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A domestic State aid regime and the challenge of a “no deal” Brexit

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The UK Government has recently indicated its intention to transpose the EU State aid rules into domestic legislation, even in the event of the UK exiting the EU without a Withdrawal Agreement on 29 March 2019. This was made clear in a “no deal” Brexit technical notice on State aid (the “notice”) published, alongside 24 other “no deal” Brexit technical notices, on 23 August 2018.

This policy is the natural consequence of the Government’s strongly held belief that “a rigorous State aid system… is good for taxpayers, consumers, and for businesses”. Indeed, unregulated State aid interventions, whether at the local, devolved or central government level, can distort domestic competition, affect trade and have an adverse effect on the competitiveness of the UK economy.

At the same time, the implementation of a *purely* domestic State aid regime – that is a regime, which the State sets up voluntarily, rather than implements as a result of an international treaty obligation, is likely to give rise to a number of issues which would require careful consideration.

This note outlines briefly the key aspects of EU State aid regulation, discusses how a domestic State aid system is expected to operate in the event of a “no deal” Brexit, and comments on its ramifications, including the key challenges that are likely to arise under such system.

The EU State aid framework

EU State aid rules generally prohibit EU Member States from using State resources to grant aid selectively to “undertakings” (essentially businesses offering goods or services on the market), to the extent that such aid may distort competition and affect trade between Member States (the “general State aid prohibition”). At the same time, State aid rules set out the types of aid which are, or may be, deemed compatible with EU law.

The EU State aid system is regulated by the European Commission which has sole responsibility for determining whether a State aid measure is compatible with EU law requirements. Accordingly, other than in cases where an exemption applies, Member States have an obligation to notify proposed State aid to the Commission for authorisation. State aid which is found to have been implemented illegally must normally be recovered from the beneficiary with interest.

The "no deal" Brexit domestic State aid framework

According to the notice, the EU State aid framework will be transposed into UK law by means of secondary legislation under the European Union (Withdrawal) Act 2018, this autumn, with only "technical modifications" to ensure that the State aid regime works in a domestic context. The Competition and Markets Authority (CMA) will take on the role of domestic State aid regulator and will issue further guidance in early 2019, setting out in more detail how it will operate its State aid regulatory function.

It would be reasonable to interpret the Government's intention of replicating "the existing State aid framework", that "will apply to all sectors" and "mirror existing block exemptions" as an intention to incorporate into domestic law not only the core principles of EU State aid regulation, set out in the Treaty on the Functioning of the EU (TFEU), but also the full panoply of State aid-related EU secondary legislation and Commission communications.

As regards the practical implications for State aid regulation in the event of a "no deal" Brexit, the notice indicates that, in such an event:

- UK public bodies would be required to notify aid to the CMA as they previously would have done to the Commission;
- State aid that has already been approved prior to Brexit would remain valid;
- any full notifications not already approved by the Commission prior to Brexit would have to be submitted to the CMA for approval instead; and
- State aid complaints should be directed to the CMA.

The notice does not clarify what should happen in cases where the Commission concludes before Brexit that aid was granted illegally and should be recovered but such recovery is still outstanding on 30 March 2019. Presumably, under the Government's proposed model, it would be for the CMA (after it has been granted the relevant powers) to pursue, if necessary, the recovery of that aid so as to ensure that distortions of competition do not persist. A policy decision would also need to be made as to whether, in those circumstances, the CMA should automatically pursue the outstanding recovery of aid or whether it should first confirm that the aid in question remains illegal under domestic State aid laws.

Also not addressed in the notice is the key issue of whether, in the event of a "no deal" Brexit, the intention is for the domestic State aid regime to continue to "approximate" EU State aid rules as a matter of course or whether it might deviate from the EU State aid rulebook as the CMA considers appropriate. The importance of this issue is discussed further below.

How the general State aid prohibition might be transposed into UK law

It is a given that in transposing the EU State aid framework into UK law there would be a need for certain changes to the rules to take into account the fact that these would now operate in a purely domestic context. As noted earlier, EU State aid rules are concerned with the risk of State aid distorting competition and affecting trade in the EU's internal market. In the context of a purely domestic State aid regime, UK State aid law would only be concerned with distortions of

competition and effects on trade within the UK.

Accordingly, the UK's transposition of the general State aid prohibition, set out in Article 107(1) TFEU, might be along the following lines:

"Save as otherwise provided in [this Regulation], 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 [within the United Kingdom], be [prohibited]."

The notice refers to this type of adaptations as "technical modifications". However, their effect might be decidedly greater than this nomenclature might suggest. Indeed, it is important to recognise that the conclusions reached as to the compatibility of a State aid measure by reference to the technically modified domestic State aid law might be different to those reached on the basis of EU State aid rules and their wider concern with the way in which State aid by one Member State might distort competition in the internal market and affect trade between Member States.

Narrower test, wider scope for State aid intervention?

In certain cases, this might mean that the narrower domestic test would lead to the State having a wider scope for State aid intervention. A simple example might be where the decision is taken to relax the conditions, including by increasing the amounts of aid which are permissible in the UK, under the equivalent to the Commission's General Block Exemption Regulation.[1] This sets out the conditions (including maximum aid amounts) on the basis of which certain categories of aid are deemed compatible with EU State aid rules and may be granted without prior notification to the Commission. Another example might be where a decision is taken to diverge from the EU State aid "rulebook" and relax UK State aid rules in areas such as aviation, environmental protection or indeed, rescue and restructuring aid.

