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Is state aid to start-ups and SMEs becoming illegal if the company is sold?

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Small and Medium-sized Enterprises (SMEs) are often target companies of corporate acquisitions. The acquisition secures their continuation and expands their prospects on the market. Especially start-ups are often supported by subsidies. Will the subsidies subsequently become illegal and have to be returned if the company loses its SME status as a result of a corporate acquisition? These questions affect both EU law and the laws of the member states. The authors examine them with a focus on due diligence and the drafting of acquisition contracts.

Government support measures are important for SMEs[2] as well as for larger and large companies.[3] They do not just occur in

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[2] See below in the text for their EU-wide definition.

[3] In 2019, according to the EU's transparency register (https://webgate.ec.europa.eu/competition/transparency/public?lang=de), 1748 SMEs alone received funding of more than €500,000. The register of the state of North Rhine-Westphalia (https://www.efre.nrw.de/daten-fakten/liste-

individual cases, but are part of the standard instruments of economic policy and corporate development. Within the framework of a free market economy, they pursue goals affecting the general (climate protection), macroeconomic (digitalization, reduction of Co2-emissions, energy saving), industry-related or regional development goals. Thus, a large number of companies benefit from subsidies. Most of them are dynamically growing companies with innovative products. The subsidies are tied to specific funding purposes, such as reducing energy consumption. Insofar as subsidies are granted to SMEs, the SME character is either the main purpose[4] or the state aid pursues a dual purpose (a general economic one and a SME-related one in which case hereinafter the additional subsidy granted to support the SME purpose is called SME supplement). For example, a subsidy of 30% for investments in energy efficiency measures can be increased by e.g. 10 percentage points (for medium-sized companies) or 20 percentage points (for small companies)[5]. The reason for SME support is, on the one hand, the overall economic significance of these businesses and, on the other, their contribution to growth and

der-vorhaben/) lists 949 companies with average funding of around €450,000 for 2019 alone.

[4] See the EU-Program: Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME) https://ec.europa.eu/growth/smes/cosme_en.

[5] See, for example, Art. 38(4) and (5) of Commission Regulation (EU) No. 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty on the Functioning of the European Union (hereinafter: GBER); according to the EU Commission's communication, the GBER, which actually expires at the end of 2020, has been extended until 2023 https://ec.europa.eu/germany/news/20200702-beihilferegeln-corona_de.

innovation. This is particularly true for start-ups, whose business concepts require not only VC investors, but also government support.

This article specifically deals with the effects of corporate acquisitions on the promotion of SMEs. For these, the proportion of subsidies in the total financing volume is much greater than for other companies. This is particularly true for start-ups. In addition, SMEs - and here again start-ups in particular - are much more frequently the subject of corporate takeovers which can entail the loss of the SME position.

SMEs are defined for the purposes of EU law in Art. 2 No. 2 in conjunction with Annex 1 of the General Block Exemption Regulation of the EU (GBER, the afore-mentioned hereinafter referred to as the '**SME definition**') as enterprises which employ fewer than 250 persons and which either have an annual turnover not exceeding EUR 50 million or whose annual balance sheet total does not exceed EUR 43 million. These SMEs typically develop dynamically. In the course of this process, SMEs are often acquired by non-SMEs or they otherwise join forces with an industrial or financial partner. If the SME is acquired as part of a corporate purchase, its status as an SME usually ceases to exist because the SME is no longer to be regarded as an independent undertaking[6] for

[6] According to Art. 3(1) Annex 1 GBER, an autonomous undertaking is any undertaking which is not a partner undertaking or which is deemed to be an affiliated undertaking. According to Art. 3(2) Annex 1 to the GBER, "Partner undertakings" are all undertakings which are not considered to be related undertakings and between which the following relationship exists: An undertaking (the upstream undertaking) holds - alone or together with one or more related undertakings -25% or more of the capital or voting rights of another

the purposes of subsidy law due to the subsequent group consideration as set out in Art. 3 Annex 1 of the GBER and the aforementioned figures in the group with the purchaser exceed the relevant thresholds.

How this change impacts on whether the SME may keep the subsidies or must return them once they had already been granted and (possibly partially) already used is the subject of this article. It is not intended to address the question of whether subsidies granted unlawfully from the outset may be reclaimed in connection with M&A transactions. This topic has already been the subject of numerous publications[7]. In contrast, the constellation presented here, which is very relevant for the practice of due diligence and the drafting of the corporate acquisition agreement, has hardly been

undertaking (the downstream undertaking). According to Art. 3(3) Annex 1 to the GBER, "related undertakings" are undertakings which have one of the following relationships with each other:
a) an undertaking holds the majority of the voting rights of the shareholders or partners of another undertaking;
b) an undertaking has the right to appoint or remove a majority of the members of the administrative, management or supervisory body of another undertaking;
c) an undertaking is entitled to exercise a controlling influence over another undertaking pursuant to a contract entered into with that undertaking or a clause in its articles of association;
d) an undertaking that is a shareholder or partner of another undertaking exercises sole control over the majority of the voting rights of its shareholders or partners pursuant to an agreement entered into with other shareholders or partners of that other undertaking.

[7] Verse/Wurmnest, ZHR 167 (2003), 403; Soltész/Schädle, BB 2008, 510; Soltész/Imgenberg, BB 2020, 194.

discussed so far[8]: Initially granting the subsidy had been lawful, but at some point before the investment phase is completed, the subsidized company is sold and thus loses its SME status. If the aid has been used in full and the company is acquired only afterwards, the question of recovery should not arise.

