

# Continuity or change? State aid control in a post-Brexit United Kingdom

Morris Schonberg<sup>1</sup>

## Introduction

Eight months or so on from the referendum on membership by the UK of the EU and the 'leave' vote, some of the parameters of the UK's new trade relationship with the EU post-Brexit have started to emerge. While the UK government has sought to limit discussion as to its approach to the forthcoming EU exit negotiations, repeatedly emphasising that it will not be providing a 'running commentary', as this would not be in the UK's best interests,<sup>2</sup> the government has recently outlined its stance in relation to a number of headline issues. In particular, for present purposes, the government has confirmed that the jurisdiction of the Court of Justice of the European Union (CJEU) and the primacy of EU law in the UK will end and that the UK will no longer be part of both the EU internal market and the customs union.<sup>3</sup> This means that there will be real, substantive changes to the current status quo.

It remains to be seen whether the government will release further material details in relation to its position as it moves to commence the EU exit negotiations. However, notwithstanding the government's relative reticence thus far, there has already been a sustained and lively debate within wider civil society in the UK as to numerous aspects of the new order post-Brexit, touching upon issues such as the possible retention of EU passporting rights for UK financial services firms, UK-Irish relations, UK agriculture and fisheries policy and the UK immigration system.<sup>4</sup> That being said, the subject of this article, the future of the State aid rules in a post-Brexit UK, has not attracted much attention thus far; although the EU State aid rules featured as part of the referendum debate, being raised by the Leave side in the context of the difficulties faced by the UK's steel industry,<sup>5</sup> there has only been relatively preliminary discussion of their fate in the post-Brexit landscape.<sup>6</sup>

This article seeks to fill this space. Rather than simply sketching out the various possible alternatives in abstract, it considers the issue from the perspective of the main rationales

- 1 Senior Associate, Herbert Smith Freehills LLP, London and PhD Candidate in EU Competition Law and International Trade Law, London School of Economics and Political Science. I would like to thank Lode Van Den Hende, Eric White and Jérémie Charles for their helpful comments on an earlier draft and Leah Soloway for research assistance. All views and any errors are mine alone. The text of this article was finalised in February 2017.
- 2 See, eg, the Prime Minister's evidence to the House of Commons Liaison Committee (20 December 2016): 'I have been clear that I will not give a running commentary on our approach to the negotiations, because it is not the way to get the right deal for Britain.'
- 3 See the Prime Minister's speech in relation to the government's negotiating objectives for exiting the EU (17 January 2017) and HM Government, 'The United Kingdom's exit from and new partnership with the European Union', White Paper (2 February 2017), available at [www.gov.uk/government/publications/the-united-kingdoms-exit-from-and-new-partnership-with-the-european-union-white-paper](http://www.gov.uk/government/publications/the-united-kingdoms-exit-from-and-new-partnership-with-the-european-union-white-paper). These positions were foreshadowed in a number of earlier statements, in particular the Prime Minister's speech to the Conservative Party Conference (5 October 2016) and her evidence to the House of Commons Liaison Committee (20 December 2016).
- 4 In particular, the House of Lords European Union Committee has published a series of comprehensive reports on a number of these areas; see, for example, 'Brexit: financial services', HL Paper 81 (14 December 2016).
- 5 See, eg, *BBC News*, 'Boris Johnson on Brexit, steel and Wales' (14 June 2016), available at [www.bbc.co.uk/news/uk-wales-politics-36532871](http://www.bbc.co.uk/news/uk-wales-politics-36532871); and *City AM*, 'Michael Gove says a Leave vote would mean the UK is able to more flexibly intervene in failing sectors' (16 June 2016), available at [www.cityam.com/243514/michael-gove-says-leave-vote-would-mean-uk-able-more](http://www.cityam.com/243514/michael-gove-says-leave-vote-would-mean-uk-able-more).
- 6 Notable exceptions include G Peretz, *A Star is Torn: Brexit and State Aid* (2016) 15 *European State Aid Law Quarterly* 334; and G Peretz and K Bacon, 'Paper on post-Brexit options for State aid' (16 November 2016), available at <http://uksala.org/paper-on-post-brexit-options-for-state-aid/>.

underlying the existing EU State aid rules, which are concerned not only with international trade policy but also in promoting undistorted competition. While it is widely appreciated that the EU State aid rules are part of the fabric of the EU internal market, their specific function in this context and consequently their relationship with the issue of EU internal market access in the context of the EU negotiations is less well understood. On the other hand, the competition dimension of the EU State aid rules is less frequently appreciated altogether, yet it constitutes an important justification for the system to which the current UK government may be receptive, irrespective of the negotiations with the EU. Given these considerations, it seems possible that State aid rules quite similar to the existing EU State aid rules may continue to apply, in one form or another, in the UK post-Brexit.

### **Brexit ‘floors and ceilings’: the EU State aid rules and the WTO anti-subsidy rules**

The two main systems of international subsidy control currently in existence are the EU State aid rules and the World Trade Organisation (WTO) anti-subsidy rules. The EU State aid rules,<sup>7</sup> overseen by the European Commission (‘Commission’), apply to EU Member States only and are composed of Arts 107–109 TFEU and various EU Council and Commission regulations and guidelines. For this reason, the EU State aid rules will cease to apply to the UK once it departs from the EU, unless they are replaced with other instruments that are binding on a post-Brexit UK.

