James Webber

All Change?
UK State Aid after Brexit

What Law? Whose Courts?

POLITEIA

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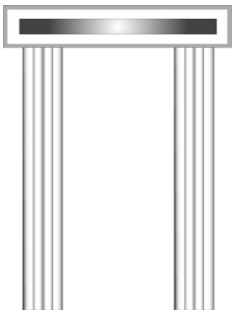

POLITEIA

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Foreword

State Aid, the EU and the UK Economy
Different Systems, Different Rules

Sheila Lawlor, Director of Politeia

The battle and its background.[1]

Very shortly the next battle with the EU will begin over an unlikely battleground: what rules should govern UK State aid and what are their implications for a trade deal with the bloc?

For the UK, a country that, more than most others, has championed free trade, unfettered and competitive markets and an economy under the rule of law, the subject seems uncontentious. The sense that the state should not use taxpayers' money to 'pick winners' or use its powers to cause distortions has been one of the threads of political debate. When Margaret Thatcher redrew the economic boundaries of Britain and became one of the first leaders to unravel late-1940s state socialism and its legacies by withdrawing public subsidies and funding from some of the largest UK industries, she also signalled a break with the idea of the economic state. That trajectory has by and large continued, but policy from time to time has also accommodated support for regional, industry-specific or sector-specific aims, or those of national interest, often for political reasons. Even so, for the UK, State aid has not been treated as an economic arm of the state to favour big corporations or multinationals or to award crony backhanders, as can happen as a matter of course elsewhere. In the UK State aid is treated as a public grant, often for a particular purpose and time-limited, subject to public and parliamentary scrutiny. In a competitive market economy it is seen as a tool used exceptionally, specifically and with restraint. And the UK's record for compliance has been exemplary: very few infringement actions (around four over 21 years, compared to 29 in France, 67 in Germany and 45 in Italy).

By contrast the EU economic model reflects that of its founder, France in its different post-war trajectory. From the late 1940s this model has included the French project to bind Germany and its renascent economy into joint Franco-German co-operative control, on the lines developed in France from the 17th century. Historically the French state had backed, directed and controlled a series of French industries and great projects, training professional elites to run them in the Grandes Écoles. This economic model, adapted over the centuries to serve the political interests and ambitions of the French state from the Bourbon kings would also serve the European project, which started life as the 1951 European Coal and Steel Community with the Benelux countries and Italy, established by the 1951 Treaty of Paris. Germany would be rehabilitated by binding it into a trade community for coal and steel under joint Franco-German led political control. Today's EU has adapted that model to joint ends, with a share of flagship, state-backed often part state-owned industries such as EADS-Airbus or locomotive industries, Alstom and Siemens, taking their place in the centralised, protected and directed system, led by its Franco-German founders.

More generally, over the decades EU economic control has been extended into a number of areas. State aid rules have also developed and been extended to become a significant tool of EU economic control

[1] The first two sections of this foreword draw on my *Now or Never, Countering the Coup against Britain's* Democracy, II-IV, Politeia, 2019.

under the umbrella title of EU 'level playing field laws'. Today these rules are, as James Webber explains, not just a matter of 'bail-outs of heavy industry and operating subsidies to state-owned airlines'. A case can be made, as he argues, that they are 'the main tool the European Commission has to regulate bank resolution; control direct tax competition; direct environmental policy; control infrastructure spending'. Moreover, as matters of Union law they are subject to the jurisdiction of the CJEU.

The contenders and their cause

At the end of the transition period, the UK will end EU State aid rules save for the NI Protocol. Having left the EU, it is committed to restoring sovereign control over economic law and the different levers of economic life and trade policy including competition and subsidy rules, a policy that has been set out by the current prime minister.[2] On that basis the UK intends to negotiate trade deals globally and with the EU, with which it shares the common aim of reaching a tariff free trade deal with minimal regulatory barriers. It intends 'full legal autonomy …[without] alignment of any kind', because the UK intends to be 'an independent actor and a catalyst for free trade' across the world.[3]

The EU, however, demands that in return for such a trade deal, the UK abides by what it calls a 'level playing field' – by which it really means continue to apply its laws and policy choices. This is the premise on which it will base its future negotiations. It has made clear it wants the UK to align dynamically with the EU on such matters as state aid, competition, social and employment standards, environmental, climate and tax matters. Moreover, alignment with such rules is, according to the Commission's president, the 'precondition' for UK access to the single market: the more the UK upholds EU 'social protection and other standards, the better the access will be'. That position, set out for the UK by Donald Tusk initially in March 2018, followed earlier guidelines and has been tenaciously held since then.[4] It has become an article of faith not only for the EU, but for the Franco-German Axis, for economic as well as political reasons. The French president, Emmanuel Macron, for instance has continued to emphasise 'ease of access to the European market will depend on the degree to which the EU rules are accepted … we cannot allow any harmful competition.' For France, no less than Germany, the resistance to the concept of competition and the Anglo-Saxon type economy, the reverse of the planned, centralised, directed and protected EU economy, will continue. The fear of the UK's becoming a dynamic adversary on the other side of the Channel, a 'competitor at our door' as the German Chancellor put it, or London 'Singapore on Thames' is strong and unlikely to dissipate.[5]

It is likely that, so long as the level playing field of European regulation is not imposed on it, the attraction of the UK as a hub for buying and selling at competitive world prices will undercut the higher cost, protectionist and controlled EU product market. This will not be as a result of the UK having lower

