



A brand new subsidy regime for the UK?

Beyond Brexit – Part of the Horizon Scanning series

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A key outstanding issue between the EU and the UK in the negotiations on the future partnership agreement is the implementation of a level playing field for competition. The resolution of this issue will likely affect the shape of any future domestic subsidy regime in the UK.

This article summarises the parties' current positions and examines whether a compromise is possible. It also briefly discusses some of the questions that the House of Lords EU Committee recently raised on the negotiations and the UK's future regime.

The Political Declaration

The starting point for any discussion on the “level playing field” issue is the 2019 Political Declaration, which states that, given the parties' geographic proximity and economic interdependence: *“the future relationship must ensure open and fair competition, encompassing robust commitments to ensure a level playing field. The precise nature of commitments should be commensurate with the scope and depth of the future relationship and the economic connectedness of the Parties. These commitments should prevent distortions of trade and unfair competitive advantages. (...) The Parties should in particular maintain a robust and comprehensive framework for competition and state aid control that prevents undue distortion of trade and competition; (...). In so doing, they should rely on appropriate and relevant Union*

and international standards, and include appropriate mechanisms to ensure effective implementation domestically, enforcement and dispute settlement.” (emphasis added)

The idea of this provision is that the parties commit to a set of “common high standards”, including on State aid/subsidy control, aimed at ensuring open and fair competition between them.

The parties' positions on level playing field and state aid/subsidy control

Recent statements and the draft texts of each party for the future partnership agreement show, however, that there is a wide gap between the EU and UK positions on the issue of a level playing field for competition, including State aid control or “subsidy control” (the UK Government's preferred term).

The EU's position

The EU Member States are concerned that a wide access Free Trade Agreement (FTA) without any commitments in this area would allow the UK to free-ride; it could subsidise its industries that are exporting to the EU while staying free from concerns that EU Member States - who would remain subject to the EU State aid rules - could do the same.¹

¹ Although at least in theory EU State aid rules would not prevent subsidies that were solely targeted at exports to the UK market and so had no effect on trade within the EU.



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Beyond Brexit – Part of the Horizon Scanning series

The Council negotiating directives therefore set out that the future agreement “*should uphold common high standards, and corresponding high standards over time with Union standards as a reference point*” in the area of State aid.² This objective has been translated into the European Commission (EC)’s draft text for the agreement (published on 18 March 2020); this includes a section on State aid control that ensures the application of EU State aid rules to and in the UK.³ The section requires the UK to set up an operationally independent State aid authority with equivalent powers to those of the EC and that should work in close co-operation with the EC.

Any disputes about the application of the State aid rules should be subject to the agreement’s dispute settlement mechanism, according to the EU. This mechanism provides for disputes between the parties to be referred to an independent arbitration panel and for the panel’s decisions to be binding on the parties. However, in line with principles of EU law concerning the autonomy of the EU’s legal order, any questions of interpretation of EU law should be referred to the Court of Justice of the EU (CJEU) as the sole arbiter of EU law.⁴ This approach is common in EU association agreements, such as the EU’s agreement with Ukraine.

The UK’s position

The EU’s position on the substantive regime corresponds relatively closely to the proposal of the previous UK Government announced in March 2018 that there would be a self-standing State aid regime in the UK, which would largely be modelled on the EU approach and would cover a measure “*so far as it affects trade between the UK and the EU*”. This regime envisaged the appointment of the Competition and Markets Authority (CMA) as a domestic State aid authority and a State aid team was established at the CMA in anticipation of this regime becoming operational.⁵

However, since the adoption of the Political Declaration, the current UK Government has indicated that it intends to seek a free trade agreement that is no more ambitious than that which Canada or Japan have agreed with the EU and that level playing field commitments are therefore unnecessary. It believes that “*any agreement must respect the sovereignty of both parties and the autonomy of [their] legal orders*” and “*cannot therefore include any regulatory alignment*” and “*any jurisdiction for the [CJEU] over the UK’s laws*”. The UK Government will therefore “*not agree to measures [in the areas of competition policy, subsidies, (...)] which go*

² Paragraph 94 of the Council negotiating directives.

