Georg Brüggen/Anke Geppert[1]

Recovery of State aids, transfer of undertakings and how the bankruptcy administrator can protect the buyer against recovery claims

This article deals with the legal problems raised by the recovery of unlawful State aids in the scope of bankruptcy. Special legal problems occur when the insolvent undertaking is sold. In theses cases the question is if the buyer can be asked to repay the aid. The article indicates what the bankruptcy administrator can do in order to protect the buyer against recovery claims. In this way, he may find buyers that wouldn't buy the insolvent undertaking otherwise. The focus is put on a special tendering procedure and/or a due diligence expertise. In fact, all problems discussed can occur in case of liquidation (Regelinsolvenzverfahren), when the undertaking is transferred for restructuring (übertragende Sanierung) and when the undertaking is restructured according to a bankruptcy plan (Insolvenzplanverfahren).

1. Recovery of State aids in accordance with the national law

According to article 14 paragraphe 1 of the Regulation 659/1999[2] where negative decisions are taken in cases of unlawful aid, the Commission shall decide that the Member State concerned shall take all necessary measures to recover the aid from the beneficiary ("recovery decision"). More precisely, the Commission requires the Member State to recover the aid from the recipent[3]. Removing unlawful aid by means of recovery is the logical consequence of a finding that it is unlawful and seeks to re-establish the previous situation[4]. The main purpose of the repayment of an unlawfully paid State aid is to eliminate the distortion of competition caused by the competitive advantage afforded by the unlawful aid[5]. That purpose is achieved once the aid in question, together where appropriate with default interest, has been repaid by the recipient or by the undertakings which actually benefited from it. By repaying the aid, the recipient forfeits the advantage which it had enjoyed over its competitors on the market, and the situation prior to payment of the aid is restored[6].

---

[1] Georg Brüggen, lawyer, former Minister of State, Saxony, head of Brüggen-Rechtsanwälte (Dresden) a law firm specialised in public law. He is lecturer at the University. You can contact him by e-mail to info@brueggen-ra.de, www.brueggen-ra.de;
Anke Geppert is associate of Brüggen Rechtsanwälte.

[2] Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 83, 27 March 1999

[3] Judgement of the Court of 12 July 1973, Commission/Germany, case 70/72, EC reports 1973, page 813;

[4] Judgement of the Court of 13 June 2002, Netherlands/Commission, case 382/99, EC reports 2002, page 5163;

[5] Judgement of the Court of 29 April 2004, Germany/Commission, "SMI", case 277/00, EC reports 2004, page 3925;

[6] Judgement of the Court of 21 March 199, Italy/Commission, case 303/88, EC reports 1991, page I - 1433; Judgement of the Court of 4 April 1995, Commission/Italy, case 350/93, EC reports 1995, page I - 699

.../2

The European Law does not contain any procedural rules to recover State aids. According to Article 14 paragraphe 3 of the Regulation 659/1999, the recovery shall be effected without delay and in accordance with the procedures under the national law of the member state concerned, provided that they allow the immediate and effective execution of the Commission's decision. In any case, the application of national law must not affect the scope and effectiveness of community law. In Germany, Article 48 of the Verwaltungsverfahrensgesetz (Law on administrative procedure) applies to the withdrawal of administrative decisions. According to this article, administrative decisions granting a pecuniary advantage may not be revoked in so far as the beneficiary has relied upon the decision and his expectation, weighed against the public interest in revoking the decision, merits protection.

2. Recovery decisions against bankrupt undertakings

Recovery decisions must also be carried out against bankrupt undertakings or undertakings that risk to bankrupt. Actually, the elimination of the distortion of competition resulting from the unlawfully paid aid may be achieved by the undertaking's liquidation. In the SMI case, the European Court pointed out that the re-establishment of the previous situation and the elimination of the distortion of competition resulting from the unlawfully paid aid may, in principle, be achieved by registration of the liability relating to the repayment of the aid in question in the schedule of liabilities[7]. By decision of 15 December 2005, the Bundesgerichtshof (Federal Court of Justice) decided that a claim to recover unlawfully paid aid must be registered in the schedule of liabilities even after the registration deadline[8]. Actually, the "effet utile" of the Community law is stronger than the national bankruptcy law. However, it is not imposed by the Community law's "effet utile" to give priority to recovery claims.