[2] Boris Johnson, 3 Feb 2020, https://www.gov.uk/government/speeches/pm-speech-in-greenwich-3-february-2020; see below, chapter I.
[3] *Ibid.*
[4] For a summary of the approach, see: EC Guidelines (Art. 50) 29 April 2017, https://www.consilium.europa.eu/en/press/press-releases/2017/04/29/euco-brexit-guidelines/ 23 March 2018, https://www.consilium.europa.eu/media/33458/23-euco-art50-guidelines.pdf, EC Council, 13 December 2019, https://www.consilium.europa.eu/en/meetings/european-council/2019/12/13/art50 UKTF(2020) 4-Commission to EU 27, 14 Jan 2020, 'Internal EU27 preparatory discussions on the future relationship: "Level playing field"' https://ec.europa.eu/commission/sites/beta-political/files/seminar-20200114-lpf_en.pdf Ursula von der Leyen, European Parliament, 29 Jan 2020, https://www.youtube.com/watch?v=pYoORssZrms.
[5] https://www.elysee.fr/emmanuel-macron/2020/02/01/a-letter-from-emmanuel-macron-to-the-british-people.en; Angela Merkel, 13 Dec 2019.

standards in the areas no longer regulated by Europe. In many fields of labour market or social protection, the UK led the world; as Beveridge put it for schemes of social insurance in 1942, its provision was unparalleled. The EU leaders may even, privately, accept this point, but they are faced by a challenge to the economic status quo, and there is also the political determination to discourage the EU's millions of Eurosceptics wanting to follow where Britain led. Brussels therefore demands that the UK continues on a trajectory of 'dynamic alignment' with its level playing field rules including those on State aid, themselves now a tool of EU economic control.

Ending EU State aid rules

For the UK, the constitutional case for ending such laws is as strong as the economic. It matters for constitutional sovereignty and democratic freedom that the laws under which people are ruled are decided by a government elected by and acting on the authority of the electorate. It also matters that the rules and system of law in the UK command popular consent, reflecting principles that have been commonly accepted, assumptions about freedom, the rule of law and accountability of government. So the decisions about public subsidy, about whether (or if so what) to subsidise should be taken by the elected government of the day on principles tested in the country and carried through by the new government and freshly elected Parliament. Not only are there good democratic reasons to restore control over State aid law but it is particularly important that politically and economically sensitive decisions are taken with popular support.

James Webber's analysis makes clear that, from the legal perspective, too, there is a strong case for ending the EU rules. It explains that the EU approach to State aid, its role, the application of the rules and the frailties of the system are in themselves a good reason to leave EU state aid rules behind. He warns that not only does the EU insist that dispute resolution in relation to the use of State aid will be decided by the Court of Justice of the EU, which is no longer a neutral dispute resolution body because it no longer has UK representation among its judges, but its initial negotiating mandate on 'level playing field' laws implies the same approach to future trade (Section A). Given the weaknesses in the EU system, EU rules should not be prolonged and a new UK system that controls wasteful subsidies and potential distortions will be more accountable than EU State aid (Section C). Besides, it is perfectly possible to have a subsidy control regime that respects both UK sovereignty and the EU's powers, which protects against genuine distortion and provides a true level playing field (Section D).

The author explains that the UK's desire to follow WTO subsidy rules would be a sound basis for future trade deals. WTO rules, as Webber explains, are not only more in keeping with UK practice, but provide a more effective alternative to the EU's in line with the principles on which the UK economy can flourish.

Unfinished Business?

As the UK has made clear it intends to end EU law after the transition, which will end on 31 December, whereas the EU intends to press for full UK alignment on EU State aid rules, there is likely to be a spirited negotiation. The likelihood is that a trade deal can be struck taking into account the wider context of the EU/ French wish list for UK co-operation on such matters as security, counter terrorism, defence, scientific and cultural cooperation. As part of that trade agreement the UK should insist on superseding the Northern Ireland Protocol by the new FTA. This is especially important because as matters stand dispute resolution, will in the last resort, be decided by the CJEU.

Should the EU refuse to replace the Northern Ireland protocol with an agreed FTA, the post transition arrangement for Northern Ireland would start with a dual customs system, with Northern Ireland a part of the UK and within both its internal customs union and also sharing the EU's customs union arrangements and under single market rules. (The aim of such an arrangement is to keep the Irish border soft, facilitate cross-border traffic and the all island economy, and for the EU, to protect the integrity of the Union). Given, however, that the EU would have its foothold into Northern Ireland, and some leverage with regard to UK State aid law operating there, the EU could try to claim that the UK's economic arrangements infringe EU State aid rules as they apply to Northern Ireland. For example, subsidy to Nissan in Sunderland could be caught on the basis that Nissan cars produced there could cross the Northern Irish border with the Republic of Ireland.

The UK should, therefore, move right away to take appropriate steps under UK law to minimise the potential impact of the Northern Ireland Protocol on the UK's economic sovereignty. James Webber proposes "quick legislative action" to resolve ambiguity in the Northern Ireland Protocol. In particular the UK should end "any supposed requirement to notify State aid to beneficiaries in Great Britain to the European Commission following the end of transition" for such an obligation could be "highly damaging to the Government's freedom of action in rebalancing the economy. "

Though a potential EU attempt to undermine UK economic sovereignty through its State aid (or other) rules in Northern Ireland would be on legally untested ground, none the less the UK should prepare to limit such an unintended effect, which would violate the UK's constitutional freedom and its restoration of sovereign economic control.

Sheila Lawlor

Director, Politeia
9 February 2020

THE AUTHOR

James Webber is a partner of Shearman & Sterling LLP in the firm's specialist global antitrust practice. His work predominately concerns EU competition and administrative law representing companies and governments before the European Commission and European Courts. He has particular expertise in the EU State aid rules, advising Eurozone banks and creditors on bank bailout programmes, inward investors to the EU and governments – including Cyprus, Japan, Slovakia and the UK.

He graduated in law from University of Birmingham, worked for a number of years in Brussels and now lives in London. Amongst Europe's new generation of competition lawyers under 40, he has been named by Global Competition Review as one of the 40 brightest competition lawyers in the world. His publications include *Access to Evidence in Market Investigations*, in the Competition Law Journal, Vol. 13, Issue I at 72 (C. Brown, D. Bailey & S. Long eds., Jordan Publishing Limited, 2014) and, with Barnabas Reynolds, *The Withdrawal Agreement, State Aid and UK Industry: How to Protect UK Competitiveness.*

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I

UK State Aid after the Transition – Leaving the EU Rule Book

EU State aid rules ban governments from providing subsidy (in any form) to their industry or regions without an exemption or prior approval of the European Commission. The idea is that a state, State A, must be sure that another state, State B, is not unfairly subsidising its industry before State A will allow B's companies unfettered access to their market. The rules work by giving the European Commission and Court of Justice of the European Union (CJEU)[6] the exclusive power to act as referee and adjudicator.