First of all, the context of EU state aid law and the provisions of German funding law with regard to reclaiming of funding for the case as it is relevant in the present context will be briefly described (item 1). This is followed by an examination of the very important question under company acquisition law of how the risk of loss of SME status affects the buyer's due diligence and the seller's duties to provide information. It also deals with which provisions are to be recommended for the company purchase agreement with regard to the risk of recovery of state aid. A distinction must be made between asset and share deals (Sections 2 and 3). Following this - after a brief description of the special features when EU funding law is applicable (item 4) - the impact of the results of the legal investigations on the drafting of the corporate acquisition agreement is discussed (item 5).

1. The basics of EU state aid law and national state aid law relevant for M&A transactions

With regard to the recovery of subsidies, both EU state aid law and the national law are applicable to the national or regional

[8] Apart from a single publication by Töpfer/Butler in ZIP 2003, 1677, from which this article differs by taking current case law into account, the constellation presented here is not dealt with in the reviewed publications.

subsidy authority. The principles of EU state aid law are set out in Articles 107 et seq. of the TFEU[9]. Accordingly, state aid granted by EU member states is generally prohibited because it impairs fair competition in the internal market. Exceptionally, it may be approved by the EU Commission if it is compatible with the internal market. Compatible with the internal market is, according to the exceptions in Article 107 (2) TFEU, state aid granted to compensate for certain hardships (e.g. as a result of natural disasters). According to the exceptions in Article 107 (3) TFEU, which are left to the discretion of the EU Commission, the latter may declare state aid to compensate for structural differences in the member states, for example, to be compatible with the internal market. The fundamental prohibition of state aid requires the respective member states to notify the EU Commission in advance of any planned state aid. Accordingly, it may not be granted until the EU Commission has decided on its compatibility with the internal market[10]. In addition, the EU Commission controls whether state aid is being misused. Without approval in individual cases, state aid is only permissible if it is covered by a state aid scheme (program approval in the sense of a general exemption[11]) or is exempted from

[9] Treaty on the Functioning of the European Union (TFEU) as published on May 9, 2008; The Federal Republic of Germany approved the Treaty of Lisbon by Act dated 8.10.2008 (Federal Gazette II p. 1038); Entry into force on December 1, 2009, see Public Announcement. dated 13.11.2009 (Federal Gazette II p. 1223).

[10] This was also the case, for example, with the Corona aid program measures: Commission, Dec. 24.03.2020, https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_56814.

[11] In this context, exemption always refers to the general or individual exemption of any state aid from the otherwise existing prohibition on granting state aid.

the notification requirement by a legal act of the EU Commission. For the promotion of SMEs, the exemption criteria of the GBER and the regulation governing de minimis state aid are regularly[12] used.

There is no legal definition of the term "state aid" within the meaning of European law. Based on a commentary definition, state aid can be any measure that has a favorable effect compared to the generally existing market and legal conditions and that burdens public financial resources.[13] It is thus much broader than the German definition of a subsidy.[14]

Art. 1 lit. f) of the EU State Aid Procedure Regulation[15] provides that state aid granted in breach of the notification procedure is illegal from the outset. Pursuant to Art. 16 (1) of the EU State Aid Procedure Regulation, the EU Commission is generally obliged, with regard to unlawfully granted aid that is incompatible with the internal market, to declare by way of a decision that the Member State concerned must take all necessary measures to recover the aid from the recipient. In the constellation in which the SME status given at the time of the grant ceases to exist as a result of a subsequent company acquisition, the question then arises as to

[12] Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis state aid.
[13] Vedder/Heintschel von Heinegg, EU Law (Europäisches Unionsrecht), TFEU (AEUV) Art. 107 Rn. 7.
[14] Heidenhain, Handbook of European State Aid Law (Handbuch des Europäischen Beihilfenrechts), § 3 para. 2.
[15] COUNCIL REGULATION (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, ("EU State Aid Procedure Regulation").

whether the subsidy can thereby subsequently become unlawful as a whole because the SME-related purpose of the subsidy has ceased to exist. The assessment of this question is based on EU state aid law at the first stage and on the national law of the respective member state at the second stage. Indeed, the recovery itself is carried out according to national administrative law. Furthermore, the statistically more frequent constellation[16] in which the subsidies are co-financed from EU funds[17], in particular from the European Regional Development Fund, is to be analyzed. In this respect, EU funding law must also be taken into account. This is to be separated from EU state aid law.

There is no legal definition of the term "subsidy" in German law. Subsidies are grants or benefits with a financial value that in the context relevant here are awarded by the public sector to private companies in order to promote a purpose in the public interest.[18] Under German law, subsidies can be granted in the form of a notice of approval or a public or private law contract. In our example case (company acquisition with loss of SME status before completion of a subsidized measure), the notice of approval concerns a multi-layered subsidy: According to this, the subsidy purposes consist on the one hand of a general purpose (e.g. energy efficiency, Art. 38 GBER), which can also be pursued by other companies irrespective

[16] In 2017, SMEs in Germany were subsidized by government funds in the amount of around EUR 1.066 billion; by the EU in the amount of around EUR 5.8 billion, see 27th Subsidies Report, printed matter 19/15340, overview 10, p. 55.