The adoption of such measures at a national level would clearly be selective, discriminatory and distortive of competition if implemented unilaterally by an EU Member State and assessed by reference to their effect in the context of the internal market. Equally, it is very likely that such an approach would be inconsistent with the terms of a theoretical future UK-EU trade agreement were this to provide that, any State aid granted by the UK or the EU Member States which distorts or threatens to distort competition by favouring certain undertakings is incompatible with that agreement in so far as it may affect trade between the parties.

On the other hand, the relaxation of State aid rules might be deemed to be justifiable in a UK "no deal" Brexit context, on the basis of an analysis that demonstrates that to do so does not distort competition in the UK or to the extent that it does the distortions are not significant and any negative effects are outweighed by the benefits obtained, for example, in terms of the development of certain economic activities. While the UK would still need to be mindful of its obligations under the WTO's Agreement on Subsidies and Countervailing Measures (ASCM), in reality, ASCM's scope is narrower and the ability of a WTO member to take action limited to those cases where there is injury to its domestic industry, market access impairment or "serious prejudice" to its interests. In practice, this means that depending on the type and extent of any relaxation of State aid rules in the UK, the likelihood of this raising issues under the WTO's ASCM can be

limited.

Accordingly, if the intention is to allow UK State aid rules to diverge subsequently from EU State aid rules, it would be important to establish who would determine the timing, scope and extent of such divergence. Would it be correct to assume that this would be for the CMA alone to determine or would it be possible for the Government to provide the CMA with directions or guidance in this regard or indeed, to intervene in relation to State aid measures which the Government considers appropriate to implement irrespective of the State aid analysis?

In seeking answers to these questions it is necessary to understand the different dynamics at play in the context of a purely domestic State aid regime.

The risk of political intervention in a domestic State aid framework

First, it is important to recognise that whilst the CMA's new State aid regulatory function would also be concerned with the regulation of competition in the UK, it would, in fact, be significantly different from its other regulatory responsibilities. Under its current remit as competition regulator and enforcer, the CMA is essentially concerned with the behaviour of businesses (and those involved in their running). Under a domestic State aid regime the CMA would be tasked with the role of regulating the behaviour of the State, prohibiting it from using State resources to grant aid selectively if that risks distorting competition, and presumably requiring it to recover such aid where this has been granted illegally. In this context, the CMA would be taking decisions which can prove unpopular not only with the public but also with the Government.

Whilst it is true that certain EU State aid decisions can also give rise to public and political discontent, the regime's supranational character, means that the ability of a Member State to influence the State aid process (outside the normal regulatory procedures) is generally limited. In any event, the impact of any such attempts can be diluted given the Commission's obligation to take into account the effects of an aid measure across an internal market of 28 (soon to be 27) EU Member States.

However, in the context of a national State aid system, the temptation might be far greater for politicians and indeed, other stakeholders to try and exert pressure on the domestic State aid regulator whether through media campaigns or otherwise. Whilst there is no doubt that the CMA would rise to the task, it is important for this more challenging environment within which the domestic State aid regulator would be operating to be acknowledged.

Separately, it is relevant to note that under EU State aid rules it is, in fact, possible for Member States to intervene in the State aid process. More specifically, Article 108(2) TFEU, enables the Council (of EU Ministers), acting unanimously, at the request of a Member State, and where this is justified "by exceptional circumstances", to declare a specific State aid measure as compatible with EU State aid rules. In those circumstances, the Commission cannot investigate the particular measure, or to the extent that it has commenced such an investigation, it would be required to abandon it. While this process has only been used rarely, in principle, it is available under EU law.

Accordingly, it is possible that the current or some future Government might introduce in domestic legislation a power similar in to that set out in Article 108(2), allowing the Government of the day to intervene where it considers it appropriate as a result of "exceptional circumstances" in relation

to particular State aid measures.

Again, the concern here would be that in a purely domestic context, and in the light of strong hostile public sentiment in relation to certain State aid decisions, a national Government might find it easier, and be more readily inclined, to use such power, than an EU Member State would or could (given the need for unanimity by all Member States), in the context of the supranational EU State aid system.

Ultimately, the ability of a national Government to initiate parliamentary procedures and amend domestic legislation at will – so much an issue in the context of the Brexit debate – is potentially the Achilles' heel of a domestic State aid regulatory system. Whilst other aspects of national competition law have long since been established and are universally accepted as fundamental in regulating the behaviour of businesses, for the benefit of consumers, State aid regulation is more likely to divide opinion. This factor also, therefore, points to the risk of State intervention in State aid regulation being far greater in a purely domestic setting than in the context of an international system where States voluntarily accept the jurisdiction of a supranational regulator to authorise or prohibit their State aid measures.

Is there a way of addressing these challenges? Yes, there is. These issues should disappear if State aid regulation forms an integral part of a future UK-EU trade agreement which provides (a) for the UK to maintain a common State aid rulebook with the EU; and (b) for the domestic State aid regulator to consider also the extent to which an aid measure might affect trade not only within the UK but also between the UK and the EU.

It is notable that there would seem to be a significant meeting of minds on this issue. Both the EU27, in the context of numerous statements since June 2016, and the UK Government, most recently in the context of the Government's Brexit White Paper, have indicated, directly or indirectly, a mutual desire for a common State aid rulebook to be part of a future UK-EU free trade agreement.

In view of the challenges discussed above, it is to be hoped that this would indeed, be the case.

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[1] Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

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