Over time, the reach of the State aid rules has expanded significantly. State aid includes not just bail-outs of heavy industry and operating subsidies to state-owned airlines. It is the main tool the European Commission has – directly rather than via legislation – to regulate bank resolution; control tax competition; environmental policy; control infrastructure spending. The single unifying factor driving this expansion has been the fact that the rules give executive power to the European Commission.

The importance of EU State aid rules therefore is best understood in two ways. First, they help ensure fair competition *between* Member States (not really between companies), and second, they are a major source of executive power for the European Commission. These two factors explain why State aid plays such a prominent role in the EU's often repeated demands for a "level playing field" from the UK. If the EU can get the UK to accept their State aid rules – the European Commission and CJEU will retain control over much UK fiscal decision making and control the ability of the UK to compete against the EU going forward. Whatever the merits of subsidisation as a policy choice, the UK Government should be concerned about State aid for the same reason.

On 29 November, Boris Johnson announced that the next Conservative Government would abandon the EU's State aid rules and introduce a new system of subsidy control based on WTO commitments and on 3 February 2020 reiterated that the UK would end the EU State aid rules.[7] This announcement provoked significant criticism – both from pro-EU voices, but also from traditional Conservatives who are nervous of Government intervention in markets and see the EU State aid rules as a useful check on wasteful spending.[8]

This paper explains the four connected reasons why this criticism is mistaken and why moving away from the EU State aid rules is an excellent idea for the UK and necessary if the law is to give the Government the freedom and investors the certainty that they need.

The first and most important reason to abandon the existing EU State aid rules is that they are EU rules. The EU has chosen to insist on a dispute resolution mechanic[9] whereby EU legal concepts are not interpreted by a neutral dispute resolution body, but by the courts of one of the parties i.e. the Court of

[6] This paper refers to the institution of the Court of Justice of the European Union as CJEU – encompassing its main constituent courts the Court of Justice (ECJ) and General Court (GC).

[7] 3rd February 2020, Greenwich. For reports of 29 Nov. speech, see https://www.ft.com/content/e46f977e-12b5-11ea-a7e6-62bf4f9e548a.

[8] See for example: https://www.cityam.com/tories-slammed-by-free-market-groups-over-state-aid-pledges/.

[9] Agreement on the Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, 19 October 2019, Article 174; and Commission recommendation for a Council Decision authorising the opening of negotiations for a new partnership with the United Kingdom of Great Britain and Northern Ireland, published 3 February 2020 at recital 155.

Justice of the European Union. This decision means EU legal concepts become unusable in any balanced agreement – since the EU will not allow disputes about them to be heard before an impartial judge. (See section II).

Second, the frailties of the EU State aid regime are serious and underappreciated. There is no good reason to transfer these to a new UK regime. (See section III).

Third, a new system to control wasteful and distortive subsidisation can be more efficient and democratically accountable than the EU State aid rules. (See section III-IV).

Fourth, a subsidy control regime that protects against genuine trade distortion – a level playing field – is perfectly possible, while respecting EU legal autonomy and UK sovereignty. (See section IV).

II

The EU's Concept of 'State aid' – Unusable in a Balanced Agreement

The very words "State aid" are creatures of EU law. They do not exist independently in any other legal system anywhere in the world. The definition of State aid – what is caught by the regime, who has the decision making authority to approve, the criteria for approval, standards of evidence, policy goals that can be advanced by use of State aid – literally everything about it is an EU law concept.

The combination of this and the dispute mechanic the EU seeks (and achieved in the Withdrawal Agreement) mean that the term "State aid" together with the accumulated case law and decisional practice can have no place in a bilateral agreement that respects the legal autonomy of both sides. That is because the substance of any dispute would be decided by the courts of one party.

The European Council negotiating mandate concluded shortly after the UK served its Article 50 notice said: "*The withdrawal agreement should include appropriate dispute settlement and enforcement mechanisms regarding the application and interpretation of the withdrawal agreement, […] This should be done bearing in mind the Union's interest to effectively protect its autonomy and its legal order, including the role of the Court of Justice of the European Union."*[10]

The European Commission adopted a maximalist approach to this mandate and included in its first draft of the Withdrawal Agreement a simple reference of any disputes to the exclusive jurisdiction of the CJEU.[11]

The UK unsurprisingly objected to that, as such a more subtle mechanic was needed. The Commission found the solution in the EU's association agreements with Ukraine and Moldova.[12] Under this approach, a nominally independent arbitral tribunal would hear disputes. However, any dispute which raised an issue of EU law or "*which otherwise imposes upon a Party an obligation defined by reference to a provision of EU law",*[13] the tribunal would be obliged to refer the matter to the CJEU.

Under the "Ukrainian model" therefore there is the appearance of an independent arbitral tribunal, but any use of an EU legal concept would effectively bypass the independent tribunal and be determined by the courts of one party – namely the EU.

This solution was accepted by Theresa May and left unchanged by Boris Johnson's re-negotiation. It is now established – with minor contextual amendments – at Article 174 of the Withdrawal Agreement.

The draft negotiating guidelines published by the European Commission on 3 February 2020 adopt the same formula[14] – for the same reason of protecting the Union's autonomy. The draft guidelines also

[10] European Council (Art. 50) guidelines for Brexit negotiations, 29 April 2017, Paragraph 17.
[11] Draft Agreement on the Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, 19 October 2019, Article 162 (Settlement of Disputes).
[12] For example, see the Association Agreement between the European Union and Ukraine dated 29 May 2014, Articles 306 et seq.
[13] *Ibid* Article 322.
[14] Commission recommendation for a Council Decision authorising the opening of negotiations for a new partnership with the United Kingdom of Great Britain and Northern Ireland, published 3 February 2020 at recital 155.

anticipate that the entirety of EU State aid law should apply to the UK in a future FTA.[15] These two components combined amount to an extraordinarily aggressive position.

