

State aid in the UK post-Brexit - a familiar regime or a step into the unknown?

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Introduction

The prohibition on State aid (that is, broadly, financial or other assistance provided by public authorities to domestic industries or businesses) is a core feature of the EU's internal market. It is intended to prevent Member States from distorting competition within the internal market by favouring domestic enterprises, and responsibility for enforcing the EU's State aid rules rests primarily with the European Commission.

The EU has strongly suggested that any post-Brexit trade agreement with the UK must provide for some degree of continuing control over State aid on both sides. Following intense speculation since the June 2016 referendum on what, if any, post-Brexit subsidy controls the UK would be willing to agree, the UK Government recently announced that, in anticipation of such a trade deal, it is preparing to introduce a self-standing State aid regime in the UK. The UK Government has also noted more generally the benefits of State aid rules as a mechanism to protect the UK's internal market.

Little is known, however, of precisely what the UK State aid regime will look like. Certain concepts of EU State aid law would not readily fit in a domestic regime and there are broader questions as to how a domestic regulator would 'police' UK Government policy.

"The Government's view therefore is that the UK should be prepared to establish a full, UK-wide subsidy control framework, with a single UK body for enforcement and supervision, at the point this is required [...] the Competition and Markets Authority (CMA) would be best placed to take on the role of State aid regulator." (Letter to House of Lords' EU Internal Market Sub-Committee from Andrew Griffiths MP (BEIS), 28 March 2018)

In this briefing, we consider amongst other things what the UK State aid test could look like, the political issues and challenges that seem likely to arise in the course of creating a UK regime, and the potential future interrelation with the EU State aid regime.

A UK State aid test - what will it look like?

In its letter to the House of Lords' EU Internal Market Sub-Committee, the Department for Business, Energy and Industrial Strategy (BEIS) explained that:

"[T]he EU State aid rules will be transposed under the European Union (Withdrawal) Bill - as is the case for EU rules more broadly under this Bill. The transposition of the existing rules will apply to all sectors, including agriculture, fisheries and transport and will replicate any existing exemptions from State aid rules."

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At first glance, one might think the UK State aid rules would therefore be identical to the EU's. However, the European Union (Withdrawal) Bill (EUWB) will, *prima facie*, only incorporate into the UK statute book the following elements of the EU State aid 'acquis':

- **The Treaty provisions** which establish the prohibition on State aid, and that any such aid cannot be implemented prior to European Commission approval.
- **Regulations** such as the De Minimis Aid Exemption Regulation, the Procedural Regulation, and the General Block Exemption Regulation (pursuant to which 97% of State aid in the EU in 2016 was exempted).¹
- **Commission decisions**, including those that clarify the application of State aid rules to SGEIs.²
- **Pre-Brexit CJEU case law** will also be given the status of judgments of the UK Supreme Court. Therefore, the UK State aid regime will begin with a body of EU State aid case law and principles.

This, however, leaves a number of gaps that would need to be addressed to enable the regime to operate effectively in a domestic context:

- The Treaty articles which grant the Commission the power to approve aid as

compatible with the internal market, and to abolish or alter unlawful aid, are currently missing. It seems likely that the UK Government would seek to address these omissions to ensure the UK authorities have similar powers.

- If retained, the concept of "common interest" may need clarification as it is defined by reference to EU values and principles.
- The Treaty provisions which are incorporated require the putative aid to "affect trade between Member States". This would presumably need to be amended in line with the future relationship between the UK and the EU (e.g. an effect on trade between the UK and the EU).³
- Most importantly, without importing the Commission's State aid guidelines, which establish how the Commission conducts its compatibility assessments, there will be significant uncertainty as to how State aid would be assessed.

The new UK regime could also seek to address criticisms of the EU regime on which it is likely to be modelled. For example, there have been calls to improve the procedural rights of beneficiaries,⁴ and for streamlining and accelerating the approval of small-scale, non-

¹ European Commission, State Aid Scoreboard 2017, page 14.

² Commission decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (OJ 2011 L7/3, 11.01.2012).

