

e-Competitions

Antitrust Case Laws e-Bulletin

June 2021

The UK Government publishes its long-awaited Subsidy Control Bill

STATE AID, UNITED KINGDOM, STATE AID (NOTION), ALL BUSINESS SECTORS, JUDICIAL REVIEW, COMPETENCE, COOPERATION AGREEMENT, STATE AID (NOTIFICATION), REFORM, COMPETITION POLICY, STATE AID (NATIONAL ENFORCEMENT)

UK Government, *Subsidy Control Bill*, Bill 135, 30 June 2021

Tim Briggs | Herbert Smith Freehills (London)

Morris Schonberg | Herbert Smith Freehills (London)

Eric White | Herbert Smith Freehills (Brussels)

Sean Giles | Herbert Smith Freehills (London)

e-Competitions News Issue June 2021

On 30 June 2021, the UK Government published its much-awaited Subsidy Control Bill. In this update, we explore the key aspects of the proposed UK subsidy control regime. We conclude with five key takeaways.

Overview of the UK regime

The Subsidy Control Bill establishes a UK subsidy control regime, in accordance with the UK's obligations under the EU-UK Trade and Cooperation Agreement ("TCA") [1].

Scope of the UK subsidy control regime

The Subsidy Control Bill adopts a definition of subsidy that closely follows the definition agreed under the TCA, which, despite differing wording, adopted substantially similar criteria as the definition of 'State aid' under EU law.

The Bill defines a subsidy as financial assistance which is given directly or indirectly from public resources by a public authority, and which:

- confers an economic advantage to one or more enterprises;
- is specific insofar as it benefits one or more enterprises over one or more other enterprises with respect to the production of goods or the provision of services; and

- has, or is capable of having an effect on: (i) competition or investment within the UK, (ii) trade between the UK and another country or territory, or (iii) investment between the UK and another country or territory.

This definition is in one sense wider than that under the TCA (and indeed than under international trade agreements generally) in that it catches subsidies that do not impact international trade but only have effects domestically in the UK. This reflects the broader policy aim of the regime – the protection of the UK’s own internal market, which has been an important feature of the Government’s post-Brexit agenda. The protection of the UK’s internal market also forms one of the seven subsidy control principles with which subsidies should comply (see below).

Subsidy control principles

The Subsidy Control Bill sets out seven ‘subsidy control principles’ which public authorities must consider prior to granting any subsidy. Public authorities are prohibited from granting subsidies unless the authority considers that the proposed subsidy complies with the principles.

The subsidy control principles include the six principles with which the UK is bound to comply under the TCA (which are themselves very similar to the compatibility principles under EU State aid law) as well as an additional principle on the protection of the UK internal market. The seven subsidy control principles are:

1. Subsidies should pursue a specific policy objective in order to remedy an identified market failure or to address an equity rationale (such as social difficulties or distributional concerns).
2. Subsidies should be proportionate to their specific policy objective and limited to what is necessary to achieve it.
3. Subsidies should be designed to bring about a change of economic behaviour of the beneficiary. That change should be conducive to achieving the specific policy objective of the subsidy, and should be something that would not be achieved without the subsidy.
4. Subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy.
5. Subsidies should be an appropriate policy instrument for achieving their specific policy objective and that objective cannot be achieved through other less distortive means.
6. Subsidies should be designed to achieve their specific policy objective while minimising any negative effects on competition or investment within the UK.
7. Subsidies’ beneficial effects in terms of achieving the specific policy objective should outweigh any negative effects, in particular negative effects on domestic competition or investment and international trade or investment.

The Bill also sets out the additional principles for energy and environmental subsidies from the TCA, as well as supplementary requirements in relation to other specific types of subsidies, such as rescue and restructuring subsidies and prohibitions on certain types of subsidies. This includes the prohibition of subsidies granted on condition that the beneficiary relocates all or part of its economic activities from one area of the UK to another, which is another embodiment of the UK internal market imperative underlying the new domestic subsidy control regime.

The Government has committed to publishing guidance to assist authorities to self-assess compliance with these principles.

‘Categories’ of subsidy and compliance ‘routes’

The Subsidy Control Bill provides for different ‘routes’ through which subsidies may be granted in compliance with the subsidy control regime. The relevant route depends upon the ‘category’ of the subsidy. Under the regime, subsidies are categorised as follows:

- **Low risk subsidies:** the Government proposes to set out categories of subsidies that are at low risk of distorting competition, trade or investment and create ‘streamlined subsidy schemes’ for these subsidies. Where a streamlined subsidy scheme route is available for a particular subsidy, public authorities will only need to demonstrate that the subsidy meets the specific compliance criteria for the scheme but will not need to assess compliance specifically against the seven subsidy control principles.
- **‘Baseline route’:** this is the ‘default’ position whereby public authorities will be required to self-assess compliance against the subsidy control principles prior to granting any subsidy.
- **Subsidies of Interest:** ‘Subsidies of Interest’ are those subsidies that are more likely to affect competition, trade or investment, including by reference to the value of the subsidies and the sector in which the intended beneficiaries will operate. Subsidies of Interest are to be defined via secondary legislation at a later date. Public authorities proposing to grant a Subsidy of Interest will be able to make a voluntary referral for non-binding advice from the Subsidy Advice Unit – which will form part of the Competition and Markets Authority (the “CMA”). The advisory report will evaluate the compliance of the proposed subsidy with the applicable principles and requirements.
- **Subsidies of Particular Interest:** ‘Subsidies of Particular Interest’ are those subsidies that are likely to be at the highest risk of affecting competition, trade or investment. Subsidies of Particular Interest will be subject to a mandatory referral to the CMA and public authorities will not be able to award such subsidies until they have received advice from the CMA. Subsidies of Particular Interest will also be defined by secondary legislation.