The UK should be clear at the outset that its FTA must not include any EU legal concepts – so as to obviate the practical need for any reference to the CJEU. *"The future partnership must include appropriate enforcement and dispute settlement mechanisms that do not affect the Union's autonomy, in particular its decision-making procedures"*[16] as was stipulated in the EU's 2017 mandate for the Withdrawal Agreement talks.

The safest course now for the UK is to strip out EU legal concepts from the forthcoming FTA – and to use this as an opportunity to withdraw from the EU State aid regime and its frailties in favour of a more certain, evidence-based and transparent framework.

[15] *Ibid*, recital 91.
[16] European Council (Art. 50) guidelines for Brexit negotiations, 29 April 2017, Paragraph 23.

III

Identifying and Tackling the Frailties of the EU State Aid Regime

> "Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to **distort competition** by favouring certain undertakings or the production of certain goods shall, **in so far as it affects trade** between Member States, be incompatible with the internal market." [emphasis added] *(State aid definition, Article 107(1)TFEU)*

State aid is one of the few areas of Union law where the European Commission has been granted executive power over the Member States. Largely as a result, the State aid regime has grown from refereeing industrial subsidies within a customs union, to being an expansive system of executive control by the European Commission over fiscal decision making and de facto regulation of energy, bank resolution, infrastructure, R&D and tax policy among many other areas.

The expansion of the regime in this way has revealed significant frailties. These can be measured against the guiding principles that Boris Johnson described in his 29 November announcement proposing to change UK State aid rules after Brexit.

Clarity

The first principle that Johnson's announcement on 29 November referred to was "clarity". How does the EU State aid regime measure up against this?

State aid was first defined in the Treaty of Rome and the definition has remained intact throughout all subsequent treaty revisions. It is currently found in Article 107(1) TFEU. On top of the stable treaty definition there has been a vast amount of litigation before the CJEU and decisional practice of the European Commission. Moreover, the definition of State aid is an 'objective legal concept' – i.e. a concept whose meaning is supposed to be fixed, invulnerable to political expediency and hence highly predictable.

All of these features ought to have led to a high degree of clarity and legal certainty as to whether a given measure qualifies as State aid. In reality, the definition of State aid has regularly 'shape shifted' at the hands of the European Commission and CJEU. Most (although not all) of such change has tended to expand the authority of the European Commission and CJEU.

Distorting competition and affecting trade between Member States

The first illustration of this phenomenon relates to the two distinct references, to distorting competition or affecting trade between Member States in Article 107(1). As can be read from the text above, formally, an effect on trade and distortion of competition are two separate criteria which must both be met in order to engage the definition of State aid. In practice, an effect on trade and distortion of competition have long been merged into each other. More significantly, there are no meaningful practical tests for an effect on trade or distortion of competition. Rather, the CJEU has removed all practical significance from either criterion by applying a wholly theoretical test. A good example of this

is the *Eventech* case[17] in 2015, which concerned restricting London bus lanes to buses and black cabs while excluding minicabs. Addison Lee, the minicab company, complained this amounted to State aid to black cabs. TfL, which regulated London's bus lanes, argued *inter alia* that there was no effect on competition or trade between Member States. The European Court of Justice (ECJ) on preliminary reference from the High Court dismissed this argument and held that there was no need for the black cabs to engage in inter-state trade. It was sufficient that the bus lane rules strengthened their competitive position in their home market and hence made it more difficult for undertakings from other Member States to enter the London minicab market. There was no separate analysis of the competitive effects of the bus lane restriction.[18]

In terms of effect on competition, it is sufficient for the undertaking receiving the aid to be active in a market open to competition (i.e. effectively any market other than that reserved for certain State monopolies). From the CJEU's perspective, there is no monetary amount of aid that is too low so as to not affect trade and competition or undertaking that is too small.[19] It is simply presumed that all aid will have an effect on competition and on trade provided the beneficiary is in a competitive market.

Extension of State aid to cover infrastructure spending

A second area where the CJEU has shifted the definition of State aid away is in infrastructure.

The WTO definition of subsidy specifically excludes government provis*ion of general infrastructure such as development of roads, ports, airports, etc.*.[20] This was the case in EU State aid law as well until the *Leipzig/Halle* judgment in 2012.[21]

In this judgment, the CJEU (combined with its earlier *Aeroports de Paris* judgment[22]) expanded State aid to capture spending on infrastructure that could be economically exploited (such as toll roads or airports) – even where the market would not provide the infrastructure and even where the subsequent services offered using that infrastructure (e.g. through a concessionaire arrangement) would be let competitively.

Whatever the merits of this policy choice, it came from a court judgment not legislation, still less Treaty change – and to almost everyone's surprise – dramatically expanded the European Commission's power to control Member State infrastructure spending. Along with massive delays to litigation through the CJEU system, it had the practical effect of reducing legal certainty around State support for infrastructure investment – making such projects more difficult to finance. Project finance lenders now had to somehow price the risk that State measures to support financing for a long-lived infrastructure project might be unwound years after the event. A particularly serious example of these effects being the Øresundlink saga – the famous bridge connecting Copenhagen to Malmo in Sweden. The bridge was built between 1995 and 2000. The State aid review associated with State support for its financing is still going on – almost two decades after it opened.