[17] Grabitz/Hilf/Nettesheim/von Wallenberg/Schütte, 69th Update February 2020, TFEU Art. 107 para. 128.

[18] Matzen, in: Knott, Business Acquisitions (Unternehmenskauf), 6th ed. 2019, para. 1207.

of their size; on the other hand, of the subsidy with reference to the SME status, which is why an additional premium can be granted.

The general ancillary provisions to the notice of approval regularly provide for an obligation of notification of the recipient of the grant to the granting authority. This applies in particular in the event that the purpose of the grant or other circumstances relevant to the approval of the grant change or cease to apply, or if it becomes apparent that the purpose of the grant cannot be achieved at all or cannot be achieved with the approved grant.[19] In addition, the general ancillary provisions regularly contain a right of audit for the granting authority. This is a means of the funding authority to ensure that the subsidy is used for the intended purpose. On the basis of this audit right, the granting authority is entitled to request books, receipts and other business documents and to audit the use of the subsidy by means of local surveys[20] or have it audited by agents.[21] The granting authority is likely to take the view that the acquisition of an SME by a non-SME constitutes a circumstance triggering the notification obligation.

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[19] See Art. 5 General ancillary provisions for subsidies in relation to the promotion of projects (Allgemeine Nebenbestimmungen für Zuwendungen zur Projektförderung (ANBest-P)) North Rhine-Westphalia https://www.brd.nrw.de/wirtschaft/wirtschafts_arbeitsmarkt_foerderung/pdf/ANBest-P.pdf.

[20] These are factual investigations on site that may be relevant for the audit decision cf. Nomos-BR/von Lewinski/Burbat Federal Budget Ordinance (BHO)/Kai von Lewinski/Daniela Burbat, 1st ed. 2013, Federal Budget Ordinance (BHO) § 94 para 5.

[21] See Art. 7 General ancillary provisions for subsidies in relation to the promotion of projects (Allgemeine Nebenbestimmungen für Zuwendungen zur Projektförderung (ANBest-P)) North Rhine- Westphalia.

2. Recovery of a subsidy as a result of the loss of SME status in the context of share deals

First, a share deal will be examined in more detail with regard to the case relevant here - recovery of subsidies due to loss of SME status as a result of a corporate acquisition. First, the substantive justification for reclaiming the subsidy will be examined, followed by procedural aspects.

2.1. Recoverability of the grant

With regard to the substantive assessment of a claim for the recovery of a subsidy, the first question is to what extent EU state aid law and to what extent German administrative law is relevant in our constellation.

2.1.1. Assessment under EU state aid law

The starting point in our constellation can be a subsidy with – under the GBER exempted - investment aid for energy efficiency measures according to Art. 38 GBER, which contains an SME supplement according to Art. 38 (5) GBER. The decisive factor for the exemption is the existence of the conditions specified in the GBER. If state aid has been granted on the basis of the GBER without the conditions for exemption being met, the EU Commission has the authority to initiate the state aid control procedure retrospectively,[22] which regularly results in a recovery order if the

[22] Immenga/Mestmäcker/Nowak, 5th ed. 2016, GBER Art. 10 marginal no. 1.

state aid is incompatible with the principles of the internal market. According to the case law of the European Court of Justice, however, the member state institution that granted the aid (granting authority) must recover the funds on its own initiative even before such a decision if it notices that the conditions for exemption are not met.[23]

Therefore, the questions at which point in time an SME loses its SME status under European Union law in the case of a share deal, or – to put it differently - at which point in time and over which period of time the SME status must be fulfilled as an exemption requirement, must be answered for both eligibility criteria, the general economic one and the SME specific one.

2.1.1.1. **Loss of SME status**

The question of the point in time of the change in SME status arises against the background that, in accordance with Art. 4 (2) of the SME definition, an undertaking generally only loses its SME status if it exceeds the above-mentioned thresholds in two consecutive financial years. In the opinion of the EU Commission, however, this provision does not apply in the event of a change in ownership.[24] This legal opinion of the EU Commission appears to be well justifiable, even if it finds no support in the wording of the SME definition itself. The provision in Art. 4 (2) of the SME definition is intended to provide SMEs with planning security if they exceed the threshold values in the short term. The typical difficulties of an SME

[23] Cf. ECJ, judgment of 05.03.2019 - C-349/17.
[24] cf. EU Commission, User's Guide to the Definition of SMEs, 2015, p. 16.

in corporate financing, which the preferential treatment of SMEs in EU subsidy law and EU state aid law is intended to compensate for, are not necessarily eliminated by exceeding the thresholds in the short term. However, in case of a majority stake held by a larger undertaking, it can be assumed that improved access to the capital market can be achieved without a time lag. This argumentation is also supported by the constant ECJ case law. When assessing the SME status, not only the formal requirements of the SME definition are to be taken into account. Rather, it should be taken into account that the criterion of the independence of an undertaking contained in the SME definition serves to better capture the economic reality of SMEs and in this way exclude those companies from this category that have a stronger economic power than an SME. The privileging of SMEs in terms of support is intended to benefit only those companies that are in the situation of an SME.[25]

Upon effectiveness of the acquisition of shares in a company purchase, by which the purchaser acquires the majority of the shares in the target company, the purchaser and the target company become "affiliated undertakings" within the meaning of Art. 3 (3) of the SME definition. If the affiliated undertakings together exceed the SME thresholds in Art. 2 of the SME definition (less than 250 employees, max. EUR 50 million annual turnover or max. EUR 43 million annual balance sheet total), the target company loses its SME status (at the latest). Against the background of the ECJ case law, an integration of the target SME into financing, supplier, marketing or sales structures in anticipation of a planned share deal

[25] cf. ECJ, judgment of 27.02.2014 - Case C-110/13 "HaTe-Fo", para. 30; ECJ, judgment of 29.04.2004 - C 91/01 "SolarTech", para. 49.

prior to the effectiveness of the transaction must be assessed critically in individual cases[26]. As soon as the target company is de facto integrated into the group of companies, it loses its SME status.

