Are state aid provisions likely to form an essential component of any future trade agreement between the UK and EU? Do any existing trade agreements between the EU and third countries provide a useful precedent for future UK-EU state aid arrangements?

1. It is certain that the EU will insist on including state aid provisions in any future trade agreement with the UK. This is a logical conclusion considering the following two factors.

2. The first factor is: state aid control enshrined in Article 107 and 108 of the TFEU is one of the EU's flagship policies on which the EU is unlikely to compromise. As the CJEU has affirmed, state aid control provisions are ‘the expression of one of the essential tasks with which the European Union is entrusted under Article 2 EC, namely the establishment of a common market, and under Article 3(1) (g) EC which provides that the activities of the Community are to include a system ensuring that competition in the internal market is not distorted’.\(^1\)

3. The European Council guidelines for the Brexit negotiations of 29 April 2017 clearly state that any future free trade agreement ‘must ensure a level playing field, notably in terms of competition and state aid, and in this regard, encompass safeguards against unfair competitive advantages through, inter alia, tax, social, environmental and regulatory measures and practices’. In several interviews, the EU Competition Commissioner, Ms Vestager, reaffirmed that any future deals would have to include rules, which prevent the British Government handing out subsidies to favoured industries, in a way that would tilt the playing field against European competitors.

4. The second factor is: most international trade agreements tend to include provisions on subsidies, and in some instances these are modelled on EU rules.

5. This observation includes the EEA\(^2\), an agreement with a parallel system of state aid control. The rules applicable to the UK would be the same if it were to accede to the EEA. For instance, Article 61 of the EEA is nearly identical to Article 107 TFEU (regarding the notion of aid and on compatibility grounds) and the EFTA Court has interpreted it consistently, considering the case law of the CJEU, as required by Article 6 EEA.\(^3\) Annex XV to the EAA contains sectorial binding rules which are identical to those of the EU. In addition, the EFTA Surveillance Authority (ESA) undertakes a supranational enforcement function, which is almost identical to that exercised by the European Commission, aside from a few minor procedural issues. Obviously, the

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\(^1\)Case C184/11 Commission v Spain [2014] ECLI-316, para 70.
\(^2\)OJ No L 1, 3.1.1994, p. 3; and EFTA States’ official gazette.
\(^3\)Recent Case E-25/15, EFTA Surveillance Authority v Iceland, 29 July 2016.
influence that the UK would be able to exercise within such an agreement would be considerable.

6. All the agreements concluded between the EU and states that have, or could, accede to the EU are of limited relevance because their main aim is to conform to EU standards.4

7. WTO rules on subsidies are applicable to the UK and will continue to apply. I will not dwell extensively on the WTO provisions, which are well known, albeit a little outdated, but suffice it for the purposes of my evidence to say the following.

8. In essence, the provisions of the Agreement on Subsidies and Countervailing Measures (SCM), contain specific provisions to prohibit subsidies. The definition of ‘subsidy’ is contained in Article 1, which requires a measure to be classified as such, by either being directly taken by governments, or attributable to them, and the grant of a specific advantage to an undertaking. These criteria are broadly similar to those contained in Article 107(1) TFEU (aid granted by the state or through state resources, conferral of a selective advantage). Despite the similarities there are still many differences between the two regimes. WTO rules are more limited in scope, because the rules only apply to trade in goods, and they mainly prohibit subsidies related to export and import-substitution subsidies. To obtain a decision terminating the subsidy, the existence of ‘serious prejudice to the interests of another WTO member’ as well as the impairment of market access, needs to be proven. The SCM provides rather bland rules on notification, which are not particularly effective.

9. It is, in my view, more productive to focus on the so called ‘new generation’ of free trade agreements (FTAs) concluded by the EU on the legal basis of the provisions introduced to the Lisbon Treaty (most notably Article 3(1)(e) TEU and Articles 206 and 207 TFEU) that have extended the competence of the EU in the area of common commercial policy.5

10. The ‘new generation’ FTAs can be broadly divided in two main categories. First, those that choose to fall back on existing WTO rules, such as the Comprehensive Economic and Trade Agreement (CETA).6 Although there are improvements to rules on consultation, notification and enforcement, Article 7 of CETA mostly reproduces the SCM. Second, are those FTAs that go beyond the scope of the WTO. In

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4 The agreements with countries that are not next in line to accede to the EU, such as those with Moldova and Ukraine, are a mix of accession agreements and FTA’s. Still, Article 339 of the EU-Moldova Association Agreement replicates the wording of Article 107 TFEU.
the latter category mention should be made of those of significance which are currently in force (EU-South Korea), pending ratification (Vietnam and Singapore), or under negotiation (Japan).