³ Paragraph 96 of the Council negotiating directives and Chapter two, Section 1 of the draft text, which is available [here](#).

⁴ Paragraph 160 of the Council negotiating directives.

⁵ See letter from Andrew Griffiths MP, Minister for Small Business, Consumers & Corporate Responsibility, to the House of Lords EU Internal Market Sub-Committee, 28 March 2018. See also HM Government, *The future relationship*

between the United Kingdom and the European Union, July 2018, section 1.6.1; Juliette Enser (Director State aid), *Speech on post-Brexit state aid in the UK*, 8 October 2018; CMA, *Draft procedural guidance on state aid notifications and reporting* (CMA104); and Draft State Aid (EU Exit) Regulations 2019 (for no deal scenario).



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*beyond those typically included in a comprehensive free trade agreement”.*⁶

The UK Government’s draft text (published on 19 May 2020) therefore does not refer to “level playing field commitments” and the EU State aid rules but - using the EU’s economic partnership agreement with Japan as a precedent - envisages:

- reciprocal commitments on transparency about the award of subsidies in the parties’ territories, including an obligation on both parties to notify the other every two years on any subsidy granted within its territory, applying to goods or services;
- the right for a party to request consultations on any subsidy (except those relating to agricultural goods and fisheries products) that might be considered to adversely affect a party, with the responding party being required to accord full and sympathetic consideration to the request; and on the basis of such consultations, the responding party shall endeavour to eliminate or minimise any adverse effects of the subsidy on the requesting party’s interests.⁷

The UK Government does not want the consultation commitment to be subject to the Agreement’s dispute resolution mechanism.

The UK Government has also indicated that it will operate a separate and independent subsidy control regime in the UK after the end of the transition period, although it envisages that this

regime will not involve any alignment with EU rules.

Is a compromise possible?

So will the parties be able to narrow the relatively wide gap between their positions and find a compromise that recognises each side’s regulatory autonomy while enabling regulatory alignment? A compromise is difficult but should not be impossible.

Key to this is the UK Government’s commitment to a domestic anti-subsidy regime. This makes sense for domestic policy reasons - in particular to avoid a subsidy race between the devolved administrations - so it can be assumed that, as a minimum, this regime will apply to measures affecting trade within the UK.⁸ To avoid the UK having to develop a new regime from scratch during these challenging times, it also makes sense, at least from a pragmatic perspective, to model the domestic regime on the EU regime, possibly with a few adjustments or improvements. The EU State aid rules are a well-established regime that come with a large body of case law on both substance and procedure. This approach could therefore avoid much confusion and legal uncertainty especially in an initial phase.

An additional complication for the UK Government’s plan to move away from the EU rules is the fact that the UK Government has already agreed, to a certain extent, to remain in the EU State aid regime as part of the Northern Ireland/Ireland Protocol. Article 10 of the Protocol provides that the EU State aid rules will

⁶ UK Government, written statement to Parliament and PM Speech in Greenwich both on 3 February 2020.

⁷ Chapter 21 of the Draft UK-EU Comprehensive Free Trade Agreement (CFTA).

⁸ Paragraph 64 of HMG policy paper on the future relationship with the EU (27 February 2020) states: “The UK will have its own regime of subsidy control” (available here).



A brand new subsidy regime for the UK?

Beyond Brexit – Part of the Horizon Scanning series

apply to the UK in respect of any measure that affects “*trade between Northern Ireland and the Union which is subject to this Protocol*”. It is not yet clear how the Protocol will be implemented, and therefore how widely the scope of this obligation is likely to be in practice.