³ For example, the EEA Agreement refers to an effect on trade "between Contracting Parties" (Article 61(1), EEA Agreement) i.e. between the EU and the EEA.

⁴ UK State Aid Law Association written submission to the House of Lords' EU Internal Market Sub-Committee on Brexit and Competition and State aid (18 September 2017).

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complex forms of aid, in particular provided by local government.⁵ There may, however, be limits on the extent to which Government is able to make substantive changes as the powers set out in the EUWB limit the ability of Government to make policy changes, and there may not be sufficient time in the Parliamentary timetable to otherwise introduce changes through primary legislation in advance of Brexit.

Political context

State aid has rarely figured prominently in UK domestic political debate, but that may change when the UK has a domestic State aid regime given how closely State aid relates to the allocation of public resources.

State aid granted through primary legislation

It is unclear whether the UK Competition and Markets Authority (CMA)⁶ would, like the Commission, have the power to ‘block’ primary legislation which purports to grant State aid.

This would be a particularly controversial power in light of the desire following Brexit to restore parliamentary sovereignty.

It may be, alternatively, that the regime reflects the operation of the Human Rights Act 1998, which allows the UK’s higher courts to issue a declaration of incompatibility where a legislative

measure is found to be incompatible, leaving the burden of changing the law with Parliament.

The role of the Devolved Administrations

The Devolved Administrations may consider the ability to determine their own State aid policies to be a natural complement to their existing powers in relation to economic development and local government, and reject the notion that it is a ‘reserved matter’ for the Westminster government.⁷

BEIS has stated that it is already “engaging” with the Devolved Administrations in relation to a prospective UK-wide State aid regime and has noted in this context that “[f]ailing to implement a UK-wide regime of state aid control when the UK leaves the EU would mean there would be no legal framework to prevent subsidies that distort trade within the UK”.⁸

Further political pressure may arise in the context of considering the post-Brexit approach to regional aid across the Devolved Nations.

Industrial policy

Labour has raised concerns that adopting State aid controls would remove one of the key benefits of Brexit as State aid rules would prevent or restrict a future Government from nationalising industries (as Labour’s 2017 manifesto proposes

⁵ The complexity of the State aid rules, and delays in the Commission’s approving even the most straightforward forms of aid, were prominent findings in the House of Lords’ report, *Brexit: competition and State aid* (2 February 2018) (see, in particular, paragraphs 37-42).

⁶ The CMA has been selected by the Government to become the UK’s State aid authority.

⁷ For example, the Scottish Brexit Minister has said that “we do not agree, for example, that all of State aid is a reserved matter”:
http://thenational.scot/news/16077871.Tory_ministers_tell_Scotland_what_powers_they_want_to_grab/

⁸ BEIS response to the House of Lords’ EU Internal Market Sub-Committee report into the impact of Brexit and competition, response to Recommendation 19.

as regards the energy, water, rail and postal sectors).⁹

However, State aid rules do not prohibit State ownership (indeed, several EU Member States have nationalised industries) and, more generally, the Treaty provides that EU law does not prejudice State ownership.

As the UK Government recently noted, “*EU State aid rules have been flexible enough to provide support for major projects [...] [including] approval for the restructuring of banks during the financial crisis within short time-frames*”.¹⁰

What is the likely influence of the EU State Aid regime?

“The main challenges of a future agreement between the EU and UK in this area will probably be in ensuring, on the one hand, parallelism and alignment of the decision, and, on the other hand, effective supervision by each party of the other party’s observance of the rules. Still, solutions to this effect are workable.” (Luis Romero Requena, Head of Commission Legal Services, 22 May 2018)

The World Trade Organisation rules in respect of subsidies are narrow in scope and provide limited

⁹ Speech by Jeremy Corbyn MP, 26 February 2018: “So we would also seek to negotiate protections, clarifications or exemptions where necessary in relation to privatisation and public service competition directives state aid and procurement rules and the posted workers directive. We cannot be held back inside or outside the EU from taking the steps we need to support cutting edge industries and local business, stop the tide of privatisation and

protections (for example, the rules only apply to goods, not services). In light of this, the EU typically seeks to include State subsidy protections building on the WTO rules in its free trade agreements - for example, the proposed agreement with Japan also includes State subsidy controls in respect of services.