2.1.1.2. **Relevant point in time for the existence of the exemption requirements**

In Art. 3, the GBER requires that the conditions for exemption must be fulfilled, without defining the point in time in a generally applicable manner. In several provisions, however, it refers to the "time of granting" (e.g. in Art. 5 and Art. 7 GBER). The time of granting is in turn defined in Art. 2 No. 28 GBER as the day on which the state aid recipient acquires a legal claim to the state aid. The conditions for exemption must therefore be met not only when the application is submitted, but also when the notice of grant becomes final. In the period between notification of the decision and the date when it becomes final, the aid recipient is therefore obliged to notify a change in its SME status, with the consequence that it may no longer be allowed to collect the SME supplements or the SME subsidy. The legal consequence of a change in status before the grant decision becomes final is the reduction of the SME supplements in the case of funding under Art. 38 GBER (investment aid for energy efficiency measures).

[26] Such premature integration is to be avoided in any case in the case of transactions subject to notification under competition law against the background of the prohibition to implement the transaction.

2.1.1.3. **Duration of the existence of the conditions for exemption**

The GBER provides for holding periods for investments and permanent jobs (Art. 14 GBER). However, there is no explicit provision stating that the SME status must be maintained after the state aid has been granted. In the absence of a legal basis for ex-post control, the EU Commission can only take into account facts relating to the time when the state aid was granted, even when examining the compatibility of state aid with the internal market ex post.[27]

In addition to this argument anchored in procedural law, however, the objective of an SME state aid or of SME supplements also argues against the need to maintain the SME status of the state aid recipient after the time of granting. In recital 40 of the GBER, the EU Commission explains that SMEs typically have difficulties in obtaining capital or loans, they may also lack information on new technologies or potential markets, and their support is therefore exempted under the GBER. The support is intended to overcome the typical difficulties of the SME, but its aim is not to perpetuate the SME status.

State aid must also be aimed at providing an incentive for a change in the behaviour of the state aid recipient (Art. 6 GBER). The SME should be enabled by the state aid to carry out a project which it would not have carried out without the state aid or would not have carried out to the same extent or at the same time. At the time when the SME acquires the right to the support (e.g. when the decision becomes final), the decision of the SME to carry out the

[27] ECJ, judgment of 03.10.1991 - C -261/89 Italy v. Commission, para. 21.

project in question should be promoted. Events after the decision to carry out the project are generally not relevant for the granting of state aid, at least not if the project has actually been started. An ex post consideration that comes to the conclusion that the SME might not have needed the support because it was integrated into a larger group of companies after the granting and the group could have carried out a comparable project without or with less support is merely hypothetical in nature. For the question of the legality of the state aid, it is decisive that it gave the SME the incentive to undertake the specifically subsidized project.[28]

Therefore, in the case of exempted state aid, the GBER does not provide a legal basis for the recovery of SME support or SME supplements in the event of a subsequent loss of SME status.

Something else could only result from the national or regional support programs, in particular if these are the subject of an approval under state aid law of the support program in question.

2.1.2. Distinction between EU state aid law and national law

Against this background, the question arises as to whether national law can be used to recover subsidies. In this respect, national subsidy law, which regulates the subsidy criteria and the procedure in the relationship between the granting authority and the subsidy recipient, must be distinguished from EU state aid law, which as supervisory law concerns the legal relationship between

[28] Fundamental: ECJ, judgment of 17.09.1980 - 730/79 Philip Morris.

the EU Commission and the Member State concerned.[29] Generally speaking, EU state aid law serves to protect the internal market from distortions of competition caused by subsidy measures taken by EU member states. If recovery is not required under EU state aid law, this does not mean that the granting authority is precluded from recovering the subsidy. On the contrary, the granting authority has the right to reclaim the subsidy under national administrative procedural law on the basis of budgetary requirements (cf. Sections 44, 23 Federal Budget Ordinance (BHO)) if the subsidy is not used for the intended purpose.[30] This right to reclaim the subsidy under national administrative procedural law exists independently of EU state aid law. The conditions for recovery under both legal bases must therefore be examined cumulatively, i.e. the substantive legality is checked under the EU state aid and possibly additionally under domestic law. The procedure of seeking reimbursement of illegal state aid is governed by domestic administrative law. Thus, according to Art. 16 of the EU Regulation on State Aid the Commission is entitled to order the Member State concerned to recover the aid (recovery decision).

2.1.3. Assessment including relevant provisions of German administrative law

The question therefore arises as to whether the recovery of the

[29] See Verena Rösner/Jochen Bernhard, in: Eiding/Hofmann-Hoeppel, Administrative Law (Verwaltungsrecht), 2nd edition 2017, § 44 para. 1 et seq.
[30] Nomos-BR/von Lewinski/Burbat BHO/Kai von Lewinski/Daniela Burbat, 1st ed. 2013, BHO § 44 Rn. 18 et seq.

entire subsidy can arise under German administrative law.