In addition to the voluntary and mandatory referral processes, the Secretary of State for Business, Energy and Industrial Strategy will have a ‘call-in’ power whereby they can direct that a public authority seeks advice from the CMA. The Secretary of State will have jurisdiction to make a call-in direction in respect of Subsidies of Interest, and any other subsidy where the Secretary of State considers that there is a risk of non-compliance with the applicable principles or requirements, or a risk of negative effects on competition or investment within the UK. A call-in direction can be made before or after a subsidy is awarded.

The CMA review process under each of the voluntary, mandatory and call-in routes will be 30 working days, subject to an extension of up to 40 working days. The clock will not start until the CMA has confirmed that it has all the information it requires to conduct the review, which as a practical matter may extend the timeframe considerably.

Certain categories of subsidy will be exempted from the regime entirely. This includes: (i) de minimis subsidies (i.e. financial assistance of less than £315,000 over three years), (ii) subsidies granted in response to a natural disaster or for national security, and (iii) subsidies of less than £725,000 over a three year period granted to providers of Services of Public Economic Interest – e.g. entities entrusted with a public service obligation.

Judicial review of subsidies awarded by UK public authorities

The Subsidy Control Bill provides for the Competition Appeal Tribunal (“CAT”) to be the court of first instance for legal challenges to subsidies granted by UK public authorities. The Bill provides that challenges may be brought by persons whose “interests are affected” by the grant of a subsidy (e.g. competitors of a beneficiary) or the Secretary of State. The CAT’s review powers will be limited to the judicial review standard, rather than a review ‘on the merits’.

The CAT will have the power to order public authorities to recover subsidies that have been granted unlawfully, similar to the position with respect to unlawfully granted State aid under EU law. The Bill does not otherwise mandate any specific types of relief for subsidies. It is anticipated that early litigation before the CAT is likely to focus upon the scope of review and the appropriate relief to be granted where subsidies have been granted unlawfully.

Trade between the EU and Northern Ireland

Under the EU-UK Withdrawal Agreement, the EU State aid rules continue to apply in the UK in respect of measures which affect trade between the EU and Northern Ireland and so the UK subsidy control regime will apply subject to these rules.

Five key takeaways

- **Greater scope for political intervention**

The proposed call-in power for the Secretary of State under the Subsidy Control Bill reflects a trend towards conferring on Government greater powers of intervention seen elsewhere in post-Brexit legislation. The Government’s right to initiate reviews of subsidies will sit alongside, for example, the Government’s power to review transactions on national security grounds and its position as the final decision-maker under the UK’s trade defence regime.

It remains to be seen how ‘trigger happy’ the Secretary of State will be, but the Government has consistently stated that it does not “*intend to return to the 1970s approach of Government trying to run the economy or bailing out unsustainable companies.*” However, with the Scottish Government having *expressed concerns* that the regime “*remove[s] power over subsidy control from devolved legislatures*”, any exercise of the call-in right in respect of subsidies granted in Scotland is likely to prove controversial.

- **Role of the CMA: a de facto pre-approval process for certain subsidies?**

While the CMA will not be responsible for the approval or otherwise of proposed subsidies, the existence of a mandatory referral regime could in effect create a notification regime for certain subsidies (i.e. Subsidies of Particular Interests, or subsidies subject to a call-in by the Secretary of State). As the CMA’s report under the referral process must be published and delivered to the Secretary of State, it also puts the Government on notice of any subsidy voluntarily referred to the CMA for advice (to the extent it is not already aware). As such, it provides scope for the Secretary of State to engage informally with a public authority if they have a particular view on the CMA’s advice and/or any proposed amendments to a subsidy.

While there is no ability for the CMA or the Secretary of State to prohibit the grant of a subsidy, there is a so-called 'cooling off period' which is intended to enable the public authority to reflect on the CMA's findings before granting the subsidy. As it is unlikely that a public authority would grant a subsidy if the CMA were to find that a subsidy was not compliant, this referral procedure could create in effect a pre-approval process for 'high risk' subsidies.

