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Brexit and State aid regulation – The question of scope

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At the time of writing, there is still a lot of uncertainty as regards the question of whether the United Kingdom will leave the European Union with an exit deal on 31 October 2019. However, what is clear is that State aid regulation will continue in the UK irrespective of the way in which the country leaves the EU.

More specifically, the Withdrawal Agreement which has been agreed between the UK and the EU but which has yet to be ratified,^[1] contains provisions which set out how State aid would be regulated in the UK once it ceases to be a member of the EU, including in the absence of any other agreement on their longer-term trade relationship that avoids a physical border on the island of Ireland. These provisions are set out in the Ireland/Northern Ireland Protocol to the Withdrawal Agreement (the “Protocol”). If the Withdrawal Agreement is not ratified by both sides before 31 October 2019 (or indeed, any new Brexit day that might be agreed before then), the UK would then leave the EU without a deal.^[2] In such an event, the State aid (EU Exit) Regulations 2019 (the “Regulations”) would come into effect, introducing a purely domestic State aid regulatory regime in the country.

Key under both the “deal” and “no deal” scenarios is the question of the scope of State aid regulation. More specifically, the Protocol provides, principally, for the creation of a single customs territory for the trade in goods. Would it be fair, therefore, to assume that any State aid obligations would only arise where the aid affects UK-EU trade which is subject to the Protocol, rather than UK-EU trade more generally?

Separately, as noted above, in the event of a no-deal Brexit, the Regulations^[3] would come into force. These essentially transpose into domestic law the EU State aid regime, with some amendments to correct, primarily, certain deficiencies in the application of EU State aid law in a domestic context. However, under the Regulations the general State aid prohibition would continue to be triggered when aid affects trade with the EU, despite the fact that the UK would have left the EU without a trade deal. What is the reasoning behind this policy decision?

These issues are considered below.

The scope of the State aid rules under the Protocol^[4]

Under the Protocol, the EU State aid rules would continue to apply directly to measures that affect EU trade with Northern Ireland with the Commission maintaining its competence in relation to such measures. A parallel but substantively the same set of State aid rules would apply under domestic law in relation to measures which affect EU trade with the rest of the UK, with a domestic independent authority^[5] having competence to authorise and determine the legality of such measures. In cases where a State aid measure affects EU trade with the UK as a whole, both the Commission and the domestic independent authority would have, in principle, concurrent competence to consider those measures.

Under the Protocol the general State aid prohibition set out in Article 107(1) of the Treaty on the Functioning of the EU (TFEU) would continue to apply to the UK:

“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.”

In applying this familiar test, the reference to “Member States”, would be deemed to include also the UK.^[6] Less clear, is the question of whether for these purposes the reference to State aid affecting “trade” should be interpreted as a reference to trade between the EU27 and the UK in general or only trade which is covered under the Protocol.

In principle, the narrower interpretation would seem more appropriate. This is on the basis of two separate, and somewhat cumbersome in their formulation, Protocol provisions which seem to indicate that EU State aid rules would apply to the UK in respect of measures that affect:

- (a) that trade between Northern Ireland and the EU “which is subject to the Protocol”;^[7] and
- (b) that trade between the UK and the EU “which is subject to Annex 2” of the Protocol.^[8]

The effect of these provisions appears to be that EU State aid rules would apply to the UK (including Northern Ireland) where a measure affects UK-EU trade in goods, in line with the scope of trade covered under Annex 2.^[9] At the same time, the application of EU State aid rules to Northern Ireland could be wider, in that the scope of trade which is “subject to the Protocol” goes beyond the trade in goods covered under Annex 2.

For example, Northern Ireland and the Republic of Ireland would continue to operate a single (wholesale) electricity market with various EU rules in relation to the generation, transmission, distribution and supply of electricity, as well as in relation to wholesale trading in electricity, continuing to apply to Northern Ireland.^[10]

Separately, Article 13 of the Protocol provides that the Protocol:

“shall be implemented and applied so as to maintain the necessary conditions for continued North-South cooperation, including in the areas of environment, health, agriculture, transport, education and tourism, as well as in the areas of energy, telecommunications, broadcasting, inland fisheries, justice and security, higher education and sport.”

Although far from clear, it is arguable that State support in relation to the provision of services that relate to any of these areas of North-South cooperation could also be deemed to affect trade between Northern Ireland and the EU “which is subject to the Protocol”.

