

New year, new-ish state aid rules: the new subsidy control regime

Until a formal subsidy regime is put in place funding bodies must grapple with the complex and challenging exercise of legal obligations from the UK-EU TCA and numerous trade agreements to grant funding.

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UK-EU TCA and revocation of EU state aid rules

On 24th December the UK and EU reached an agreement in principle with the 'UK-EU Trade and Cooperation Agreement' (UK-EU TCA).

The UK government ratified it and enacted the European Union (Future Relationship) Act 2020. The EU gave its provisional approval with formal ratification to follow. At the same time, the UK government enacted secondary legislation (The State Aid (Revocations and Amendments) (EU Exit) Regulations 2020), which revoke EU State aid rules in the UK including all relevant regulations, safe gateways to grant aid and all applicable guidance with effect from 31st December 2020 (subject to the provisions of the Northern Ireland Protocol – see below).

However, while the old EU State aid rules have gone (for the most part), the UK remains committed to applying the new subsidy control principles in the UK-EU TCA. Funding bodies must grapple with the UK's legal obligations related to State aid/subsidy control emanating from the UK-EU TCA and from numerous trade agreements and apply them to potential subsidy measures to ensure that they are lawful and do not breach those obligations. Until a formal subsidy control regime is put in place in the UK, this could be a complex and challenging exercise.

The UK-EU TCA provides, amongst other things, certain principles that should underpin any new subsidy control regime which may replace the EU State Aid rules (with limited exceptions.) Those principles are likely to be the most relevant to funding bodies as they are now implemented into domestic legislation.

The UK, as a member of the World Trade Organisation, continues to be subject to commitments and agreements - the most relevant here being the World Trade Organisation Agreement on Subsidies and Countervailing Measures (WTO ASCM) which makes provision in relation to subsidy control and for countries impacted by subsidies to seek redress. In addition, the UK has signed numerous Free Trade Agreements (FTAs) with other countries which must be considered when granting subsidies, as they may include provisions on subsidies.

Further, the Northern Ireland Protocol (NIP) will need to be considered where a measure may affect trade between Northern Ireland and the EU. Through the NIP, EU State aid rules will apply in certain, limited circumstances which are relevant to trade between NI and EU. The Northern Ireland Protocol Command Paper published by UK Government provides that subsidies will be within scope of the State aid rules in the NIP where there is a 'genuine and direct' link to NI, and a 'real foreseeable' impact on trade between NI and the EU. However, the interpretation of the protocol itself is broadly reserved to the European Institutions and it is worth being aware that the concept of 'affecting trade' in EU law sets a very low bar for application of the rules. There are also limited other circumstances in which the EU State aid rules continue to be relevant, for example in respect of measures already entered into under the old rules.

Technical guidance issued by the UK government

On 31st December, the [UK government published guidance](#) to assist funding bodies in understanding what international subsidy control commitments and related obligations the UK has as of 1st January 2021. All funding bodies must comply with these obligations when awarding subsidies.

From 1st January, funding bodies must determine whether their proposed subsidy carries any 'appreciable risk' of triggering any dispute under the WTO ASCM rules or the UK's FTAs, as well as the UK-EU TCA and the NIP. They must also assess whether the proposed subsidy falls within the scope of any national subsidy control system that is established through primary or secondary legislation (although this is not yet in place).

Funding bodies must undertake their own analysis on a case by case basis to determine whether their proposed measures breach any of the international obligations. The guidance provides useful information that will help funding bodies when undertaking a review of proposed measures. However, the guidance makes it clear that it is not providing a definitive method for determining whether international and domestic legal obligations apply to a proposed subsidy and that the individual instruments themselves should be considered. It is worth noting that we are already seeing funding bodies applying for central government funding for State aid schemes being asked to revisit their State aid compliance statements to deal with the new rules.

The guidance provides a five-step process for analysing the position:

1. Determine whether a measure is a subsidy and what international obligations are relevant.
2. Evaluate whether the measure is a prohibited subsidy.
3. If in scope of the UK-EU TCA, assess the subsidy against the principles.
4. Assess the likelihood of triggering a dispute under the WTO ASCM rules and other FTA's.
5. Record the award of a subsidy.

What is a subsidy?

The WTO ASCM sets out its definition of a subsidy at Article 1, which can be summarised as a financial contribution provided by a public authority (including any public body) which confers a benefit on the recipient. A financial contribution includes (but is not limited to) measures such as a direct transfer of funds, such as a loan, potential transfers of funds, for example a guarantee and foregone revenue (not collecting debts or taxes which would otherwise be due).

In order to be a subsidy, a measure must be specific, meaning that it is targeted at a particular enterprise or industry or group of enterprises or industries within the jurisdiction of the granting authority. However, it is worth being aware that the WTO ASCM applies to goods-based activity only, whereas other agreements (for example the UK-EU TCA) apply to goods and services.