The process for the mandatory and voluntary referral regime is substantially the same, save that under the voluntary regime it is possible for the public authority to grant the subsidy before it receives a report from the CMA. The referral process comprises the following steps:

- the public authority submits a request for a report from the CMA. This report must be requested before the relevant subsidy is granted, and must comply with certain information requirements and be in the form to be specified by future regulations. The Bill states that the request must include among other things the public authority's self-assessment of compliance;
- the CMA must within five working days of receipt of the request for a report provide notice to the public authority that the request: (i) complies with the information requirements of the referral request, or (ii) does not so comply (including the reasons for why);
- once a request is accepted as complete, the CMA must within a 30 working day 'reporting period' produce a report setting out: (i) its evaluation of the public authority's self-assessment of compliance with the subsidy control regime, (ii) advice on how the public authority could improve its self-assessment, and (iii) advice on how the subsidy can be modified to ensure compliance with the regime. This 30 working day period may be extended by up to 40 working days by the Secretary of State in the case of a mandatory referral or call-in, or in the case of a voluntary referral any such period as agreed with the referring public authority;
- a five working day 'cooling off period' is initiated for subsidies subject to a mandatory referral process (i.e. Subsidies of Particular Interest or subsidies called-in by the Secretary of State).

For subsidies that are called-in by the Secretary of State after they have been awarded, the reporting period is shortened to 20 working days.

While these timescales appear relatively short, there is scope for the CMA to delay 'starting the clock' if it has not received a complete referral request from the public authority. This may mean that in practice there is 'pre-notification' dialogue with the CMA prior to submitting a request for a report, as is the case with notifications made to the CMA under the UK merger control regime.

With the CMA also responsible for operating the Office for the Internal Market under the UK Internal Market Act, the CMA will be scaling up resources to ensure it is able to fulfil these additional post-Brexit functions.

- **A UK internal market imperative**

The inclusion of an additional subsidy control principle for the protection of the UK internal market and the prohibition of subsidies conditional on relocation of economic activities between different parts of the UK reflects the Government's desire to avoid what it calls "subsidy races" between different areas of the UK. This is a phenomenon that occurs frequently in the US (which has no domestic subsidy control regime). For example, *Amazon has been accused of 'shopping around' for the best tax breaks* ²⁸ for a proposed headquarters.

This kind of internal market imperative already existed under EU State aid law, which assessed the potential location effects of State aid in terms of displacement of economic activities and took a strict approach to aid which simply led to a change in the location of economic activities within the EU's internal market.

These kinds of considerations will now be applied on a UK-wide basis under the UK's subsidy control regime. It remains to be seen however, how these principles will be applied in the case of aid to promote the economic developments of relatively disadvantaged areas, which is an area where complex rules apply under the EU State aid regime.

- **Self-assessment: from qualification to compatibility?**

The jurisdictional thresholds of the regime are broad – with the 'effect on trade' jurisdictional limb of the definition of subsidy only requiring that financial assistance is 'capable' of affecting 'competition or investment' within the UK or 'trade or investment' between the UK and a third country. It is anticipated that the threshold will be low and would be met in most cases, much in the same way that it is in practice under the EU State aid rules.

Coupled with the emphasis on self-assessment instead of notification, compliance assessment under the new regime is likely to become more focused upon compatibility (i.e. compliance with the principles) rather than qualification (i.e. whether or not financial assistance is within scope of the definition of subsidy).

This differs from the conventional approach taken to compliance under the EU State aid regime – where public authorities typically seek to avoid the notification requirement by structuring proposed aid so that it 'fits' within a Block Exemption Regulation or is not qualified as "State aid" and therefore falls outside of the ambit of the EU State aid rules altogether. The UK Government has emphasised that it will not create block exemptions under the UK regime, saying it is taking a "bespoke UK approach" – the guidance for which emphasises that it is *risk-based*²⁸, with this risk assessed by reference to the value of a proposed subsidy and the intended beneficiaries.

Under the UK regime, public authorities will be responsible for deciding whether or not to award a subsidy (based upon input from the CMA where relevant). In practice, however, it is likely that public authorities will seek to 'push' assessment of subsidy control compliance to beneficiaries. Beneficiaries should therefore ensure that they obtain appropriate advice prior to the receipt of any subsidy, in particular in light of the potential for the CAT to order the recovery of any unlawfully granted subsidy from a beneficiary.

- **More is still to come**

It is likely that there will be debate as the Bill passes through Parliament regarding the scope for Government intervention, and the extent of the CAT's powers of review. The extent to which the Bill will be passed in its current form therefore remains to be seen, but the key aspects of the regime are unlikely to be amended to any significant degree.

The Bill also provides for the making of statutory instruments, including regulations defining the meaning of 'Subsidies of Particular Interest' and 'Subsidies of Interest' and issuing guidance in relation to the applicable principles and requirements. This will be key to understanding when public authorities will be expected to undertake a more extensive and involved subsidy control analysis, which in a particular case may extend to seeking the views of the CMA, and how compliance with the applicable principles and requirements will be assessed.

[1] See *Tim Briggs, Lode Van Den Hende, Mark Jephcott, Eric White, Morris Schonberg, The UK Government and the EU Commission issue a trade and cooperation agreement clarifying the subsidy control regime following the end of the Brexit transition period, 31 December 2020, e-Competitions December 2020, Art. N° 99656.*