It is also important to keep in mind in this context that Article 107(1) TFEU defines measures of State interventions in relation to their effects.^[11] Accordingly, EU State aid rules would apply to the UK in relation to *any* State aid measure that affects trade which is subject to Annex 2 or the Protocol more generally, as outlined above. That may cover, for example, the grant of loans or guarantees on non-market terms, or selective tax incentives or indeed, subsidies which are directed at the provision of services, or the construction or operation of infrastructure for the provision of certain services which might ultimately be deemed to have an effect on trade in goods.^[12] On that basis, the effect of a narrower definition of “trade” for the purposes of applying Article 107(1) TFEU, might be less drastic than it might appear at first. This interpretation would also seem to be supported by the fact that the Protocol incorporates substantively all current EU State aid rules.

However, that is not to say that the scope of State aid regulation in the UK would be unaffected. Indeed, a number of measures which are currently subject to State aid regulation, would arguably fall outside the scope of the post-Brexit State aid rules under the Protocol. For example, absent any cross-subsidisation issues, it is not immediately evident how subsidising public passenger transport services by rail in Great Britain could be deemed to affect trade with the EU which is subject to Annex 2.

At the same time, a potentially narrower scope of State aid regulation under the Protocol raises the important question of whether the UK would wish to apply a domestic system of State aid regulation to measures that would no longer fall within the scope of EU State aid rules. This would be so as to prevent distortions of competition in its own domestic market. For example, even if the grant of a selective advantage to users of a subsidised infrastructure can be avoided by ensuring that they pay market rates for its use, there would clearly be concerns about the potential distortion of domestic competition if certain owners or operators of ports, airports or other types of infrastructure, were being subsidised to the detriment of other undertakings.

It should be recognised that applying a separate domestic system of State aid regulation alongside the State aid rules which would apply under the Protocol, would create an additional layer of complexity to what would already be an overly complex regulatory system. Indeed, redlines and other political sensitivities aside, it would be simpler for the UK and the EU to agree that the Protocol’s provisions on State aid would apply, in principle, in relation to all measures that affect trade between the two, rather than only measures which affect trade which is subject to Annex 2 (in relation to Great Britain) or the Protocol (in relation to Northern Ireland). In any event, that would seem to have been the intended approach under the Government’s 2018 Chequers Plan^[13] and, as discussed further below, this is, in principle, the approach which the Government has adopted under the Regulations.

Finally, over and above the question of the circumstances in which EU State aid rules would apply to the UK under the Protocol, there is also the separate issue of the regulation of State aid measures which another EU Member State, not least the Republic of Ireland, might take and which can affect trade between the two sides. Would such measures be subject to Commission scrutiny under the EU State aid rules?

Although not without doubt, it would seem possible to interpret the Protocol as bringing within its scope such measures, so that the Commission would have the competence to investigate these, and with the UK, or businesses in the UK, ultimately, having the right to challenge relevant State aid decisions in the CJEU.^[14]

The scope of the State aid rules under the Regulations

In the event of a no-deal Brexit, the Competition and Markets Authority (CMA) would take on the role of the domestic State aid regulator. In taking effect, the Regulations would apply the general State aid prohibition in Article 107(1) TFEU, in a slightly modified form. According to this:

“Any aid granted by the 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 the United Kingdom and the European Union, be prohibited unless it is approved in accordance with Article 108(3) of the TFEU.”

A modified Article 108(3) provides that the CMA must be notified of any plans to grant or alter aid and that the aid grantor must not put its proposed measures into effect unless the aid is approved.

The obvious question that arises as regards the scope of the modified Article 107(1) TFEU is why this is concerned with the aid’s effects on trade with the EU rather than the aid’s effects on trade within the UK alone.

The Explanatory Memorandum to the Regulations indicates that a key consideration in deciding to modify Article 107(1) TFEU in this was concern about a purely domestic trade-focused general prohibition being met far too easily even in cases of purely local concern. By applying the general prohibition by reference to the aid’s effects on UK-EU trade instead, this risk is avoided. Another benefit in keeping the amended Article 107(1) TFEU as close as possible to the EU “original”, is that it provides continuity and certainty for users by maintaining the established terminology and, “more importantly”, maintains the link to relevant EU case law: “there is a large amount of EU case law which shapes the interpretation of the concepts such as state resources and we do not wish to break this link. If we did it would lead to greater uncertainty for aid givers, beneficiaries and the CMA.”^[15]