Under German administrative law, the legality of the revocation of an administrative act granting a one-time or ongoing monetary payment or divisible payment in kind for the fulfillment of a specific purpose or which is a prerequisite for this purpose (i.e. a subsidy) is governed by Section 49 (3) sentence 1 Administrative Proceedings Act ("APA"/VwVfG) of the respective federal state. According to this, a subsidy **can be** subsequently revoked if

1. "the payment is not used, is not used soon after it is provided, or is no longer used for the purpose specified in the administrative act";

2. if a condition is attached to the administrative act and the beneficiary has not complied with it or has not complied with it within a time limit set for him/her."

2.1.3.1. **Relevant point in time for the existence of SME status**

The granting authority could initially take the position that both the support's main purpose in the form of e.g. energy efficiency and the SME-related purpose can no longer be achieved as a result of the acquisition of the SME by a non-SME. However, it should be considered that the promotion of energy efficiency is not linked to the SME status and is legally separable from the latter due to the respective independent exemption regulations in the GBER (see above) and also in terms of the amount of aid granted. As far as the SME-related support is concerned, from the perspective of European law, the existence of SME status, apart from cases of abuse, basically depends on the point in time of the granting (see

above No. 2.1.1.2.).[31] From the perspective of German administrative law, this analysis is also supported by the fact that a subsidy approval notice is not considered a permanent administrative act.[32] This means that the requirements for legality need only be met at the time of the grant. The classification as a permanent administrative act is based on the respective special law.[33] As described above, the requirements for granting a subsidy only have to be met at the time the subsidy is granted. If we assume in our case that the granting authority nevertheless justifies the revocation of the SME-related subsidy on the grounds that the SME status has ceased to exist, which in the opinion of the authority leads to the subsidy having **to be** reclaimed for reasons of European law, then in our view it must be assumed that the revocation decision of the authority suffers from a discretionary error in the form of a misuse of discretion. A misuse of discretion occurs when the authority assumes incorrect factual circumstances or incorrect legal considerations.[34] In this respect, the authority wrongly assumes that the relevant point in time for the assessment of the SME status is the date of the change of status.

[31] See Töpfer/Butler, ZIP 2003, 1677, 1685; Immenga/Mestmäcker/Nowak, 5th ed. 2016, GBER Art. 17 para. 18-19.

[32] Schoch/Schneider Administrative Court Proceedings Ordinance ("ACPO"/VwGO)/Pietzcker/Marsch, 39th Update July 2020, ACPO/VwGO § 42 para. 1 marginal no. 148.

[33] BeckOK ACPO/VwGO/Decker, 55th ed. 1.10.2020, ACPO/VwGO § 113 para. 21.

[34] Schoch/Schneider ACPO/VwGO/Riese, 39th Update July 2020, ACPO/VwGO § 114 para. 64 et seq.

2.1.3.2. **No cessation of purpose due to project-related funding**

If the authority determines and controls - on the basis of the subsidy recipient's notification obligations on material changes already addressed above - whether the subsidy has been used in accordance with the purpose pursuant to Section 49 (3) sentence 2 no. 1 APA/VwVfG, it must be determined by interpretation whether the subsidized purpose has already been achieved at the time of the change in status. Here, the multi-layered nature of the subsidy purpose in the notice of approval, namely main subsidy in the form of energy efficiency and secondary subsidy in the form of the SME-related subsidy, is considered.

As is so often the case, the individual case must be considered when evaluating a subsidy. What purpose was the subsidy intended to promote? A specific project or a specific company? In view of the fact that Section 49 (3) sentence 1 APA/VwVfG grants the authority discretion, it should be argued to the authority that the purpose of the SME subsidy is to promote a specific project for a specific category of companies. The funded project (e.g. increase in energy efficiency) will continue even after the loss of the SME status. In the absence of conditions agreed in individual cases or underlying the funding, SME funding is not linked to the continuation of the SME status for the entire duration of the program. However, such additional conditions, which require the continued existence of the SME status for the continued entitlement of the funding to remain with the grantee, could result from supplementary regulations of the funding program or the funding guideline under national law. Such a regulation, which promotes the perpetuation of the SME status, would, however, have to be measured against higher-ranking

law. The inevitable interference with the entrepreneurial freedoms of the target company and the acquirer could violate both fundamental rights and European primary law, in particular the freedom of establishment and the free movement of capital.

Irrespective of the above, from the point of view of the grandfathering of the funding commitment, it must be taken into account in each case to what extent (a) funds have already been spent before the loss of the SME status, (b) their use has already been contractually agreed, or (c) the purpose of the project would be jeopardized without the use of the funds that are still missing. In case of doubt, all these circumstances speak in favor of the fact that funding already granted cannot be reclaimed and that the project implementation should not be cancelled for the future either due to the purpose-oriented use of funds (or obligation to use).

2.1.3.3. **Maximum: repayment of the SME surcharge**

If the authority should not follow this argumentation, we recommend arguing that at most the SME supplement may be reclaimed because the general purpose of the subsidy can be pursued regardless of the SME status of the recipient.

2.2. Procedural aspects

In terms of procedural law, the following should be noted: After the administrative procedure has been carried out, an action may be brought before the administrative court in the form of an action for annulment. This is successful if the recovery notice is unlawful

due to a discretionary error on the part of the authority. In this respect, it is important to argue that, under European law, the fulfillment of the SME-related purpose of the subsidy depends on the time at which the subsidy was granted. In such proceedings, the administrative court may refer the matter to the ECJ in the context of a referral procedure on a preliminary question to be assessed under EU law pursuant to Article 267 TFEU.