Are any subsidies prohibited?

Certain subsidies are prohibited or subject to further conditions set out in the UK-EU TCA, other FTAs and the WTO ASCM. These are flagged in the guidance but should be checked on a case by case basis as the detail of each prohibition is not included within the guidance.

What are the principles a subsidy must comply with?

The UK-EU TCA contains a number of principles which aim to ensure that subsidies are not granted where they have, or could have, a material effect on investment or trade. Many other FTAs contain similar principles, aimed at avoiding subsidies being granted which have anti-competitive effects on trade between the parties to the FTA. As set out above, the UK-EU TCA will be the most relevant to funding bodies as it is incorporated into domestic law and so imposes legal duties. Any principles contained within the UK-EU TCA and/or any FTA must be followed and applied on a case-by-case basis, subject to any exemptions which apply.

The principles set out within the UK-EU TCA:

- subsidies pursue a specific public policy objective to remedy an identified market failure or to address an equity rationale such as social difficulties or distributional concerns ("the objective");
- subsidies are proportionate and limited to what is necessary to achieve the objective;
- subsidies are designed to bring about a change of economic behaviour of the beneficiary that is conducive to achieving the objective and that would not be achieved in the absence of subsidies being provided;
- subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy;

- subsidies are an appropriate policy instrument to achieve a public policy objective and that objective cannot be achieved through other less distortive means;
- subsidies' positive contributions to achieving the objective outweigh any negative effects, in particular the negative effects on trade or investment between the Parties.

These principles were already embedded into the previous State aid regime – particularly in the case of GBER. The UK-EU TCA also sets out guidance dealing with specified areas such as transport and R&D. Usefully, there is also an increased 'de minimis' limit of 325,000 Special Drawing Rights (just under £350,000).

For subsidies which are in scope of the UK-EU TCA, as a matter of best practice, funding bodies are advised to complete the template included in Annex 2 to the guidance, which records their compliance with the principles in designing the subsidy. This should be retained for record and may be requested by the EU or by an interested party. Public bodies should be aware that other subsidy control instruments may also contain provisions on transparency and consultation which should be considered when granting any subsidy.

How likely is it that a subsidy will trigger a potential challenge?

The Guidance provides that funding bodies must assess any proposed subsidy against any UK FTAs (including the UK-EU TCA), and the WTO ASCM rules. Any subsidy may be subject to challenge through the relevant mechanisms if the other country evidences that the subsidy causes actual adverse effects on their interests.

However, the more likely risk would be a domestic challenge to the subsidy. Until a new regime is implemented this is most likely to take the form of a judicial review action and this is expressly anticipated in the guidance.

How should a subsidy be awarded?

Unlike the EU State Aid rules currently there is no requirement under the UK-EU TCA to notify subsidies to a body for approval before awarding the subsidy. This may change once a national subsidy control system, including an independent body is created. Similarly, there is no prior approval mechanism under the WTO ASCM. However, funding bodies should be aware that if a measure is caught by the EU State aid rules as a result of the application of the Northern Ireland Protocol, the usual requirement to notify the Commission unless the measure is subject to an exemption will apply.

Funding bodies should consult relevant legislation and carry out a proportionate assessment in making the decision to award any subsidy and ensure this is recorded in accordance with the guidance and the terms of the relevant international instrument if applicable. Eventually this may be collected by BEIS as part of its planned transparency database.

Concluding remarks

Any subsidies which were lawfully entered into under the EU State aid rules prior to 1st January will be compliant and will not require any further review.

For projects where State aid advice was obtained before 1st January, but the aid has not yet been awarded, e.g. where a grant agreement has not been entered into, the funding body will need to consider whether the funding continues to be lawful under the new regime. There may also be projects where a funding body was awarded "upstream" funding (e.g. from central government) but where it has not yet awarded that funding "downstream" (e.g. to a different delivery body). In these circumstances, the funding body may need to consider both the old and the new rules in relation to the project in question.

Where a funding body has relied on an exemption in the past (e.g. under GBER), it is possible that this can be relied upon in applying the principles set out in the UK-EU TCA. However, this should be carefully cross checked to ensure compliance with the principles and also needs to be considered in the light of the WTO ASCM and the FTAs.

It is likely that the guidance on subsidy control will be updated to take account of new FTAs, as well as the launch and use of the database to record subsidies, the role and functions of the independent body which is responsible for any new subsidy control system and on the role of the courts in subsidy cases.

We can expect the UK government to begin a consultation shortly with proposals for a national subsidy control regime, which is not only important for compliance with international obligations but also to establish a national framework for all parties involved that is clear and

workable.

If you have any questions on these latest developments, including the technical guidance, please do get in touch.

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