. The Commission shall take into account the information received and any observations made by the Member State concerned, as well as the adequacy of any proposed remedial measures, when deciding whether or not to submit a proposal for a decision on the appropriate measures.
6. Where the Commission considers that the generalised deficiency as regards the rule of law is established, it shall submit a proposal for an implementing act on the appropriate measures to the Council.
7. The decision shall be deemed to have been adopted by the Council, unless it decides, by qualified majority, to reject the Commission proposal within one month of its adoption by the Commission.
8. The Council, acting by a qualified majority, may amend the Commission's proposal and adopt the amended text as a Council decision.

Article 6
Lifting of measures

1. The Member State concerned may, at any time, submit to the Commission evidence to show that the generalised deficiency as regards the rule of law has been remedied or has ceased to exist.
2. The Commission shall assess the situation in the Member State concerned. Once the generalised deficiencies as regards the rule of law which on the grounds of which the appropriate measures were adopted cease to exist in full or in part, the Commission shall submit to the Council a proposal for a decision lifting those measures in full or in part. The procedure set out in paragraphs 2, 4, 5, 6 and 7 of Article 5 shall apply.
3. Where measures concerning the suspension of the approval of one or more programmes or amendments thereof referred to in point (i) of Article 4(2)(b) or the suspension of commitments referred to in point (ii) of Article 4(2)(b) are lifted, amounts corresponding to the suspended commitments shall be entered in the budget subject to Article 7 of Council Regulation (EU, Euratom) No XXXX (MFF Regulation). Suspended commitments of year n may not be entered in the budget beyond year $n+2$.

Article 7
Information of the European Parliament

The Commission shall immediately inform the European Parliament of any measures proposed or adopted pursuant to Articles 4 and 5

Article 8
Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*. It shall apply from 1 January 2021.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the European Parliament
The President

For the Council
The President