3. Transfer of undertakings and recovery decisions

3.1. Outline of legal problems
Special legal problems come up when the undertaking in question is sold by share or asset deal before or during the bankruptcy. The purchaser may buy shares or assets burdened with a recovery claim and the question is if he can be asked to repay the aid.

To cope with this question, it is very important to distinguish between share deal and asset deal, in particular the bundled asset deal. Furthermore, it must be pointed out that according to the Commission's definition an undertaking is made out of assets, capital assets, debts and committments, capital resources. In consequence of this economic approach the undertaking in the sense of State Aid law may be different from the legal entity.

The Commission's view and the European Court's decisions

[7] Judgement of the Court of 29 April 2004, Germany/Commission, "SMI", case 277/00, EC reports 2004, page 3925;
[8] Decision of the Bundesgerichtshof (German Federal Court) of 15 December 2005, IX ZB 135/03;

.../3

Brüggen Rechtsanwälte
Passage Königstraße/Rähnitzgasse 23
01097 Dresden
Tel: 0351 . 56 33 00 Fax: 0351 . 56 33 015
info@brueggen-ra.de www.brueggen-ra.de

3. 2. 1. Share deal

In the case of a share deal the undertaking retains its legal personality, but there is a transfer through a sale of shares. Therefore, it is normally this undertaking that retains the competitive advantage connected with that aid and it is therefore this undertaking that must be required to repay an amount equal to that aid. The buyer cannot be asked to repay such aid[9]. However, in some decisions, the Commission extended the recovery decision on the buyer of the shares[10]. All these decisions were annulled by the European Court. In its SMI judgement the European Court pointed out: *The Court has consistently held that where an undertaking that has benefited from unlawful State aid is bought at the market price, that is to say at the highest price which a private investor acting under normal competitive conditions was ready to pay for that company in the situation it was in, in particular after having enjoyed State aid, the aid element was assessed at the market price and included in the purchase price. In such circumstances, the buyer cannot be regarded as having benefited from an advantage in relation to other market operators.*[11] Nevertheless, European Court's judgements are not always that clear and may be misunderstood. In the "Banks" case the European Court did not deal with the question if the sold undertaking shall repay the aid, but it verified if the recovery decision could be extended on the buyer. Finally the Court hold that the companies which succeeded British Coal were acquired subsequently in the context of an open and competitive tendering procedure under market conditions, so in this case the buyer did not have to repay the aid: *Where a company which has benefited from aid has been sold at the market price, the purchase price reflects the consequences of the previous aid, and it is the seller of that company that keeps the benefit of the aid. In that case, the previous situation is to be restored primarily through repayment of the aid by the seller*[12]. However, the Banks-judgement has been considered as a turning away from the SMI judgement, but in fact it was not confirmed by later decisions[13]. In every case, the Banks-judgement must be considered as an atypical, particular case. In principle, the buyer of shares cannot be asked to repay the disputed aid. But since the undertaking must repay the aid, the buyer is also concerned: he does loose his money up to the purchase price. However, it is very important that the shares are acquired at the market price. Otherwise the buyer risks to loose more than the purchase price, because he could be asked to repay the aid. That can be more than the purchase price.

Asset deal

---

[9] Judgement of the Court of 29 April 2004, Germany/Commission, "SMI", case 277/00, EC reports 2004, page I 3925;

[10] for example: Commission Decision 2000/536/EC of 2 June 1999, Seleco, OJ 2000 L 227; Commission Decision 2000/567/EC of 11 April 2000, SMI, OJ 2000 L 238, page 50;

[11] Judgement of the Court of 29 April 2004, Germany/Commission, "SMI", case 277/00, EC reports 2004, page I 3925;

[12] Judgement of the Court of 20 September 2001, Banks, case 390/98, EC reports 2001, page I – 6117;

[13] Judgement of the Court of 8 May 2003, "Seleco", joined cases 328/99 and 399/00, EC reports 2003, page I-04035

.../4

A distinction must be drawn between the separate transfer of assets and the transfer of bundled assets ongoing concern. In cases where assets have been sold separately, at the market price, the buyers are not required to repay the aid, because the subsidised activity disappears, which leaves scope for the beneficiary company's competitors. In this way, the recovery of aid from the seller, whether it be from the beneficiary company itself or from the assets of the bankrupt or liquidated company, makes it possible to eliminate the distortion of competition[14].