The UK Government has made it clear that the Protocol provisions do not mean that EU State aid rules “*will apply to Northern Ireland as they do today*” as they are limited in scope to the movement of goods and wholesale electricity markets.⁹ But, in a letter to BEIS on the Government’s position on the level playing field commitments, the House of Lords EU Committee considers that: “*it should be a key UK priority to renegotiate provisions on State aid in the Protocol as part of the future relationship agreement with the EU, or negotiate alternative arrangements for Northern Ireland-Republic of Ireland trade, as envisaged in the previous Withdrawal Agreement, which would replace the Protocol entirely.*”¹⁰

Renegotiating or replacing the Protocol would, however, take time and there are still many other issues in the wide-ranging negotiations between the EU and the UK that require resolution. The UK Government has, however, ruled out an extension of the transition period meaning that it has until 31 December 2020 to resolve the outstanding issues.

The House of Lords EU Committee also asked BEIS for further details on the new domestic regime, including an update on how the Government proposes to engage with the devolved administrations and clarification about the role of the Competition and Markets Authority (CMA) in this regime.¹¹ But BEIS’s response was limited stating that it will “*share more detail on domestic subsidy control with key stakeholders in due course*” while also acknowledging that “*there are several complexities*” as the Government is developing its domestic policy “*in tandem with the EU negotiations on open and fair competition*”. This statement suggests that the Government considers the design of the domestic regime to be linked - at least to a certain extent - to the negotiations with the EU.

Stakeholders need legal certainty in the COVID-19 era

It remains to be seen whether the parties will be able to narrow the gap between their positions and find a compromise on the issue of State aid (or subsidy) control in the future relationship agreement. The key areas of tension appear to be:

- (i) which standards should be used as a reference point for the parties’ commitments to each other in this area? Is it a commitment to apply an equivalent of the EU rules (with an independent State aid authority to enforce those rules) or more general commitments in relation to subsidies

⁹ Cabinet Office, *The UK’s Approach to the Northern Ireland Protocol* (CP226) May 2020, p. 15.

¹⁰ House of Lords EU Internal Market Sub-Committee letter to Paul Scully MP (Minister for Small Business, Consumers and Labour Markets), 2 April. This letter is part of its “Level playing field and state aid” inquiry, which explores how the level playing field and state aid rules will feature in

negotiations of the future relationship between the UK and the EU. Note that this sub-committee ceased to exist on 23 April 2020 when the EU Committee adopted a new structure to reflect the UK’s changed relationship with the EU.

¹¹ BEIS response to letter House of Lords EU Committee, 15 May 2020, available here.



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Beyond Brexit – Part of the Horizon Scanning series

that are used in certain other FTA's? In other words, how strict should the parties' treaty commitments be; and

- (ii) how should disputes about the application of the commitments be resolved, i.e. the agreement's dispute resolution mechanism or a consultation mechanism only (with no arrangements to police the application of this consultation mechanism).

The outcome of the negotiations will likely affect the shape of any future domestic State aid regime in the UK. If the UK moves away from the EU model towards a more light-touch regime without an independent authority to apply and enforce the regime (e.g. based on the WTO regime),¹² this would presumably reduce the administrative burden on, and therefore benefit, aid-granting authorities and aid beneficiaries. However, companies that want to complain about potentially distortive aid measures are unlikely to welcome such a regime. Given the many other challenges that authorities and businesses face in the wake of the global COVID-19 pandemic, a pragmatic, transparent and coordinated approach that avoids legal uncertainty is, however, "a must have" for all stakeholders.

¹² The WTO anti-subsidy regime, which applies to goods only, differs from the EU regime in several respects most notably in procedural respects and in terms of enforcement. The regime does not provide for exemptions from the subsidy prohibition and there is therefore no approval process or mechanism. The WTO provides for state-to-state

enforcement or imposition of countervailing duties by the affected state only. There is no role for non-state actors such as companies that wish to complain about a subsidy measure. WTO rulings do not generally require retrospective recovery of subsidies already received.



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