3. Recovery of a subsidy due to the loss of the SME status in the case of an acquisition of assets (Asset-Deal)

The case constellation described above is to be modified below to the effect that the SME transfers its material assets to a group of companies as part of an asset deal and, as a result, the SME requirements are no longer met even during the implementation phase. In this case, it is easy for the German authority to argue that the SME-related funding purpose can no longer be achieved because the basis for it has been withdrawn as a result of the transfer of the essential assets. In contrast to the share deal, where the subsidy remains with the original subsidy recipient and the subsidized project can therefore be completed, the subsidy recipient in the asset deal is regularly only a shell without any material substrate after the transaction, which means that the SME-related subsidy purpose can no longer be achieved by the recipient, the seller of the assets. In this constellation, it will be difficult to argue that the subsidy recipient can still realize the SME-related purpose of the subsidy, unless the subsidy is transferred to the acquirer by way of an amendment notice (in which case, the argumentation as shown in the case of the share deal above, may

be advanced). For the constellation without a notice of amendment, the question arises as to whether the SME-related subsidy can be reclaimed under EU state aid law or under national administrative law. The subsequent question concerns the possibility of liability of the acquirer with regard to the right to recover the subsidy.

3.1. Law governing recovery in the case of an asset deal

There are no deviations from the argumentation presented above with regard to the share deal, according to which EU state aid law is based on the time at which the subsidies were granted and a subsequent change in status does not require recovery either with regard to the general subsidy (energy efficiency) or with regard to the SME-related subsidy.

The question is whether there is a possibility under national administrative law to reclaim the SME-related funding. A revocation pursuant to Section 49 (3) sentence 1 no. 1 APA/VwVfG due to improper use is possible. In contrast to the share deal, it is not possible in this case to use a project-related argumentation to affirm that the project has been used for the intended purpose, because the project is merely being continued by the purchaser of the assets as a person who is not involved in the original subsidy relationship. However, continuity in the person of the original subsidy recipient would be required.[35] Thus, the SME-related subsidy can be revoked pursuant to Section 49 (3) sentence 1 no. 1 APA/VwVfG. A different assessment would result in the case of an extension of the subsidy

[35] Federal Supreme Administrative Court (BVerwG), judgment of 26.08.1999 - 3 C 17/98, NVwZ-RR 2000, 196, 197 et seq.

to the purchaser by way of an amendment notice (see above).[36]

3.2. Recovery from the acquirer

In its notice on the recovery of unlawful and incompatible state aid (2019/C 247/01), the EU Commission advocated under point 4.3.2.1. an extension of the repayment order to the acquirer in cases of economic continuity. Against this background, the question arises whether these principles in our case constellation mean that such a repayment order can also be issued against the purchaser in application of EU state aid law. However, EU state aid law does not require the recovery of the subsidy from the original recipient (see above). In that case, recovery against the acquirer of the subsidized entrepreneurial activity is even more remote. Consequently, the scope of application of this notice is not opened at all.

However, the possibility of a claim for repayment against the purchaser may still arise under German administrative law from the principles governing legal succession in administrative law. According to these principles, it is recognized that in the case of object-related notices, the rights and obligations arising from the notice may be transferred in the event of legal succession.[37] However, the granting of a subsidy is not such an object-related notice.[38] Therefore, the principle remains that a revocation pursuant to Section 49 (3) sentence 1 APA/VwVfG must be

[36] Töpfer/Butler, ZIP 2003, 1677, 1678.
[37] Stelkens/Bonk/Sachs/Stelkens, 9th ed. 2018, APA/VwVfG § 35 para. 259 et seq.
[38] Federal Supreme Administrative Court, BVerwG, judgment of 26.08.1999 - 3 C 17/98, NVwZ-RR 2000, 196, 197.

addressed to the party to whom the legal relationship to be revoked was established, i.e. to the original addressee of the subsidy notice. [39] An exception to this principle only arises if the original subsidy notice stipulates the inclusion of the third party (here the purchaser) in the subsidy relationship.[40]

4. Consideration of EU funding law in the case of funding from the European Regional Development Fund

If funding is provided from the European Regional Development Fund, EU funding law must be taken into account in addition to EU state aid law[41]. In practice, Art. 71 EU Regulation No. 1303/2013 (ESI Regulation) is relevant in the above-mentioned constellation. According to Art. 71(1) (c) ESI Regulation, the funding contribution shall be repaid if within five years or - if the Member State concerned has made a corresponding reduction to three years after the final payment in the case of SME funding - the case of a significant change in the nature, objectives or implementing provisions of the project that would undermine its original objectives occurs. In order to negate the occurrence of this case due to the acquisition of an SME by a non-SME, it should again be argued on a project-oriented basis that the funded project can still be implemented or completed after the acquisition. Another

[39] Federal Supreme Administrative Court, BVerwG, judgment of 26.08.1999 - 3 C 17/98, NVwZ-RR 2000, 196, 197 et seq.
[40] Federal Supreme Administrative Court, BVerwG, judgment of 26.08.1999 - 3 C 17/98, NVwZ-RR 2000, 196, 198.
[41] Grabitz/Hilf/Nettesheim/von Wallenberg/Schütte, 69th Update February 2020, TFEU Art. 107 para. 128.