The EU State aid rules, however, provide the strongest protections and therefore agreements incorporating EU State aid rules are much less common; of the over 30 trade agreements the EU has agreed (or is in the process of negotiating), only two agreements - the EEA Agreement and the Swiss Agreement on Air Transport - incorporate the EU State aid rules.

The nature of the post-Brexit relationship between the EU and the UK is likely to guide the scope of the State aid regime in the UK. In turn, the extent to which the UK regime is formally tied to the EU regime will determine how the UK regime is likely to develop over time.

Alignment of substantive State aid law?

There are at least two potential models for the relationship with EU State aid law:

- **Agreement to substantive alignment with EU State aid law.** This could be set out in the trade agreement with the EU, or be

outsourcing or from preventing employers being able to import cheap agency labour to undercut existing pay and conditions.”

¹⁰ BEIS response to the House of Lords’ EU Internal Market Sub-Committee report into the impact of Brexit and competition, response to Recommendation 14.

implemented through domestic legislation.¹¹ The Prime Minister has suggested this could be agreed in return for market access but the precise scope of this substantive alignment is unclear at this stage. The EU has also suggested that alignment of EU State aid rules will be an important part of the post-Brexit relationship between the EU and the UK in ensuring a “level playing field”.¹² At its strongest, this may take the form of a mutual commitment to uniformity in State aid enforcement, similar to that in the EEA Agreement.¹³

- **Independent (but likely parallel) development of UK State aid law.** In the absence of a trade agreement, UK State aid law may nevertheless have a close relationship with EU State aid law. The EUWB imports pre-Brexit State aid case law and affords it Supreme Court status, which in practice means it would bind UK courts and the CMA to a significant extent as challenges to the Supreme Court are rare and take time to arise. The EUWB as currently drafted specifically enables UK courts to have regard to post-Brexit EU case law if it is relevant to the interpretation of EU provisions that have been imported.¹⁴ In practice, as the UK has no history or experience of State aid law, and no

“[T]he UK has much to gain from maintaining proper disciplines on the use of subsidies and anti-competitive practices. As with any trade agreement, we must accept the need for binding commitments - for example, we may choose to commit some areas of our regulations like state aid and competition to remaining in step with the EU’s.” (Prime Minister, Mansion House speech, 2 March 2018)

other jurisdiction has a developed body of case law on State aid, it seems likely that UK courts would seek guidance from the EU jurisprudence.

Supervision and cooperation in enforcement?

Depending on the nature of the UK’s future relationship with the EU, there may need to be mechanisms for supervision and cooperation between the UK and the EU in relation to State aid. Assuming the UK and the EU remain economically close, neither party is likely to be comfortable without meaningful rights to supervise and influence the application of each other’s regimes.

As explained above, the substantive test for the assessment of State aid post-Brexit is likely to involve an assessment of the potential for distortion of competition between the UK and the

¹¹ For example, the equivalent of section 60 of the Competition Act 1998 as regards the antitrust prohibitions of EU competition law.

¹² Notably, Paragraph 12 of the European Council’s Article 50 Guidelines (23 March 2018) states: “[T]he future relationship will only deliver in a mutually satisfactory way if it includes robust guarantees which ensure a level playing field. The aim should be to prevent unfair competitive

advantage that the UK could enjoy through undercutting of levels of protection with respect to, inter alia, competition and state aid”.

¹³ Article 62(2), and Protocol 27, EEA Agreement.

¹⁴ Section 7(2) of the EUWB (draft dated 8 May 2018).

EU. Both sides are likely to want mechanisms in place to ensure an adequate and objective assessment is undertaken.