The WTO anti-subsidy rules apply to all 164 WTO Members, ie the great majority of countries, including all EU Member States and the EU itself, which is responsible for all of its Member States before the WTO.<sup>8</sup> The WTO anti-subsidy rules are set out, in main part, in the WTO Agreement on Subsidies and Countervailing Measures (‘SCM Agreement’).<sup>9</sup> The WTO anti-subsidy rules currently apply to the UK (although for all practical purposes they apply at the level of the EU, as the EU is responsible for all of its Member States before the WTO) and they will continue to apply to the UK post-Brexit when the UK attains a WTO Member status that is separate to the EU. The WTO anti-subsidy rules and the EU State aid rules therefore effectively form the ‘tramlines’ for what State aid strictures might apply in the UK post-Brexit.

### **The EU State aid rules and WTO anti-subsidy rules in overview: substantive and procedural aspects**

Both the EU State aid rules and the WTO anti-subsidy rules are aimed at various types of State intervention in the national economy that constitute either ‘State aid’ or ‘subsidies’. These concepts are defined in a broadly similar manner under both sets of rules. There must be, essentially: (i) a State measure; (ii) that provides a financial or economic advantage or benefit; (iii) through ‘State resources’ or by way of a ‘financial contribution’ from the State; (iv) such benefit being ‘selective’ or ‘specific’ to certain beneficiaries or industries; and (v) having some adverse effect on competition and/or inter-State trade.<sup>10</sup> These criteria have, however, been interpreted and applied in rather different ways under the two sets of rules.

In particular, under the EU State aid rules, the *effect on competition and trade criterion* has been interpreted in a very liberal manner. In most cases, it is sufficient simply to show that:

7 EU State aid control has been a feature of the EU legal framework since the establishment of the European Economic Community, as it then was, through the 1957 Treaty of Rome.

8 Due to issues concerning competence, both the EU and the EU Member States, separately, became original members of the WTO. However, the EU now has exclusive external competence for almost all matters covered by the WTO agreements.

9 The specific rules in relation to the agricultural sector are also set out in the WTO Agreement on Agriculture, while the residual rules are set out in Arts XVI and VI of the General Agreement on Tariffs and Trade (GATT).

10 See Art 107(1) TFEU and SCM Agreement, Arts 1–3 and 5. For an in-depth analysis and comparison, see L Rubini, *The Definition of Subsidy and State Aid – WTO and EC Law in Comparative Perspective* (Oxford University Press, 2009).

(i) the aid releases the beneficiary from costs which it would normally have to bear in its day-to-day management or normal activities; and (ii) the beneficiary itself is either active in trade between EU Member States or, if it is not, that it is conceivable that it is in competition with operators established in other Member States;<sup>11</sup> this is, of course, the case for the great majority of sectors in today's EU internal market.<sup>12</sup> While a *de minimis* threshold exists, it is very low, being only €200,000 in value of aid granted to a single undertaking over a period of three years.<sup>13</sup>

Under the WTO anti-subsidy rules, by contrast (and although there are two categories of subsidies that are prohibited without regard to their effects, ie export and import substitution subsidies,<sup>14</sup> which are deemed distortive of trade by their very nature<sup>15</sup>), for a subsidy to be challengeable generally, material injury or the threat thereof to another Member's domestic industry or serious prejudice to its interests must be rigorously demonstrated.<sup>16</sup>

The EU State aid rules have also been applied more expansively, and thereby more intrusively, to Member States' taxation arrangements. This is typified by the Commission's recent high-profile investigations into the tax ruling practices of Member States in relation to multinational companies, including the tax rulings issued by Ireland in favour of the Apple group, leading to a recent Commission recovery order of potentially up to €13 billion plus interest,<sup>17</sup> which is a matter of some controversy. In addition, it is important to appreciate that the WTO anti-subsidy rules only apply to trade in goods, while the EU State aid rules apply to any benefit granted to 'economic undertakings' and are thus not restricted to trade in goods alone.<sup>18</sup> For these reasons, the substantive scope of the EU State aid rules is considerably wider than the WTO anti-subsidy rules.<sup>19</sup>

11 See, for example, *Commission v Italy and Wam* (Case C-494/06 P) EU:C:2009:272, [2009] ECR I-3639, at paras 50–54. This case effectively represents the high watermark for the effect on inter-State trade criterion, in that the CJEU criticised the Commission for not providing a sufficient statement of reasons in relation to aid in the form of an Italian export facilitation programme for exports to the Far East, in circumstances where the aid in question was of relatively low value and was not directly connected to the beneficiary's activity on the EU internal market, but was intended to finance its projects to penetrate the markets of third countries: see para 62.

12 As part of the Commission's recent State aid modernisation initiative (launched in May 2012) the Commission has, in its own enforcement practice, accorded greater significance to the assessment of the impact on trade between EU Member States with a view to focusing the Commission's resources on enforcing the State aid rules in cases with the biggest impact on the EU internal market and reducing the administrative burden for public authorities and companies. The Commission's enforcement approach does not, however, change the legal definition of State aid for the purposes of Art 107(1) TFEU, which is enforceable in the national courts of the EU Member States.