argument in favor of this view is that the EU Commission only has the authority to order the recovery of the subsidy under EU state aid law if this subsequent development may be considered. As already explained above (see section 2.1.1.3.), subsequent developments can only be considered as a new circumstance if the consideration of the objective of SME support allows this. This objective does not result from Union law. It can only result from the national or regional funding regulations. However, it must be taken into account that these subsidy provisions must themselves be in conformity with Union law or must be interpreted accordingly. Since the acquisition of an SME is fundamentally protected by the freedom of establishment and the free movement of capital, it is doubtful whether the preservation of SME status, which tends to stand in the way of an acquisition, can constitute a permissible subsidy objective. Thus, a recovery cannot regularly be based on Art. 71 (1) c) EU Regulation No. 1303/2013.

5. Practical recommendations in the context of a business acquisition – Provisions regarding State Aid in the Acquisition Agreement

Pursuant to Section 49 (3) sentence 2 in conjunction with Section 48 (4) APA/VwVfG, a subsidy decision in our constellation can only be revoked within one year of the date on which the authority becomes aware of facts justifying the revocation. Against this background, we recommend as a first step as a purchaser to pay particular attention in the due diligence process when acquiring an SME to whether the target company has received SME-related subsidies. These measures include, in particular, requesting the

subsidy notices and the related documentation (application, notice of grant, any general ancillary provisions, proof of use) from the target company and checking them.

Particular caution is required in the case of so-called preliminary subsidy notices, i.e. subsidy notices that are issued subject to the final decision in the final notice.[42] In these cases, the authority is not bound in its final decision by Sections 48, 49 APA/VwVfG and the one-year period mentioned above or other limitation periods.[43] Should it become apparent during the review of the subsidy notices that an SME-related subsidy was in fact granted, a proactive approach should be taken vis-à-vis the subsidy authority and the planned corporate acquisition should be presented. This will ensure that the one-year period for revocation begins to run. It also provides clarity about the authority's planned course of action. The parties to the company purchase agreement should not speculate that the authority will allow this deadline to pass idly.

5.1. Guarantee and indemnity

We recommend that the purchaser require the seller to provide at least a guarantee or indemnity against risks relating to the fact that the subsidy has been lawfully granted and that there are no grounds for reclaiming it. It is in the interest of the purchaser to extend this guarantee specifically to the fact that the implementation of the corporate acquisition does not constitute a

[42] Teuber, NVwZ 2017, 1814, 1818.
[43] Federal Supreme Administrative Court, BVerwG, judgment of 15.03.2017 - 10 C 1/16, NVwZ 2017, 1893.

reason for recovery. The seller will object that this legal question can be examined by the purchaser himself. This is only partially true because the legal assessment may depend on facts which are not known to the purchaser. One can then limit the guarantee in the negotiations to the fact that the seller has informed the purchaser of all facts which are relevant for the assessment of the initial or subsequent illegality of the subsidies granted to the target company. In this respect, reference can be made to the contents of the due diligence report and other documents (e.g. minutes of management interviews), which are often annexed to the corporate acquisition agreement for evidentiary purposes anyway.

Such guarantees can also be included in the scope of warranty insurance.[44] However, in order to include the subsidy guarantee in the warranty insurance, it must not be structured as a forward-looking statement. These are generally not insurable.[45] From the purchaser's point of view, however, such a design of the subsidy warranty is not even necessary. What matters to the purchaser is that the subsidy is lawful at the time the company is acquired, that the funds have been used for the intended purpose and that the acquisition does not give rise to any claims for repayment. The latter aspect is difficult to concede from the seller's perspective and should therefore be coordinated with the funding authorities in advance as far as possible.

Accordingly, the acquirer should demand from the seller, beyond a contractual guarantee, an indemnity of the target company (or, if applicable, also of the acquirer) against a future recovery of the

44 Deubert/Lewe, BB 2020, 235.
[45] Hoger/Baumann, NZG 2017, 811, 812.

SME-related subsidy, to the extent that the recovery is based on actions up to (and including) the closing of the acquisition. All actions of the target company thereafter can, after all, be controlled by the acquirer.

5.2. Statute of limitations; ten-year period for recovery under EU state aid law

With regard to the duration of this indemnity, the following should also be taken into account: According to Art. 17 of the State Aid Procedure Regulation, the Commission may recover state aid within a period of ten years. According to the case law of the ECJ, this provision is applicable even if the limitation period under national law has already expired[46]. Admittedly, this provision does not apply according to the view expressed here, according to which the state aid does not subsequently become unlawful as a result of the acquisition of the company. The provision presupposes that the EU Commission has the power to recover[47] the subsidy, which is not the case according to the view expressed here.[48] It is true that the recovery of a subsidy in our constellation takes place in two stages within much shorter limitation periods under German administrative law: At the first stage, the subsidy decision must be revoked pursuant to Section 49 (3) sentence 1 of the APA (VwVfG) within one year of the date on which the authority becomes aware of facts justifying the revocation. At the second stage, the subsidy is

[46] ECJ, judgment of 30.4.2020, - C 627/18 (*Antunes da Cunha Lda.*)
[47] See Groeben, von der/Schwarze/Wolfgang Mederer, 7th ed. 2015, TFEU Art. 108 para. 63.
[48] See above 2.1.1.3.

then reclaimed in accordance with Section 49a (1) APA/VwVfG. This claim for recovery is subject to the three-year general statute of limitations (year-end statute of limitations) in accordance with sections 195, 199 (1) of the German Civil Code.[49] However, according to the aforementioned ECJ decision, this does not preclude the implementation of a recovery decision by the Commission within the ten-year period of Art. 17 EU State Aid Procedure Regulation.