11. The **EU-South Korea** FTA is the first tentative step to make control on subsidies more effective. The two parties agreed to extend the WTO prohibition on subsidies to two extra categories: first, subsidies to ailing companies without any credible plan to return to profit, and second, those measures providing unlimited state guarantees. New rules were introduced to enhance transparency and notification, and an alternative dispute mechanism, with powers to impose commercial sanctions, was introduced. For the very first time a party can bring a complaint that - after an attempt at conciliation - is referred to an arbitration panel. The arbitration panel decision is binding and enforceable.

12. The FTAs with **Vietnam and Singapore** are even more interesting, because they could be considered as almost 'WTO plus, plus'. In Chapter 11 of the Vietnam agreement and Chapter 12 of the Singapore agreement, there are several provisions devoted to subsidies. Despite anchoring the scope of application to the WTO conditions as laid down in the SCM agreement, these two agreements go further. Both very clearly extend their application to services. Article x2(8) of Chapter 11 to the EU-Vietnam FTA lists services which can fall within the scope of the FTA, such as: telecommunications; banking; insurance; transport (including maritime); energy; and construction and environmental services.

13. The two agreements detail the kind of government measures which can be considered subsidies, considerably extending their scope of application. For example, Article 12.7 (2) of the Singapore FTA provides that a subsidy will include (a) any legal arrangement whereby a government or any public body is responsible to cover debts or liabilities of certain undertakings without any limitation, in law or in fact, as to the amount of those debts and liabilities or the duration of such responsibility; and (b) support to insolvent or ailing undertakings.

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10 Both agreements implicitly acknowledge the limited impact of WTO rules. See for instance Footnote to Article 12.5 (1) in the Singapore FTA that states that the Parties shall give positive consideration to the adoption of a possible decision by the Trade Committee to update this Agreement to reflect the agreement reached at the WTO on the definition of subsidies for services.

11 The EU-Japan draft agreement includes services related to architecture and engineering; banking; construction; telecommunication; energy; environment; computer; insurance; express delivery services; and transport. The audio-visual sector is for the time being excluded.
in whatever form (such as loans and guarantees, cash grants, capital injections, provision of assets below market prices, tax exemptions) without a credible restructuring plan based on realistic assumptions with the view to ensuring the return of the ailing undertaking within a reasonable time to long-term viability and without the undertaking significantly contributing itself to the costs of restructuring’.

14. Both FTAs are also significant because they reaffirm that subsidies rules will not impair the ability of the contracting parties to pursue public policies and fulfill welfare related duties. The Vietnam FTA categorically excludes non-economic activities from the definition of subsidies (there is even a specific note confirming that education provided under the national systems will not be considered as an economic activity). This is an important reaffirmation that funding public aims and activities will not be affected.

15. There is another very important observation to be made. EU state aid law seems to have been adopted as a blueprint, heavily influencing the final provisions. Article 107(2) and (3) TFEU on compatibility of aid is repeated verbatim in the Vietnam FTA and in an Annex to the Singapore FTA. Important principles developed by the CJEU and adopted by the European Commission have been transplanted into the agreement. For instance, the Altmark principle, that there is no control on subsidies granted as compensation for conducting public service obligations, is repeated in Article 12(7) 4 of the EU-Singapore Agreement.

16. Finally, the EU–Singapore agreement is also ‘constitutionally’ significant for a future UK trade relationship with the EU. In the CJEU’s Opinion as to whether the EU had exclusive competence to conclude the agreement with Singapore without the need for approval from the Member States, the CJEU opined that the agreement could not be concluded by the EU only, because the provisions of the agreement relating to non-direct foreign investment, and dispute settlement between investors and States, did not fall within the exclusive competence of the EU. The agreement could not therefore be concluded without the participation of the Member States. What is relevant in this context, is that the Court held that the EU has exclusive competence to conclude an agreement in the field of competition and subsidies, as both matters fall within the field of the common commercial policy, not the internal market. A future EU-UK trade agreement on subsidies would be considered an EU exclusive competence, except the delicate question of dispute settlement.

Will the UK require a domestic state aid authority after Brexit?