13 Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 TFEU to *de minimis* aid (2013) OJ L 352/1, Art 3(2).

14 SCM Agreement, Art 3.

15 Notwithstanding their treatment under WTO law, there is, in fact, some disagreement between economists as to the desirability of export subsidies: see, eg, Rubini, n 10, above, at pp 44–46.

16 See SCM Agreement, Arts 5 and 6, footnote 45 and Art 15, which set out the definitions and methodological considerations involved. For an example of this assessment in practice, see the WTO Panel Report in *EC and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/R (30 June 2010), at pp 833–1045, which was one part of the long-running EU and US Airbus/Boeing subsidy dispute at the WTO. By contrast, in Commission State aid decisions, the section examining the competition and trade criteria typically does not run beyond two pages.

17 *State aid implemented by Ireland to Apple* Case SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) (30 August 2016); and see Commission press release, 'State aid: Ireland gave illegal tax benefits to Apple worth up to €13 billion', IP/16/2923 (30 August 2016) for the possible recovery amount referred to. This decision is under appeal: *Ireland v Commission* (Case T-778/16) and *Apple Sales International and Apple Operations Europe v Commission* (Case T-892/16).

18 The WTO General Agreement on Trade in Services (GATS) obliges Members to enter into negotiations to develop the necessary multilateral disciplines in relation to subsidies affecting trade in services and appropriate procedures. However, no material progress has yet been made in relation to this. The GATS also allows a Member which considers that its services industry has been adversely affected by another Member to request consultations. However, that Member is only required to accord such consultations 'sympathetic consideration': GATS, Art XV.

19 This notwithstanding, for some time it was thought that the WTO anti-subsidy rules might be slightly broader than the EU State aid rules in relation to the 'financial contribution or state resources' criterion in so far as the EU State aid rules required that the measure must involve resources belonging to the State, a requirement that was emphasised by the CJEU in its landmark judgment in *PreussenElektra* (Case C-379/98) EU:C:2001:160, [2001] ECR I-2099. However, the notion of 'through state resources' under EU State aid law has since been expanded, such that it would cover, in the great majority of cases, even State regulatory measures that require the redistribution of private financial resources from one

The most significant difference between the EU State aid rules and the WTO anti-subsidy rules lies, however, in their institutional and procedural aspects. Under the EU State aid rules, any measure that fulfils the State aid definitional criteria cannot, subject to certain prescribed exemptions, be implemented unless it is notified to, and approved as ‘compatible’ State aid by, the Commission.<sup>20</sup> State aid control is thus *ex ante*. State aid that has been granted in breach of this ‘standstill obligation’ is ‘unlawful aid’ and is subject to recovery by the Member State with interest; this may be enforced by private parties, such as competitors of the beneficiary of aid, in the national courts. As a result, EU State aid control is a powerful tool and compliance, while variable as between different EU Member States, is relatively good.

By contrast, subsidy control as such under the WTO anti-subsidy rules is primarily *ex post* and is relatively weak. Subsidies within the scope of the WTO anti-subsidy rules may be challenged under one of two ‘tracks’:<sup>21</sup> (i) through the inter-State WTO dispute settlement mechanism<sup>22</sup> (the ‘multilateral track’); or (ii) through the State impacted by the subsidies imposing countervailing duties on the subsidized products, in accordance with the rules under the SCM Agreement<sup>23</sup> (the ‘unilateral track’). Under both tracks, remedies are prospective only: there is generally no recovery of any subsidies received. There is also no possibility of private enforcement of the WTO rules in the national courts; instead, private complainants must persuade a WTO Member government or investigating authority (in the cases of the multilateral and unilateral tracks respectively) to take action, and such State may have in mind other economic, or indeed political, interests in deciding whether to act.

Finally, it should be noted that the assessment of compatibility (or ‘approval’) stage is a feature of the EU State aid framework only; under the WTO anti-subsidy rules there is no possibility for potentially trade-distortive subsidies to be ‘approved’.<sup>24</sup> The notion at the heart of the EU State aid compatibility assessment in most cases is that of market failure,<sup>25</sup> ie is the State aid targeted at addressing a genuine situation in which markets, if left to their own devices, are unlikely to produce ‘efficient’ outcomes in terms of, for example, environmental protection, research and development and innovation, and rescuing and restructuring a failing firm where the social fall-out would outweigh the adverse effects of the restructuring aid. In addition, the Commission will also test whether the aid has an incentive effect on the beneficiary, is proportionate (in that it is limited to the minimum necessary) and does not *unduly* distort competition and trade between EU Member States, ie it will consider whether the positive impact of the aid outweighs any negative impact on competition and trade (the ‘balancing test’).<sup>26</sup>

## The rationale for the EU State aid rules

There are thus significant and far-reaching differences between the substantive, procedural and institutional dimensions of the EU State aid rules and the WTO anti-subsidy rules. These

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private entity to another, where those resources are redistributed through a public or private entity designated by the state to channel them to the beneficiaries; see, for example, *Essent Netwerk Noord* (Case C-206/06) EU:C:2008:413, [2008] ECR I-5497. This has significantly narrowed any possible discrepancy in scope as to this criterion.