These may take the form, in a trade agreement, of:

- Consultation and information exchange provisions similar to those in the EEA Agreement regarding State aid cases, which include requirements for each surveillance authority to inform the other of its decisions;¹⁵ and/or
- Provisions allowing the UK's CMA and the European Commission to submit *ex ante* observations on each other's decisions relating to State aid (similar provisions were included in the Swiss Agreement on Air Transport).¹⁶

There may also need to be escalation provisions to deal with instances where either authority takes issue with the other's decisions. The EEA Agreement, for example, provides for a two-week consultation period in such circumstances, and escalation to an adjudicative body (the EEA Joint Committee) in case of continuing disagreement.¹⁷

Further concerns may arise in relation to complaints (e.g. where a complainant from an EU Member State complains about potentially unlawful State aid in the UK, there may be a question of whether due consideration has been given to non-domestic complaints). The EEA

Agreement contains a provision for disagreement regarding action taken in response to a complaint to be referred to the EEA Joint Committee for independent assessment.¹⁸

Cooperation provisions may also be required. For example, the Commission's (albeit rarely used) information gathering powers extend to compulsory information requests to undertakings within the EU Member States.¹⁹ Provisions may need to be put in place to enable each authority to assist with information gathering in the other's territories.

Enforcement by the CMA

The CMA has been selected by the UK Government to become the State aid authority for the UK.

The CMA has already begun to make preparations in anticipation of this role, including by appointing an interim Senior Director and Project Director of State aid.²⁰

When announcing the selection of the CMA for this role, the UK Government noted that the appointment "*reflects [the CMA's] experience and understanding of markets as the UK's competition regulator and the independence of its decision-making from Government*".²¹

It will be important for the CMA to maintain its independence. The CMA has recently commented that State aid "*is a major new function for us at*

¹⁵ Protocol 27 to the EEA Agreement.

¹⁶ Article 14, Swiss Agreement on Air Transport.

¹⁷ Article 64(1), EEA Agreement.

¹⁸ Article 109(5), EEA Agreement.

¹⁹ Article 7, Procedural Regulation.

²⁰ See CMA Twitter announcement of 10 April 2018.

²¹ Letter to House of Lords' EU Internal Market Sub-Committee from Andrew Griffiths MP (BEIS), 28 March 2018.

the CMA... It is one that we are determined to make a success of, building on our expertise in applying legal and economic principles in the service of effective competition".²²

Transitional cases

The treatment of Commission State aid cases that straddle Brexit remains to be decided. The EU's proposed text in the draft Withdrawal Agreement - which at the time of writing remains subject to agreement with the UK - provides that the Commission would retain jurisdiction over ongoing administrative procedures, and new administrative procedures in relation to pre-Brexit facts/conduct.²³

There is also the question of any ongoing commitments given by, and recovery orders imposed on, UK public authorities pursuant to a pre-Brexit Commission decision. The EU's proposed text in the draft Withdrawal Agreement provides that such decisions would remain binding, and failure to comply would, post-Brexit,

remain subject to proceedings in the European Courts.²⁴

It remains to be seen what the outcome of the negotiations will be.

Concluding thoughts

The UK State aid rules are likely to be similar in substance to the EU State aid rules and therefore would be broadly familiar to practitioners in this area.

Yet, differences could arise as a result of how the regime is imported into the UK statute books. Notably, enforcement practice may vary as regards the degree to which a domestic regulator could, legally or in practice, 'block' Government policy.

While some of this will become clearer as the terms of the UK and EU's future relationship are agreed, much could depend on the approach to State aid enforcement and the support for State aid policy by future UK Governments.

²² Speech by Michael Grenfell, *A view from the CMA: Brexit and beyond* (16 May 2018).

²³ Article 88 and 89, *Draft Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland*

from the European Union and European Atomic Energy Community (19 March 2018).

²⁴ *Ibid*, Article 90.

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Anna Lyle-Smythe
T +32 (0)2 737 9410
E anna.lyle-smythe@slaughterandmay.com



Neha Dhaun
T +44 (0)20 7090 4218
E neha.dhaun@slaughterandmay.com



Will Manley
T +32 (0)2 737 9431
E will.manley@slaughterandmay.com

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