[17] Case C-518/13, *Eventech Ltd v The Parking Adjudicator*, Judgment of 14 January 2015, ECLI:EU:C:2015:9.
[18] Note that the CJEU found there was no State aid on other grounds – hence black cabs are still the only taxi able to use London bus lanes.
[19] The European Commission ameliorated this somewhat by adopting the *de minimis* regulation, finding that aid beneath the thresholds in that regulation do not meet the conditions of Article 107(1).
[20] WTO Agreement on Subsidies and Countervailing Measures, Art 1.1(a)(iii).
[21] Case C-288/11 P, *Mitteldeutsche Flughafen and Flughafen Leipzig-Halle v Commission*, Judgment of 19 December 2012, ECLI:EU:C:2012:821.
[22] Case C-82/01 P, Aéroports de Paris v Commission of the European Communities, Judgment of 24 October 2002, ECLI:EU:C:2002:617.

Merging two criteria – selectivity and advantage – in tax cases

A third area where clarity as to what is caught by State aid has been lacking relates to tax. The Commission – and Member States such as France and Germany – have long objected to tax competition between Member States. However, since direct taxation is outside the reach of the Treaty and certain Member States (especially the UK, the Netherlands, Ireland and Luxembourg) have refused to consider extending EU competence to direct taxation, there has been little the Commission can practically do to tackle variance in tax rates themselves.

Commissioner Margrethe Vestager in her first mandate as competition commissioner decided to try and use the State aid rules to attack tax competition between Member States indirectly. She launched a variety of cases designed to test the boundaries of the law. As the appeals of these cases reach judgment, we can now see how the CJEU has again decided to redefine State aid – and again so as to grant the Commission extended power.

In September's judgment in the *Fiat* case,[23] the General Court (GC) held that tax rulings by Luxembourg were unlawful State aid, and in the process effectively merged the previously separate criteria of: (i) whether the beneficiary has received an advantage; and (ii) whether that advantage is specific to that beneficiary (usually referred to as selectivity). The GC instead held that selectivity could now be presumed where an applicant had received an advantage, provided that the advantage had not come from a general scheme. Since tax rulings are invariably individual, this means that their lawfulness under the State aid rules now depends to a large degree on whether the European Commission and CJEU consider the tax rulings as part of a general scheme or not.

An earlier judgment in *World Duty Free*[24] introduced another entirely new concept of "behavioural selectivity" – i.e. a measure (such as a tax relief) might apply generally as a matter of law and fact but if companies change their behaviour to qualify for it, it becomes selective in favour of those companies.

The logical incoherence and policy dangers of these changes have been commented on – including by an Advocate General of the Court[25] but there is nothing in practice that can be done except by the ECJ itself.

Despite all of the advantages that EU State aid should have for clarity and legal certainty therefore – in practice it falls far short. The European Commission and CJEU together regularly 'shift' the supposedly stable definition. Unsurprisingly, those shifts also tend to expand the reach of the European Commission and CJEU.

[23] Joined Cases T-755/15 and T-759/15, *Luxembourg v Commission and Fiat Chrysler Finance Europe v Commission*, Judgment of 24 September 2019, ECLI:EU:T:2019:670.
[24] Joined Cases C-20/15 P and C-21/15 P, *European Commission v World Duty Free Group SA and Others*, Judgment of 21 December 2016, ECLI:EU:C:2016:981.
[25] Opinion of AG Øe in Case C-374/17, Finanzamt B v. A-Brauerei, 19 September 2018, ECLI:EU:C:2018:741.

Permissive

Permissiveness was the second principle that Johnson's proposals referred to. Critics of Johnson's proposals from the right focused on this element. The IEA said:[26]

> "*Extending these rules, by government to use taxpayers' money to prop up industries that have no future, would be to move swiftly in the wrong direction, crippling the emergence of new and innovative businesses that our economy relies on.*"

The merits or otherwise of using taxpayers' money to provide support to industry is a political decision. Reasonable people can reasonably disagree. Part of the point of Brexit is to allow such political judgments to be taken differently by different governments, reflecting the democratically expressed view of the people.

Wherever the policy line is drawn, permissiveness in design of the system should be understood in the general sense of the common law. Governments and citizens ought to be permitted to act, with legal restriction only so far as necessary to prevent undue harm to others.

The EU State aid system works in the opposite way. All State aid (within the shifting definition described above) is prohibited unless approved. The approval can either be via notification to the Commission or qualifying for an exemption. In practice, over 95% of State aid in Europe is approved via exemption regulation rather than notification to the Commission.

This structure means that the Commission is directly via notification (or more commonly indirectly via defining exemptions and *ex post* policing of them) supervising large amounts of innocuous expenditure. This regulatory supervision carries significant costs:

- Public authorities and private companies have to invest effort and resources in complying with the exemptions.
- The exemptions are highly prescriptive and bureaucratic. The definitions alone of the General Block Exemption Regulation run to 23 pages.
- The costs associated with compliance are high: reporting, auditing, data tracking.
- The Commission can (and regularly does) call in projects granted under the exemption and may well take a different view to the Member State of what the correct interpretation ought to be. Imposing uncertainty and risks on beneficiaries that they may have to pay back.

These costs are also regressive, affecting the smaller aid beneficiaries most. Obtaining Government support via a State aid scheme – e.g. for R&D or training is often so cumbersome it is barely worth doing for many companies. Not all of this is the fault of the State aid rules because national bureaucracy is often layered on top of State aid requirements.[27] In my experience, the UK Government is a particularly weak performer in this respect and the current Government may now wish to tackle this anew.

[26] IEA: Calls to expand state aid translate to "support for cronyism", 29 November 2019, available at https://iea.org.uk/media/iea-calls-to-expand-state-aid-translate-to-support-for-cronyism/.

[27] National Audit Office rules, value for money assessments, contractual requirements in grant agreements straying beyond the GBER aid requirements.

Permissiveness – as principle of system design – is really about governance. To what extent is it appropriate for there to be bureaucratic control over innocuous spending decisions of democratic governments?

Speed

Speed was the third principle of Johnson's proposal for a new UK subsidy control regime.

The EU State aid regime can be extraordinarily slow. The Øresundlink case noted above – where the State aid position is still not settled two decades after the bridge opened – is an outlier. But notified aid will regularly take over two years to complete the administrative process. It is often said in response to this complaint that most aid is exempted and can proceed without formal notification. In a narrow formal sense that is true, but the time taken to establish compliance with the terms of the exemption, complete the summary notification, and respond to questions from the Commission can also result in extended periods of uncertainty.