20 Article 108(3) TFEU.

21 While these tracks may be run simultaneously, ultimately, only one form of relief may be made available.

22 See WTO Understanding on Rules and Procedures Governing the Settlement of Disputes, as supplemented by the SCM Agreement, Arts 4 and 7, which provide for specific elements in the case of subsidies disputes, including a more streamlined procedure.

23 See SCM Agreement, Pt V.

24 It should be noted that under the SCM Agreement, Art 25, Members are required to notify all subsidies to the SCM Committee, one of the Committees provided for under the WTO Agreements, ostensibly for transparency and information purposes. However, it would appear that compliance with this obligation is far from universal.

25 See the Commission’s Common Assessment Principles, which were developed as part of the Commission’s State Aid Modernisation programme (see Commission Communication on State aid modernisation, COM(2012) 209, para 18) and have been applied to most of the Commission’s current State aid guidelines.

26 *Ibid.*

differences are due to many factors, including the very different political contexts in which they operate,<sup>27</sup> but also their underlying rationale.

The rationale for the EU State aid rules is essentially two-fold.<sup>28</sup> On the one hand, as the EU courts have themselves consistently affirmed, the aim of the EU State aid rules is to prevent trade between EU Member States from being impacted by certain aid measures taken by national governments,<sup>29</sup> ie the *'trade' rationale*. On the other hand, and this is where the rationale underlying the EU State aid rules may differ from the WTO regime, the EU State aid rules reflect an acceptance that the baseline for economic life across the EU internal market as a whole is that of the market mechanism, free of distortions, ie the *'competition' rationale*.

In relation to the *'trade' rationale*, the EU State aid rules and the WTO anti-subsidy rules have a common objective, in so far as they provide for controls that are designed to prevent negative spill-over effects arising in other countries impacted by subsidisation. At the most extreme, they are intended to prevent the emergence of a damaging *'subsidy race'*, in which countries whose domestic industries are detrimentally impacted retaliate by subsidising them in return.<sup>30</sup> Similarly, international subsidy control has a role to play in safeguarding agreed market access commitments, which applies in the context of any trade agreement, such as the multilateral WTO Agreement and the EU internal market. In the specific EU context, EU State aid control has been construed as a necessary complement to the EU internal market in so far as the free movement of goods, services, labour and capital within the EU should not be frustrated by forms of government intervention beyond the *de jure* or *de facto* trade barriers already proscribed by the EU internal market rules.<sup>31</sup> This is particularly important in the EU context, given the extent of market integration within the EU internal market, which is the most developed free trade area in existence, and the fact that under the EU internal market rules, EU Member States have given up their right to invoke traditional trade defence measures – the so-called *'unilateral track'* permitted by the WTO anti-subsidy rules – such as countervailing duties against subsidised goods and counter-measures against subsidised services from other Member States.

In relation to the *'competition' rationale*, the function of the EU State aid rules is evident from the CJEU's first judgment concerning the concept of State aid, in 1961, in *Steenkolennijnen*,<sup>32</sup> where it explained that State aid:

'... in itself constitutes an obstacle to the most rational distribution of production at the highest possible level of productivity inasmuch as, being a payment made by someone other than the purchaser or consumer, it makes it possible to fix or maintain selling prices which are not directly related to production costs and thereby to establish, maintain and develop economic activity which does not represent the most rational distribution of production at the highest possible level of productivity. Judged on this

<sup>27</sup> See Rubini, n 10, above, at pp 31–33.

<sup>28</sup> For an in-depth treatment, see *ibid*, at pp 37–67.

<sup>29</sup> See, eg, *Commission v Italy* (Case 173/73) EU:C:1974:71, [1974] ECR 709, at para 13; *SFEI v La Poste* (Case C-39/94) EU:C:1996:285, [1996] ECR I-3547, at para 58; and *Air Liquide Industries Belgium SA v Ville de Seraing and Province de Liège* (Joined Cases C-393/04 and 41/05) EU:C:2006:403, ECR I-5293, at para 27.

<sup>30</sup> See, eg, L Hancher, T Ottervanger and PJ Slot, *EU State Aids* (Sweet & Maxwell, 5th edn, 2016), at pp 34–35; and H Friederiszick, L-Hendrik Roller and V Verouden, 'European State Aid Control: An Economic Framework', in P Bucicrossi (ed), *Handbook of Antitrust Economics* (Cambridge, MIT Press, 2008), at pp 625–669.

<sup>31</sup> See, eg, A Biondi, 'The Rationale of State Aid Control: A Return to Orthodoxy', in C Barnard and O Odudu (eds), *Cambridge Yearbook of European Legal Studies, Vol 12, 2009–2010* (Hart Publishing), at pp 35–52; and Friederiszick, Roller and Verouden, n 30, above, at p 641.