In case of a bundled asset deal the Commission required the buyer to repay the aid in question if it was established that they actually continued the undertaking's activities (asset deal ongoing concern). According to the Commission, the recovery decision must not be restricted to the original firm but must be extended to the firm which continues the activity of the original firm, using the transferred means of production in order to prevent the effectiveness of the decision to recover the aid from being frustrated and the market from continuing to be distorted. The Commission based its assessment on the existence of an intention to evade the consequences of the recovery decision, since the purpose of such a transaction could be to place the assets out of reach of the Commission decision and to continue the economic activity in question indefinitely[15]. The elements examined by the Commission include the purpose of the transfer (assets and liabilities, continuity of the workforce, bundled assets, etc.), the transfer price, the identity of the shareholders or owners of the acquiring firm and of the original firm, the moment at which the transfer was carried out (after the start of the investigation, the initiation of the procedure or the final decision) and, lastly, the economic logic of the transaction[16].

As far as the extension of the recovery decision on the buyer was concerned, the European Court annulled the Commission's decisions. Nevertheless, it must be pointed out, that as a matter of principle, the European Court has not disapproved the Commission's view.

In its SMI judgement, with regard to hive off companies, the European Court hold that there is no intention to evade the recovery decision provided that the claims in respect of recovery of the disputed aid were properly listed among the liabilities of the liquidation if,

- firstly, the sale of assets were made at the market price,
- secondly, the transactions were performed on the initiative of the bankruptcy administrator who, acting under judicial supervision, was responsible for working to satisfy creditors as far as possible,
- thirdly, the procedure followed was sufficiently open and transparent. If the sale in question was supervised by a court and did not take place immediately, but was pre-

[14] Judgement of the Court of 29 April 2004, Germany/Commission, "SMI", case 277/00, EC reports 2004, page I 3925;
[15] Decision of the Commission of 2 June 1999, Seleco, OJ 2000, L 227;
[16] Decision of the Commission of 2 June 1999, Seleco, OJ 2000, L 227;

.../5

ceded by unsuccessful attempts with other companies, it can be suggested that the procedure was sufficiently open and transparent.

Recently, the Court of First Instance annulled the Commission's decision in the CDA case[17], because the Commission had failed to apply correctly its criteria mentionned above. According to the Court, the parties did not have an intention to evade the recovery decision. Furthermore, referring to the SMI-judgement, the Court hold that the procedure followed was open and transparent, because the sale was preceded by unsuccessful attempts to sale to third parties.

However, taking in account the CDA judgement, it is not clear if the Court considers an expertise on the current market value sufficient for the sale or if – as the Commission demands - a special tendering procedure is necessary.

4. What to do to protect the buyer against a recovery claim

In the light of the foregoing it is apparent that the Court of First and Instance and the European Court have not excluded, in principle, neither for share deals nor for asset deals, that the recovery decision may be extended to the buyer. Consequently, bankruptcy administrators should always take in consideration the worst case as long as not all legal problems are resolved. One way to solve the problem is a State aid related expertise combined with a special assurance. If the problem can not be solved in this way, a special tendering procedure is necessary. With regard to bundled asset deals ongoing concern, an open and transparent procedure should be employed, that can be based on the European legislation on tendering procedures. Certainly, M&A experts may not like this procedure, it is however the only "chinese wall" to protect the buyer if it is combined with a special assurance. At the same time, it protects the potentiel buyer that knows the risk of recovery decisions.

[17] Judgement of the Court of First Instance of 19 October 2005, CDA/Commission, case 324/00;

/