If the CJEU becomes involved, the time taken spirals completely out of control. I am currently acting on a State aid case[28] where the Commission undertook an investigation and made the appealed decision on a single day (the case relates to the ongoing Eurozone banking crisis where the Commission does often move with exceptional speed and dedication). Almost 5 ½ years later, the GC has decided that the complainants do not have standing to bring the complaint. There has been no discussion of the substance.

Despite the significant time taken, EU State aid procedure offers very few procedural rights to those affected by the decision. The aid beneficiary has no formal right to be heard in the vast majority of cases. The exception is a right to respond to a public consultation on opening a phase 2 investigation. This is despite the fact that the consequences of an adverse decision fall *exclusively* on the aid beneficiary and can be very material. Apple, for example, has been ordered to repay €13bn to the Irish Government as a result of a State aid case.[29] Third parties have even fewer rights – unless either the Commission or the Member State concerned wish to assist them. Access to the Courts is also excessively difficult. In a recent case, Air France was denied standing to appeal State aid to Ryanair at Marseille Provence airport.[30] Ryanair and Air France were by some distance the largest users of the airport, however, the Court denied Air France standing on the basis that since Royal Air Maroc, British Airways, and Iberia had also used the airport, the effect on Air France's competitive position was not sufficiently differentiated or serious. Lufthansa has had the same problem – again with respect to aid to Ryanair – this time at Frankfurt Hahn airport.[31]

Consistency

This was the final principle that the Johnson proposals referred to. Subsidy control involves supervision of fiscal decision making by governments – within the EU State aid regime the Commission's role is to referee subsidy competition between Member States. It is inherently political and so consistency is difficult and not even always desirable from the EU's point of view.

[28] Case T-812/14 RENV, BPC Lux 2 Sarl v. Commission, judgment 19 December 2019.
[29] Commission decision of 30.8.2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple.
[30] Case T-894/16 Société, *Air France v Commission*, Judgment of 11 July 2019, ECLI:EU:T:2019:508.
[31] Case T-492/15, *Deutsche Lufthansa v. Commission*, Judgment of 12 April 2019, ECLI:EU:T:2019:252.

Nevertheless, whether by design or otherwise, the EU's State aid regime is inconsistent in both visible and less visible ways.

The GC's decision to uphold the Commission's approval of the UK's support to the nuclear power station Hinkley Point C[32] found on the one hand that the aid the UK wished to grant was necessary to secure sufficient energy security. Yet simultaneously, the GC also decided that the aid did not have a substantial impact on energy output and trade in electricity. These positions are in obvious conflict, yet according to the GC it was not necessary to carry out a quantification or weighing of these two opposing effects, for a State support package running to tens of billions of pounds.

The inconsistency is more common in less visible respects. The standard of evidence required to substantiate a case is almost entirely a matter for the European Commission, the choice of which GBER exemption cases to 'call in'; the *ex oficio* cases of non-notified aid to pursue; the evenness of enforcement and level of recovery from unlawful aid are also choices made by the European Commission – inevitably taking into account political considerations between the Member States.

The challenge of consistency is made easier if the ambitions of the regime are more modest and decisions are made transparently on the basis of evidence of distortion to competition.

A new UK regime can improve on all these elements.

[32] Case T-356/15, *Austria v Commission*, Judgment of 12 July 2018, ECLI:EU:T:2018:439 (appeal to the CJEU pending).

IV

Focus for the Future – A WTO Subsidy Regime

The Johnson proposals of 29 November refer to a regime based on WTO commitments. This is sensible for three reasons: first, it is the only other multi or plurilateral system of subsidy control; second, the legal terms (and hence concepts) underlying it are distinct from EU State aid; third, the UK will as a signatory to the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) be subject to its disciplines in future international trade matters. The SCM Agreement is designed to restrain use of subsidies in tradeable goods by authorising WTO members to impose tariffs to "countervail" the effect of subsidies given by another WTO member. In most cases it is necessary to show that the subsidies caused injury before imposition of countervailing tariffs is lawful. The SCM Agreement only covers tradeable goods.

The SCM Agreement is a sensible starting point. It contains a definition of subsidy which contains three elements:

- Financial contribution from the State (State revenue foregone or State funds paid out);
- Benefit to the recipient, measured against what would have been the case under normal market conditions; and
- Specificity.[33] There are three principles to specificity:
    - Explicitly limited to certain enterprises;
    - Specificity does not exist where clearly stated objective criteria are used to govern eligibility automatically (i.e. without use of discretion); and
    - Even if a measure is not caught by either point above, specificity can still be found if there are other *de facto* factors suggesting it favours certain enterprises disproportionately.

The new UK regime would then consider – as the SCM regime does – whether subsidies are prohibited export subsidies and or merely 'actionable' subsidies.

A prohibited subsidy is either a subsidy that is contingent on export performance or on the use of domestic over imported goods. For example, providing a subsidy on every car exported to the US. These subsidies are quite rare – outside export credit agency operations, which are explicitly carved out.[34]

Actionable subsidy is the key concept for a domestic subsidy control regime, since it is into this category that the vast majority of subsidisation will fall. An actionable subsidy will only arise where the subsidy causes "adverse effects to the interests of another WTO Member". Adverse effects arise in three ways:

- Injury to domestic industry of another member;
- Nullifying or impairing their benefits under GATT 1994;
- Causing "serious prejudice".

[33] Article 2.1, SCM Agreement.

[34] The list of prohibited subsidies in Annex 1 of the SCM Agreement excludes ECA measures that satisfy the OECD Arrangement.

Injury and serious prejudice are by far the most relevant grounds in practice. The UK system will need a structured way to assess injury and serious prejudice. Both concepts require *evidence of harm* – such as displacing imports of a like product; displacing the exports of another WTO Member to the markets of a third country; significant price undercutting; unusual increase in global market share.[35] In each case the injury or prejudice is measured against a counterfactual – i.e. what would have happened had the subsidy not been in place.