<sup>32</sup> *Steenkolennijnen v High Authority* (Case 30/59) EU:C:1961:2, [1961] ECR 1. This judgment concerned the concept of State aid under Art 4(c) of the European Coal and Steel Community Treaty (no longer in existence).

basis and in the sense in which they are normally defined, subsidies or aids granted by the States are incompatible with the common market because they constitute an obstacle to one of its essential aims.<sup>33</sup>

The role of EU State aid control in minimising ‘distortions of competition’ has become more pronounced following the Commission’s publication of its 2005 State Aid Action Plan (the ‘SAAP’).<sup>34</sup> In the SAAP, the Commission affirmed that EU State aid control addresses the need of maintaining a level playing field for all undertakings in the EU, responding to interruptions to the market mechanism caused by State aid.<sup>35</sup>

The trade and competition rationales underlying the EU State aid rules explain the two key drivers that could militate towards significant preservation of the existing EU State aid rules in the UK post-Brexit, ie the EU’s possible demands in the context of negotiations over its future trade relationship with the UK and the UK’s own independent interests in maintaining a robust State aid regime.

### **The external dimension: the EU’s requirements with respect to the future UK/EU trade relationship**

Having regard to the trade rationale underlying the EU State aid rules, it is at once clear why and how the parameters of the UK’s future trade relationship with the EU could influence the State aid control framework in the UK post-Brexit. Revisiting the theme of ‘floors’ and ‘ceilings’ introduced above, the EU State aid rules may be understood as protecting market access commitments that are substantially in excess of the otherwise applicable ‘floor’, ie the market access commitments in the WTO Agreement, which are safeguarded by the less intrusive generally applicable WTO anti-subsidy regime. The EU State aid rules themselves represent the ‘ceiling’, as the market access commitments they protect – the EU internal market – constitute the ‘ceiling’ for existing free trade agreements, given the economic free movement principles and the removal of EU Member States’ ability to use unilateral anti-subsidy measures against each other as part of the EU internal market rules, all of which go significantly beyond the market access commitments under the WTO Agreement. Accordingly, the extent of State aid discipline required by the EU above and beyond the WTO anti-subsidy regime will turn, in part, on the extent of the market access commitments agreed as part of any future UK/EU trade agreement that goes beyond those in the WTO Agreement.

It is instructive to look at the EU’s existing trade agreements to see how this equilibrium has played out in practice.<sup>36</sup> There appear to be two main categories of State aid control provided for in these trade agreements: (i) parallel State aid systems, either multilateral or domestic; or (ii) ‘WTO plus’ systems, which take the WTO anti-subsidy rules as a starting point and add further substantive and/or procedural disciplines.

The most well-known example of a parallel State aid system in an EU trade agreement is the multilateral European Economic Area (EEA) system, which applies to the three European Free Trade Area (EFTA) and EEA States, Norway, Iceland and Liechtenstein. The EEA State aid system is substantially equivalent to the EU State aid system, both as to its substance and

33 Ibid, at paras 19–20.

34 Commission, ‘State Aid Action Plan, less and better targeted State aid: a roadmap for State aid reform 2005–2009’, COM(2005) 107 final.

35 Ibid, at paras 6–7. The debate as to the interplay of the trade and competition rationales has manifested itself in various ways as State aid law has developed, including notably in relation to the role of economic analysis in State aid law, triggered by the Commission’s 2005 SAAP (n 34, above), which advocated the use of a ‘more refined economic approach’: see Rubini, n 10, above, at pp 59–67 and also the discussion below as to the UK’s response to the SAAP.

36 A list of the EU’s existing trade agreements can be found on the Commission’s website at [http://ec.europa.eu/trade/policy/countries-and-regions/agreements/index\\_en.htm#\\_europe](http://ec.europa.eu/trade/policy/countries-and-regions/agreements/index_en.htm#_europe).

its institutional and procedural aspects,<sup>37</sup> albeit it is overseen by the EFTA Surveillance Authority, as opposed to the Commission, and ultimately by the EFTA Court, in place of the CJEU. The EEA State aid system can be seen as a reflection of the market access agreed between the three EFTA and EEA States, on the one hand, and the EU, on the other: the three EFTA and EEA States are, essentially, members of the EU internal market<sup>38</sup> and, although they are not part of the EU customs union, under the EEA Agreement both sides have forgone their ability to resort to anti-subsidy measures against the other.<sup>39</sup>

The other parallel State aid systems in EU trade agreements are all ‘domestic’, with the EU’s counterparty required to implement a State aid system that is substantially equivalent to the EU State aid system and which is, in most cases, overseen by an ‘operationally independent’ domestic authority. These trade agreements comprise those with the five current EU accession candidate countries (Albania, Macedonia, Montenegro, Serbia and Turkey<sup>40</sup>) and those with other Eastern European countries which are not currently EU accession candidates, but which might become so in future (Bosnia and Herzegovina, Kosovo, Moldova and Ukraine<sup>41</sup>). Each of these agreements provides, to somewhat differing degrees,<sup>42</sup> for the creation of a free trade area incorporating substantial aspects of the EU free movement principles concerning, in particular, the free movement of goods and freedom of establishment and, to a degree, the free movement of labour.<sup>43</sup> In many cases, these can be seen as envisaging the potential of full internal market membership as future EU members.<sup>44</sup> In most cases, both the EU and its partner retain their ability to resort to imposing anti-subsidy measures against the other party; however, it seems ultimately unlikely that the EU would take action in circumstances where its partner had complied with its obligations to create and run an adequate State aid regime; indeed, this proviso applies in some of the trade agreements.<sup>45</sup>