Admittedly, this rule could only be applied if the Commission were to reject the view taken here and consider itself entitled to recovery. In that case, however, the principles of the protection of legitimate expectations would have to be taken into account. The ECJ rejected the application of these principles in the *Antunes da Cunha*[50] decision because the state aid was illegal from the outset due to the lack of notification to the Commission required in the case in question (Art. 2 EU State Aid Procedure Regulation). This is precisely not the case in the context of possible subsequent unlawfulness of the state aid discussed here.

The application of the provision cannot be ruled out with absolute certainty also in the constellation relevant here, especially if the authority granting the subsidies was not approached in connection with the acquisition of the company. After all, the publication of this article at the latest means that the problem and the resulting legal uncertainty can be assumed to be known. An application of Art. 17 EU State Aid Procedure Regulation can be

[49] Federal Supreme Administrative Court, BVerwG, judgment of 15.03.2017 - 10 C 3/16, NVwZ 2017, 969.
50 See above footnote 46.

considered at any rate if the national or regional subsidy program (approved by the Commission under state aid law) on which the granting of subsidies in the specific case is based contains a provision explicitly deviating from the view represented here on the subsequent recovery of subsidies after the loss of SME status. From the buyer's point of view, the long limitation period would then also have to be taken into account in the corporate acquisition agreement. Such a requirement naturally makes negotiations considerably more difficult. In this respect, too, it is useful to coordinate the risk with the responsible authority. How the D&O insurers will react to this legal situation can also be expected with excitement. In all probability, however, the long statute of limitations will not apply in the context discussed here.

Under German Administrative law, there is discussion as to the point in time at which the claim for recovery arises. The claim for recovery must arise before the three-year limitation period pursuant to Sections 195 and 199 (1) of the German Civil Code can commence. In the case of revocations for the past, it is sometimes argued that the claim for repayment arises retroactively from the time the subsidy notice was issued. It is argued in this respect that a revocation with effect for the past results in the subsidy notice ceasing to apply retroactively, which means that the legal basis for the payments ceases to apply. Against this background, the granting authority would be entitled to demand repayment as soon as the revoked subsidy notice is issued.[51] However, this must be countered by the fact that a claim has only arisen within the meaning of

[51] Scherer-Leyendecker/Laboranowitsch, NVwZ 2017, 1837, 1840; Folnovic/Hellriegel, NVwZ 2016, 638, 641.

Section 199 (1) of the German Civil Code (Bürgerliches Gesetzbuch - BGB) when it can be asserted by way of an action.[52] In the case of a claim for repayment under Section 49a APA/VwVfG, this is the point in time when the revocation notice is issued.[53] At this point in time, the authority will regularly be aware of the circumstances giving rise to the claim.[54] Thus, from the acquirer's point of view, the exemption should be demanded for a period of three years from the end of the year in which the revocation notice was issued.

5.3. Seller's duty to inform, participation of the seller in the proceedings concerning a possible recovery

From the acquirer's point of view, it is important to have all the information concerning the granting and use of the subsidy. This also helps the seller, because he can then claim that all the necessary information was available to the acquirer. If, after the takeover of the company, proceedings arise, for example concerning the reclaiming of subsidies, the purchaser, as the new owner of the company, should be responsible for these proceedings, similar to a tax clause in a corporate acquisition agreement. In addition, the cooperation of the seller must be provided for - also parallel to the tax clause. This relates to the purchaser's duty to provide information and, where applicable, the seller's requirement for consent, for example to a settlement or to

[52] Teuber, NVwZ 2017, 1814, 1815; BeckOGK/Piekenbrock, 1.11.2020, German Civil Code (BGB) § 199 para. 16; Jauernig/Mansel, 18th ed. 2021, German Civil Code (BGB) § 199 para. 2.
[53] Teuber, NVwZ 2017, 1814, 1816.
[54] Teuber, NVwZ 2017, 1814, 1817.

the withdrawal of a claim. The seller also usually has a considerable interest in the successful outcome of these proceedings. The seller may also have a right of instruction vis-à-vis the purchaser and the target company with regard to the conduct of the proceedings. If the buyer does not involve the seller in the conduct of the proceedings regarding the recovery of the subsidy, a provision should be made according to which the buyer's claim against the seller arising from the indemnity will be adjusted accordingly. However, the resulting damage is difficult to prove. Finally, the question of whether and to what extent the seller is to contribute to the costs of conducting the proceedings should also be provided for.

6. Evaluation and outlook

The existing legal uncertainty regarding the potential subsequent illegality of state aid as a result of the loss of the SME status in the wake of an acquisition can be attributed to a considerable extent to EU law. This current status is quite unsatisfactory. Start-ups are hampered in their development if the legal consequences of an acquisition or majority stake are unclear. It also appears to be an undesirable consequence that it is more difficult for subsidized SMEs that have run into difficulties as a result of the pandemic to seek affiliation with a larger, financially strong company or group of companies. The European Commission would be well advised to make it clear to the member states that the goal of SME support cannot be the perpetuation of the SME status.

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