These are the building blocks for a UK subsidy control regime designed around an evidence-based approach to the actual harm caused by the subsidy to the UK internal market or another WTO member. The system design components could work as follows:

Goods and Services

The SCM Agreement only applies to goods.[36] It would be open to the UK to limit the application of its own subsidy control measures to goods also. There is some appeal to this – since many services are not traded significantly across borders (rail, bus services, health) or where subsidy control has proven to be a somewhat clunky tool to weigh governmental interference in markets – e.g. financial markets, creative industry/sport, and infrastructure services.

However, it also introduces controversy about classification as a good or service – for instance, is subsidy to R&D a service (such as tertiary education or engineering consultancy) or a good (such as a new battery or drug that might ultimately result). Such classification problems exist elsewhere and are overcome (e.g. in VAT) but it would introduce undesirable complexity and uncertainty. Moreover, excluding services is arguably inconsistent with the Political Declaration[37] and would gift the EU a ready argument to resist granting improved market access to UK services business.

On balance it is probably better for the new UK regime to apply across the economy to both goods and services – both to make the system simpler and ease the negotiations with the EU.

Authority

The May administration had asked the Competition and Markets Authority (CMA) to act as the UK State aid agency. This was a sensible choice, even more so in respect of a regime that needs to consider evidence of adverse effects of a subsidy.

Obligation to notify UK State aid measures to the European Commission

The Withdrawal Agreement anticipates that the European Commission retains jurisdiction over aid measures that "*affect that trade between Northern Ireland and the Union which is subject to this Protocol*".[38] The extent of this jurisdictional threshold is unclear and untested. Moreover, the CJEU would, if this arrangement were not to be replaced in a future FTA, be responsible for interpretation.[39] As such, there is a risk that UK courts on application from complainants would make an early preliminary reference on the point or aid granting authorities themselves would seek to notify the

[35] Paras. 2-4, Article 6, SCM Agreement.
[36] Article XV of GATS operates effectively as a placeholder for subsidy control in services, but this has not led to material progress on multilateral subsidy discipline in services.
[37] Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom, dated 19 October 2019, Paragraph 77.
[38] Art 10(1), Protocol on Ireland and Northern Ireland.
[39] *Ibid* Art 12(4).

Commission of UK aid – both of which would pass the opportunity to first interpret such a provision entirely to the EU institutions. Granting the European Commission jurisdiction over fiscal decision making in Northern Ireland is highly anomalous and a good illustration of why the Government is wise to ensure that the coming FTA with the EU should replace the Protocol on Ireland and Northern Ireland.

The Protocol remains in place from the end of transition until a subsequent agreement is reached on a successor arrangement, or the democratic consent mechanic is triggered. The consent mechanism requires a vote by simple majority of those present, and voting in the Northern Ireland Assembly to continue with the arrangements anticipated by the Protocol. The first vote will be four years after the end of transition and each four years thereafter. For the period the Protocol is in place the Government would be wise to delineate in statute a conservative interpretation of the "affect that trade" concept, prohibiting notification to the Commission of aid measures to beneficiaries outside of Northern Ireland. If the EU disagreed and considered the Withdrawal Agreement granted it power over aid measures in Great Britain – despite the differential customs tariffs between GB and NI – it would then need to raise the matter via the Withdrawal Agreement's extensive dispute resolution mechanics.

If the approach advocated in this paper is adopted and the UK develops an independent subsidy control regime built on the SCM Agreement, only intervening against subsidies where there is evidence of harm to the UK internal market or trading partners, the UK can determine its own notification arrangements for aid measures outside Northern Ireland. There is no need to follow the Commission's process, and it can be improved upon in many respects. One attractive model would be a voluntary system where aid granting authorities or beneficiaries can notify the CMA to obtain legal certainty but there is no obligation to do so. This could be supplemented by a common database that UK aid granting agencies would complete with aid they intended to pay – starting a short window for the CMA to "call in" the aid on its own initiative. Such a system would mirror the existing EU GBER regime and UK merger regime and allow the CMA to focus on the most significant cases.

Review procedure

Even enthusiasts for EU State aid accept that the notification and review procedure is idiosyncratic and a product of historical legal development and political pressures – rather than systematic design. The process is not one that anyone would sensibly design for the purpose today. Defects include opacity, profound lack of due process for beneficiaries and complainants, sluggishness without legal certainty, excessive room for Commission discretion and inconsistency, vulnerability to gaming by Commission, Member States and (to a much lesser extent) beneficiaries.

The UK has an opportunity to make large procedural improvements – the vast majority of which are already present in CMA practice in mergers and antitrust. For instance:

- Transparent phase 1 and phase 2 investigations, publication of decisions to open both phase 1 and phase 2 investigations, publication of parties submissions and consultation responses;
- Formal rights to be heard by parties to the investigation;
- Statutory right to access to the CMA file and assess the evidence the case is built on;
- Statutory powers to collect information to support the investigation;
- Statutory timetables to phase 1 and phase 2;

- Judicial review of decision making before CAT within tight timetables – similar to the merger regime;

- Standing for parties to the original investigation or in respect of non-notified aid for anyone meeting the usual sufficient interest test for judicial review;

- Standing for damages claims in respect of non-notified aid against HMG or potentially even the aid beneficiary – provided causation and loss can be shown.

Substantive review

As noted above, a system based on the SCM Agreement will focus the substantive investigation on injury or serious prejudice to the UK internal market or WTO members. The EU State aid regime by contrast has no formal concern with prejudice to other WTO members and is solely concerned with intra-EU market effects. The EU regime also permits an explicit trading off or "balancing" between adverse effects on competition and trade vs. advantages for other EU objectives (regional cohesion or climate change policy etc.). This may of itself not be compliant with the SCM Agreement.