As for the second category – ‘WTO plus’ systems – examples of the high watermark include the EU/Korea free trade agreement (FTA) and the as yet unratified EU/Singapore FTA, which both set out additional obligations. The EU/Korea FTA extends the WTO anti-subsidy rules by adding to the list of ‘prohibited subsidies’ two additional types of subsidy that are always considered as incompatible under the EU State aid rules, ie unlimited guarantees and subsidies for companies without a credible restructuring plan. It also provides for reporting obligations in relation to subsidies, facilitating enforcement under both the FTA and the WTO anti-subsidy rules, and contains a commitment to discuss extending the rules to subsidies in services.<sup>46</sup> In a similar vein, the EU/Singapore FTA also adds the same two

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37 There are, of course, some minor differences with the EU State aid system, which stem from the inherent differences between the EU and the EEA.

38 This is subject, of course, to those sectors that are excluded from the EEA Agreement, notably agriculture and fisheries policies.

39 EEA Agreement, Art 26. This prohibition does not apply to those sectors outside of the scope of the EEA Agreement (see Protocol 13 to the EEA Agreement). Notably, in 2006 the EU imposed anti-dumping duties on Norwegian exports of farmed salmon, which in turn led to Norway bringing successful WTO dispute settlement proceedings against the EU.

40 See EU/Albania Stabilisation and Association Agreement, Art 71; EU/Macedonia Stabilisation and Association Agreement, Art 69; EU/Montenegro Stabilisation and Association Agreement, Art 73; EU/Serbia Stabilisation and Association Agreement, Art 73; and Decision No 1/95 of the Association Council between the EU and Turkey on implementing the final phase of the Customs Union, Art 34.

41 See EU/Bosnia and Herzegovina Stabilisation and Association Agreement, Art 71; EU/Kosovo Stabilisation and Association Agreement, Art 75; EU/Moldova Stabilisation and Association Agreement, Arts 339–341; and EU/Ukraine Association Agreement, Arts 262–267.

42 The more recent agreements, in particular those with Moldova and Ukraine, are more far-reaching and are described as ‘deep and comprehensive free trade agreements’.

43 The agreement with Turkey, which constitutes a customs union, is applicable to goods only, but not to agricultural goods, which are carved out.

44 The Commission’s website continues to list Albania, Macedonia, Montenegro, Serbia and Turkey as being candidate countries, while it also lists Bosnia and Herzegovina and Kosovo as being ‘potential candidates’: see [https://ec.europa.eu/neighbourhood-enlargement/countries/check-current-status\\_en](https://ec.europa.eu/neighbourhood-enlargement/countries/check-current-status_en).

45 See, eg, the EU/Macedonia Stabilisation and Association Agreement, Art 69(5) and Decision No 1/95 of the Association Council between the EU and Turkey, Art 38.

46 EU/Korea FTA, Arts 11.9–11.15.

subsidies to the list of prohibited subsidies, albeit this is qualified somewhat, including by permitting such subsidies where the subsidising party is able to demonstrate that the subsidy does not affect trade of the other party nor is likely to do so. On the other hand, the EU/Singapore FTA goes further than the EU/Korea FTA, as the additional prohibited subsidies apply to subsidies in relation to services in addition to goods, and the FTA also includes an 'in principle' commitment not to grant other subsidies if they would affect the trade of the other party, unless they would satisfy criteria that are based on the compatibility criteria applied in the EU State aid rules.<sup>47</sup> The 'WTO plus' systems under both the EU/Korea and EU/Singapore FTAs are also enforceable under each FTA's dispute settlement mechanism.<sup>48</sup> In contrast, an example of the low watermark for 'WTO plus' systems is the EU/Canada Comprehensive Economic and Trade Agreement (CETA). CETA contains enhanced procedural provisions only, namely obligations relating to the provision of information and consultations with the other party if a subsidy or a particular instance of government support related to trade in services adversely affects its interests, in which case the responding party is to *endeavour* either to eliminate its support measures or to minimise any adverse effects.<sup>49</sup>

In contrast to the EU trade agreements with parallel State aid systems which either provide for, or potentially envisage in future, full participation in the EU internal market, EU trade agreements with 'WTO plus' systems tend to be more 'traditional' FTAs. They focus mainly on reducing or eliminating tariffs applied with respect to trade in goods between the parties and providing for a degree of liberalisation of trade in services, with some market access and national treatment commitments in certain sectors. However, they do not envisage EU internal market integration. As between the two categories, even allowing for potential disparities in the respective negotiating strength of the EU and the trade agreement partner, there is a certain correlation between the degree of market access provided for and/or envisaged and the extent of the State aid control required.

It is now clear that the UK will no longer be part of the EU internal market post-Brexit. Nevertheless, it remains to be seen what degree of market access the UK and EU will seek to conclude as part of their negotiations and, consequently, what kind of State aid control the EU may seek to require of the UK. However, it seems likely that the burgeoning substantive scope of the EU State aid rules, described above, would tilt the equilibrium towards the EU seeking a more comprehensive State aid regime as part of any future trade relationship with the UK.

