

Liability issues relating to the accounting of the JEREMIE initiative

The local venture capital market has undergone significant developments due to the JEREMIE initiative launched in 2009 because 28 managing authorities participating in the initiative received mandate to pay out subsidy of HUF 131, 5 billion in order to boost the Hungarian SMEs sector. The allocation period just ended on 31 May 2016 but numerous irregularities have been already revealed. The expert of KRS Attorneys-at-Law, Dr. Attila Pintér was questioned about the liability of the managing authorities participating in the initiative and about repayment obligations.

The Ministry for National Economy regularly audited and shall regularly audit all funds and fund Managing Authorities participating in the JEREMIE initiative, which identified many faults in venture capital investment and unauthorised use of resources. Among the most common irregularities: is

- The use of resource in the eligible region, on the basis of which, indeed, the amount of subsidy was used in a region that was not specified in the subsidy contract. The extreme case is when the subsidy is used by an undertaking outside Hungary.
- The subsidy was used for illicit purpose, for example purchase of interest, or
- The beneficiary could not have been subsidized due to its activity. An extreme example of this can be agricultural production or subsidy expressly intended for export.

The establishment of irregularities may ultimately result in repayment obligation. The repayment obligation – on the basis of the contract practice of the JEREMIE initiative - may always be based on two contracts: either on which was concluded by the managing authority with the investor in order to obtain the subsidy or on which was concluded by the managing authority with the final beneficiary. The chain of contract is always linear, namely, the investor may enforce a claim against the managing authority (fund) in case of irregular use whereas the managing authority may enforce his own claim against the final beneficiary but only in the case when the contract concluded with the final beneficiary provides for such an opportunity.



Namely, the Managing Authorities acted legally in the allocation if they laid down the same rules in their contract concluded with the final beneficiary that they must also comply with under the contract concluded with the investor.

It follows from the above that if the managing authority does not “delegate further” any liabilities to the final beneficiary in the contract concluded with the final beneficiary, the latter has acted according to contract even if he made a legal statement which is contrary to the contract between the investor and the Managing Authority. In this case, the Managing Authority is subject to repayment obligation, which he can not pass on the final beneficiary; therefore a special situation arises that due to the contract concluded inaccurately between the Managing Authority and the beneficiary, the Managing Authority will be finally held liable due to the legal statement of the beneficiary.

Of course, if the contract between the Managing Authority and final beneficiary accurately includes all liabilities under the contract between the investor and managing authority, the Managing Authority will be able to pass the liability for the breach of the contract on the final beneficiary due to the breach of the latter contract.

It could rise to misunderstanding in many cases that funds from asset of the beneficiary, from resources outside the JEREMIE subsidy were also used, or the beneficiaries performed operations which were qualified as illicit operation from the perspective of the managing authorities participating in the JEREMIE initiative. Such example includes the establishment of a subsidy abroad, or when the final beneficiary itself acquired a subsidiary undertaking. However, the contract between the investor and the Managing Authority may not be automatically applied to the final beneficiary thus, for example, the former operations are prohibited for the managing authorities (funds) operating in the JEREMIE initiative but they are not prohibited from the perspective of the final beneficiaries (unless the contract between the managing authority and the final beneficiary provides otherwise).

The expert of KRS Attorneys-at-Law also notes that since it were the funds who received the subsidiary and the managing authorities contracted with the investor on behalf of the funds, therefore it is also the fund who will be subjected to repayment obligation resulting from an irregularity procedure, which inevitably requires for the clarification of liabilities between the fund and the managing authority; namely to which extent was it attributable to the managing authority that the two contracts were not synchronized.



The irregularity procedures are always complex legal procedures. The accurate determination of certain obligations is always a task of legal experts; therefore it is recommended that a legal expert with proper experience be involved in such procedures as from the start of the procedures.