A UK subsidy control regime that looked only at an injury / serious prejudice test may not permit interventions which may generate significant countervailing benefits for the UK. This is a weakness but is unlikely to arise materially in practice because:

- Injury or prejudice requires evidence of actual effects – or at least such effects are likely on balance of probabilities. Conversely, the EU State aid regime requires no evidence of effects. The "balancing test" in the EU system primarily operates therefore to mitigate the effect of setting the intervention threshold so low in the first place.
- Subsidy is (generally) only an appropriate policy response when used to remedy an identifiable market failure. Market failure refers to characteristics of a market that prevent it from correctly pricing social costs or benefits. For example, research is generally priced too low (i.e. offers a rate of return that is below its total benefit) because the benefits to wider society are not captured by the private investor. Another example is where a market cannot provide a sufficient quantity of a public good (such as broadband in rural areas or energy storage capacity to maintain grid reliability during the switch to intermittent renewable generation). Used in this way subsidy is less likely to cause serious prejudice or injury to other WTO members because the benefit of a properly designed subsidy to remedy market failure in the UK is likely to be diffuse and not of a magnitude to cause displacement of another WTO member's goods. However, as the Airbus and Boeing WTO dispute saga has shown, it is still possible where subsidisation is large and affects sensitive traded products.
- The CMA will be able to impose remedies to mitigate any serious prejudice or injury that it anticipates. This would likely follow many of the principles developed by the European Commission in assessing State aid, for example prohibiting discrimination on grounds of nationality, granting subsidy following competitive processes, requiring results of publicly funded research to be made available. This reduces the likelihood of injury to trading partners.
- The CMA should also be entitled, consistent with WTO principles, to take into account subsidisation by other WTO Members with a 'matching' subsidy approach, as the EU's State aid rules allow in respect of support for R&D.[40]

[40] Framework for State Aid for research and development and innovation (2014/C 198/01), Paragraph 93.

- The CMA would be free to adopt the EU's explicit balancing test approach in respect of aid to services – since the SCM Agreement does not apply to services.

The supremacy of European law whilst a Member State means the Commission has sufficient power to prohibit State aid that is awarded even by primary legislation. Once the UK leaves the EU, the CMA and UK Courts will not be in an equivalent constitutional position – subsidy unambiguously granted by act of Parliament could not simply be prohibited by a decision of the CMA. The approaches to this issue merit a separate paper, but one solution could be for the CMA to opine on the subsidy consequences of a particular legislative proposal in a published report. Pressure would therefore be brought to bear on the design of subsidy schemes to ensure their compliance with the regime – while the ultimate decision rests with Parliament.

V

UK-EU FTA – Next Steps for the Negotiation

The EU has attached a high degree of importance to what it calls the "level playing field". The political declaration states that the Parties agreed: "*to uphold the common high standards applicable in the Union and the United Kingdom at the end of the transition period in the areas of state aid*".

Contrary to the EU's draft negotiating guidelines, the upholding of high standards does not require the UK to adopt the State aid acquis. A better and more agile policy framework can be adopted instead that still upholds the high standards committed to in the political declaration.

The battle is principally one of presentation. It is critical that the UK offer is fair, consistent with the political declaration and a good faith attempt at a balanced agreement on a "level playing field" – and presented as such. The EU will present any deviation from their State aid regime as an attempt at "unfair" competition or not a "level playing field". This is nonsense and must be robustly called out as such.

The approach proposed in this paper would create a new subsidy control regime that respects UK sovereignty and EU legal autonomy and provided the EU with a far higher standard of protection from subsidy distortion than is available in any free trade agreement anywhere in the world.

If the UK adopts a subsidy control regime as I have suggested, it could also choose to embed that in a treaty commitment with the EU - to meet their concerns about ensuring a level playing field. In return, the UK should also expect the EU to commit to using its existing State aid regime to prevent Member States using aid to the detriment of the UK.

A checklist for the UK government

In conclusion, the UK Government should, when designing a new system, take account of certain weaknesses in the EU's State aid regime and aim to avoid replicating these as it moves to a UK system in line with WTO rules. In particular, it should recognise that:

1. "State aid" and other EU legal concepts are unusable in any agreement where the interpretation of such concepts is to be exclusively adjudicated by the CJEU.

2. The EU State aid regime has a great number of flaws. A new UK regime to replace that of the EU along the lines above gives a great opportunity to remedy these and make a positive intellectual contribution to the international debate on how to assess Governmental support to companies.

3. Such a new UK regime can offer a high degree of "level playing field" protection to trading partners including the EU, without giving up decision making power or ceding responsibility for adjudication to the CJEU.

4. In particular, quick legislative action is needed to ensure that the ambiguity in the Northern Ireland Protocol is resolved satisfactorily. Any supposed requirement to notify State aid to beneficiaries in Great Britain to the European Commission following the end of transition would be highly damaging to the Government's freedom of action in rebalancing the economy.

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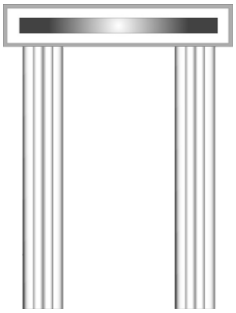

The Prime Minister has made clear that EU State aid laws will end after the transition. But the EU's draft guidelines for the forthcoming trade negotiation, published by the Commission, ignore this UK policy. They seek to apply the entirety of EU State aid law to the UK – adjudicated by the Court of Justice of the European Union – as if the UK never left the EU. In no other area is the EU's demand so extensive. Irrespective of the case made in favour or against State aid, the EU's position illustrates how important State aid is.

In *All Change? UK State Aid after Brexit - What Law? Whose Courts?*, James Webber, a Partner at Shearman & Sterling LLP, explains why the UK needs to leave the EU's State aid regime. Not only is the EU system frail and lacking transparency. But if the EU can control State aid, it can restrain the UK Government's ability to use public money to improve competitiveness and productivity.

He proposes a clearer, faster, more permissive regime, which will offer all the UK's trading partners including the EU, a level playing field while respecting the UK's sovereignty and the EU's legal autonomy.

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