Given the expansive interpretation of the effect on trade and competition criteria in defining State aid, EU Member States post-Brexit will likely be restricted in granting State aid to EU companies even where this is primarily directed towards activities in the UK. At the same time, however, the UK will be subject to fewer constraints, particularly with respect to its substantial services sector to which the WTO anti-subsidy discipline would not apply, potentially affording UK companies trading across the EU a significant competitive advantage over their EU rivals. Similarly, the intrusive application of the EU State aid rules to Member States' taxation arrangements means that, post-Brexit, as the UK would be subject only to the WTO anti-subsidy rules, it could become a significantly more attractive jurisdiction for inward investment, depending on the stance it takes with regard to taxation. The trade

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47 EU/Singapore FTA (initialled agreement), Arts 12.1–12.4 and Annex 12-A.

48 However, under the EU/Singapore FTA, this dispute settlement mechanism applies only in relation to the provisions on prohibited subsidies.

49 EU/Canada CETA, Arts 7.1–7.9. In addition, the EU Euro-Mediterranean Association Agreements between the EU and various Mediterranean countries contain substantive rules in relation to competition and State aid and, under these agreements, the Association Committee responsible for the implementation of the agreement is to adopt rules for their implementation, until which, as regards State aid, the provisions of the WTO's SCM Agreement will apply. However, it appears that no substantive rules have yet been adopted under these agreements.

distortive impact of these potential advantages would be exacerbated, given the existing high volumes of trade between the UK and the EU and the trade proximity of the two, making it all the more likely that the EU would seek to require significant State aid discipline from the UK.

### **The internal dimension: the UK's own independent interest in maintaining a robust anti-subsidy regime**

Leaving issues concerning the future UK/EU relationship aside, it may also be in the UK's own interest to devise some form of State aid control, from the perspective of both the competition and trade rationales underlying the existing EU State aid rules. Accordingly, the EU's interest in seeking to require a rigorous State aid regime in any agreement with the UK may also correspond with the UK's own independent interest and, therefore, could represent a relatively easy concession for the UK to make.

In terms of the competition dimension, the UK has long been a firm proponent of the EU State aid rules from the perspective of ensuring undistorted competition and the UK has traditionally granted less State aid than other Member States of comparable size.<sup>50</sup> It seems reasonable to assume that the UK's broad stance of non-intervention absent clear evidence of market failure would continue under the current Conservative government, notwithstanding the 'modern industrial strategy' it is developing.<sup>51</sup> Indeed, what little the UK government has said in relation to the future of the EU State aid system post-Brexit seems broadly supportive of the continuation of a robust discipline of some sort. For instance, the Minister for Research and Innovation, Joseph Johnson MP, has stated that the UK would create a new framework in which businesses can compete on a level playing field,<sup>52</sup> while Chancellor of the Exchequer, Phillip Hammond MP, has said that the UK would want 'to have a regime that allowed us to intervene appropriately, but restrained us from intervening inappropriately'.<sup>53</sup>

As for the trade perspective, a UK-wide State aid regime could also be attractive from the perspective of avoiding possible intra-UK 'subsidy wars' as such between the devolved administrations of Scotland, Wales and Northern Ireland (as well as the major cities, for which some devolution has already taken place and continues apace) to provide locational incentives. This might become a significant consideration in a post-Brexit UK, given that the Prime Minister has pledged that appropriate powers are to be passed to the devolved administrations following their repatriation from the EU as a result of Brexit.<sup>54</sup>

The implementation of a domestic State aid control regime would also allow the UK to fashion a State aid regime that is more 'effects-orientated' and focused on distortions of

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50 According to the Commission's State aid scoreboard 2015 (which covers aid in 2014), the UK granted State aid amounting to 0.35% of GDP, one of the lowest percentages in the EU; the figures for Germany and France were 1.36% and 0.73% of GDP, respectively: see [http://ec.europa.eu/competition/state\\_aid/scoreboard/index\\_en.html](http://ec.europa.eu/competition/state_aid/scoreboard/index_en.html).

51 Department for Business, Energy and Industrial Strategy, 'Building our Industrial Strategy: Green Paper' (23 January 2017), available at [www.gov.uk/government/consultations/building-our-industrial-strategy](http://www.gov.uk/government/consultations/building-our-industrial-strategy). It remains to be seen what detailed proposals will be taken forward, but the proposals, which are at a high level, do not seem to be manifestly inconsistent with the principles of the existing State aid framework.

52 See House of Lords Select Committee on Science and Technology, 'Inquiry on EU Membership and UK Science Follow-up, Evidence Session No 5' (25 October 2016), Answer to Question 53.