It is also the case that, by determining the application of the general prohibition by reference to its effects on UK-EU trade, this ensures that the domestic State aid regime would remain equally robust as that of the EU’s, an approach which is consistent with the Government’s decision to maintain current levels of State aid discipline post-Brexit. On that basis, it would be difficult, for example, to justify relaxing the rules that apply to the grant of State aid in the aviation sector or in relation to environmental protection. A more relaxed UK State aid approach would raise concerns under the modified Article 107(1) TFEU test as to the effects of such changes on trade with the EU, where undertakings would remain subject to a stricter State aid discipline. In this context it is also relevant that neither the Secretary of State nor the CMA would have the right to make or amend block exemptions and *de minimis* regulations, under the Regulations.^[16]

Finally, as it would be obvious from the wording of the modified Article 107(1) TFEU, the concern here is with the aid’s effect on trade with the EU in general and not only in relation to certain types

of trade (which might or might not be subject to a future free trade agreement with the EU).

[1] 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, as agreed at negotiators' level on 14 November 2018.

[2] The EU has made it clear on various occasions that it will not re-open negotiations over the terms of the UK's withdrawal from the EU which means that this is a binary choice between the ratification of the Withdrawal Agreement in substantively its current form or the UK exiting the EU without an agreement.

[3] Unless otherwise specified, references to any specific Regulations in this article should be deemed to be references to a Regulation in the Regulations.

[4] The analysis focuses on the application of State aid rules in the event that the Protocol comes into effect rather than the question of the application of State aid rules under the Withdrawal Agreement as a whole which provides for a transition period (until 31 December 2020 but extendable up to two years with both parties' agreement). During the transition period, EU law would continue to apply to, and in, the UK as if the country continued to be a member of the EU.

[5] Although the Government has not specifically commented on this in the context of the Withdrawal Agreement, it is virtually certain that it is the Competition and Markets Authority which would fulfil that role in the event that the Protocol were to be activated.

[6] Article 7(1), Withdrawal Agreement.

[7] Article 12(1) of the Protocol.

[8] Article 7(1) of Annex 4 of the Protocol. Any subsequent references to Annex 2 in this article should be construed as references to Annex 2 of the Protocol.

[9] See Article 6(1) of the Protocol and Article 1 of Annex 2 on various conditions and other clarifications as to the goods covered.

[10] Article 11 and Annex 7 of the Protocol.

[11] See for example Case C-124/10 P *Commission v EDF and Others* [2012] ECR, at [77] and the case-law cited.

[12] For example, subsidising the construction or operation of ports, airports or indeed, broadband infrastructure can lead to lower costs for infrastructure users, thereby granting them an advantage (if they are undertakings). This can then affect trade (in goods) between the UK and the EU²⁷.

[13] *The future relationship between the United Kingdom and the European Union*, Cm

9593, July 2018, often referred to as the Chequers Plan.

[14] Articles 4(1) and 7(1) of the Withdrawal Agreement, read alongside Articles 12(1) and 14(4) of the Protocol and Article 7(1) of Annex 4 of the Protocol. See also, Vincent Verouden and Pablo Ibáñez-Colomo, *Ensuring a level playing field post-Brexit: State aid control*, 11 January 2019, p.21. For a different view on this point refer to George Peretz, *Ensuring a level playing field post-Brexit: State aid control*, 16 January 2019 and Matthew Holehouse, MLex, *State aid questions in Brexit backstop merit clarification*, 8 February 2019.

[15] Explanatory Memorandum to the Regulations, paragraph 6.9.

[16] It is worth noting that whilst this makes sense from the perspective of seeking to ensure the same robustness as the EU in relation to State aid notification exemptions, this approach might limit the ability of the UK to adopt a more flexible regime were the EU to relax its own State aid notification requirements further.

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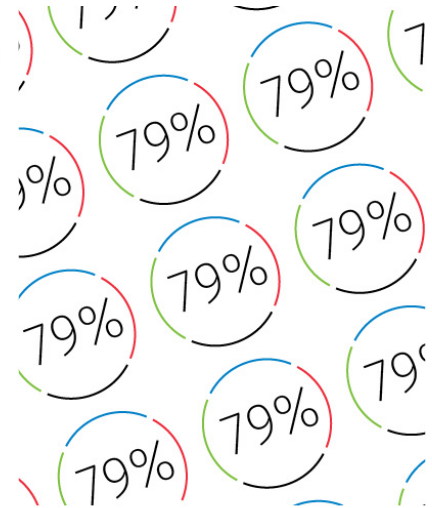
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