53 See House of Commons Treasury Committee, 'Oral Evidence: The Work of the Chancellor of the Exchequer', HC 777 (19 October 2016), Answer to Question 83. This notwithstanding, that is not to say that the UK may would not materially amend the existing framework and indeed the Minister for Business, Energy and Industrial Strategy, Greg Clark MP commented in relation to the existing rules as follows: 'I hope that one of the freedoms that will come from Brexit will be to enable us to determine our own view of that rather than having to comply with others', see City AM, 'Business Secretary Greg Clark has hinted at support for future government interventions by welcoming freedom from EU State aid rules' (2 October 2016), available at [www.cityam.com/250511/business-secretary-greg-clark-has-hinted-support-future](http://www.cityam.com/250511/business-secretary-greg-clark-has-hinted-support-future).

54 See the Prime Minister's speech in relation to the government's negotiating objectives for exiting the EU (17 January 2017).

competition, in line with the modernised approach taken in applying the competition rules.<sup>55</sup> Indeed, the UK competition authority, the Competition and Markets Authority (CMA), has in the past advocated reform of the EU State aid rules to take a more ‘economic approach’ in assessing the potential for competition distortions to arise.<sup>56</sup> Furthermore, in response to a Commission proposal in the context of the SAAP that independent competition authorities in EU Member States could share State aid enforcement responsibilities with the Commission as part of decentralisation, the UK government suggested that a national competition authority could undertake a screening for competition distortions, whereby only State aid that would be likely to distort competition to a significant extent would require further investigation, thereby focusing on enforcement.<sup>57</sup>

A domestic State aid control regime could take various different forms, including enforcement by an independent agency, for which there is some precedent. While the domestic State aid control systems under the EU’s existing trade agreements with current EU accession candidate countries remain relatively inchoate,<sup>58</sup> the example of previous EU accession countries, such as Croatia (which, in the lead-up to EU accession, was also required to set up and apply a domestic State aid enforcement system modelled on the EU State aid system), demonstrates how such a system could operate effectively. The Croatian system was overseen by the Croatian Competition Agency (CCA), an independent and autonomous competition authority, much like the CMA in the UK. Under the Croatian system, as part of the pre-legislative process, government Ministries and other authorities were required to submit legislative proposals that may have contained State aid to the CCA, which was required to issue a binding opinion on State aid issues. On the other hand, non-legislative proposals were simply notified to the CCA for approval and the CCA had the power to order recovery of State aid that had been granted without notification and approval.<sup>59</sup> The Croatian system handled a not insignificant amount of State aid cases annually, the CCA taking 30 decisions during 2011–2012; in 2012, the Commission reported favourably on the Croatian system, confirming that a proper system was in place.<sup>60</sup>

While the Croatian example may be of some interest to those considering a possible domestic State aid control system in the UK, it is of course important to appreciate that the Croatian system was specific to Croatia’s situation as an EU accession candidate country transitioning towards the EU State aid regime based around the primacy of EU law. Should the UK establish a domestic State aid system, this will necessarily need to be designed in line with the specific UK context post-Brexit, including the political situation and the outcomes of the negotiations with the EU in relation to the future UK/EU trade relationship. It would also need to take into account the institutional context, as well as the different legal instruments by which State aid may be granted in the UK, and therefore the appropriate time and form that State aid scrutiny might take, having regard to parliamentary sovereignty and judicial review principles.

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<sup>55</sup> Although such an approach would necessarily be of a different form, given the nature of State aid measures which may be of wide application, affecting various groups of undertakings and a number of different economic sectors.

<sup>56</sup> See OFT (a predecessor to the CMA) response to the SAAP (September 2005), at pp 2–5, available at [http://ec.europa.eu/competition/state\\_aid/reform/comments\\_saap/index.html](http://ec.europa.eu/competition/state_aid/reform/comments_saap/index.html).

<sup>57</sup> UK response to the SAAP, at pp 19–20, available at [http://ec.europa.eu/competition/state\\_aid/reform/comments\\_saap/index.html](http://ec.europa.eu/competition/state_aid/reform/comments_saap/index.html). The UK also noted possible disadvantages in this approach, including primarily the potential for uneven application of the rules, given the varying structures and levels of experience and expertise of national competition authorities. This concern would not, however, apply in the context of a domestic system.

<sup>58</sup> See, for instance, for a critique in relation to the Albanian system, A Gjevori, ‘State Aid Control in Albania’ (2015) 14 *European State Aid Law Quarterly* 510.

<sup>59</sup> See CCA Annual Report for 2011 (August 2012), at pp 52–53, available at [www.aztn.hr/uploads/documents/eng/documents/AR/Annual\\_Report\\_of\\_the\\_Croatian\\_Competition\\_Agency\\_for\\_2011.pdf](http://www.aztn.hr/uploads/documents/eng/documents/AR/Annual_Report_of_the_Croatian_Competition_Agency_for_2011.pdf).

<sup>60</sup> Commission Staff Working Document, ‘Comprehensive Monitoring Report on Croatia’, SWD(2012) 338 final, at p 19.

## **Conclusion**

It is correct that the system of EU State aid control, as currently constituted, will cease to apply in the UK when it exits from the EU. However, with reference to the rationale underpinning the State aid rules, this should by no means be the end of State aid control in the UK. What precise form those rules might take remains subject to speculation; however, it seems likely that some form of State aid control, beyond the baseline WTO regime, and possibly quite similar to the existing EU State aid rules, may continue to apply in the UK post-Brexit.