17. The short answer is ‘yes’. It seems unthinkable that in a modern and dynamic economy like the UK’s, there should be no control on public

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12 Case C-280/00, Altmark Trans and Regierungspräsidium Magdeburg (Altmark), ECLI:EU:C2003:415.
spending. A domestic authority would provide reassurance that public spending will be transparent, fair and not distort the market.

18. The experience with temporary decentralization of state aid control for accession countries, both in the past for Central and Eastern Europe (CEEC) and currently for the South-East Europe (SEE) countries, cannot be taken as a comparator, because the political, legal and economic context are entirely different. Bacon, Peretz and Tailoring, in a recent paper, provided an extensive proposal on how a domestic authority should function. Their main suggestion is to attribute state aid control to the Competition and Markets Authority (CMA). This is certainly a suggestion that has a lot of merit as the expertise and the prestige of the UK authority is well known. It would also dispel any fear of regulatory or political capture. For the UK, the task of a domestic authority would be as a facilitator, because EU state aid control policy has changed dramatically over the years. After the adoption of the New Block Exemption Regulation, (GBER) in particular, vast areas of economic intervention have been devolved to be controlled at national level. Certain categories of aid which are considered ‘good’ aid are not subject to European Commission control, such as research and development, innovation, broadband, regional aid, aviation, energy and the environment. These sectors are virtually immune from state aid control.

19. However, decentralization of state aid control can work, but only and in so far as transparency is guaranteed. In the EU state aid model transparency was ensured by the pre-notification procedure required by Article 108 TFEU. The GBER is now based on an ex-post control whereby Member States are not obliged to notify certain categories of aid. The applicability of the GBER is still conditional on transparency and publication of state measures. Article 10 provides that failure to comply with GBER conditions (including publication and information) might lead to a Commission decision that all, or some, future aid measures adopted by the Member State in question are to be notified to the Commission and sanctions ordered.

20. Such emphasis on transparency should be replicated in both a domestic arrangement and future EU-UK agreement. State aid control rationale is also about ‘checking’ state action. All the aforementioned trade agreements identify the ‘effects’ on trade between the parties as the essential element for a subsidy to be prohibited. Some form of supranational dialogue between parties is therefore necessary. All FTAs emphasize the importance of transparency. Article 12.9 of the EU-Singapore FTA requires that ‘Each Party shall ensure transparency in the area of subsidies related to trade in goods and the supply of services. To this end, each Party shall report every two years to the other Party on the legal basis, form, and to the extent possible,

amount or budget, and the recipient of subsidies granted by its
government or any public body. A form of dispute resolution
mechanism would be needed to deal with the transnational dimension
of subsidies. The enforcement and dispute resolution model in a future
EU-UK agreement is one of the key issues relating to the entire Brexit
negotiation, and perhaps outside the remit of the present House of
Lords inquiry. 16

What would be the opportunities and challenges for state aid or subsidy
controls in the UK if no trade agreement were to be reached with the EU?
Would WTO anti-subsidy rules restrict the UK’s ability to support
industries, or individual companies, through favorable tax arrangements.

21. One of the consequences of withdrawing from the EU system of state
aid control would be in relation to enforcement. The European
Commission’s role as state aid enforcer, against defaulting Member
States, would end, as would, presumably, the UK Government’s ability
to challenge either European Commission decisions or potential aid
measures of other Member States, particularly if there is no
preliminary reference procedure available.

22. UK companies could potentially retain their rights to complain and
inform the European Commission of possible instances of illegal aid.
Council Regulation (EU) 2015/1589 art. 24 allows ‘any interested
party’ to inform the Commission of any alleged unlawful aid and any
alleged misuse of aid. Private parties could also attempt to judicially
review an EU aid related decision. They would, however, be required to
prove their standing, which has been a notoriously difficult task.
Parties would need to satisfy the criteria contained in Article 263(4)
TFEU and prove that an EU regulatory act is of direct concern to them
and does not entail implementing measures.17

23. For the UK Government, it would be possible to rely on the WTO rules
and dispute resolution mechanism. The following observations are
however necessary: control on aid and subsidies is not about
preventing a state from pursuing public, or even economic, aims,
provided that those rules do not result in a distortion of competition or
an obstacle to trade. WTO rules, like EU state aid rules, would not
restrict the UK’s ability to pursue virtuous polices, provided that the
basic rules are complied with. As WTO rules are undoubtedly less
stringent than current EU rules, they can confer an extra degree of
flexibility on the UK in its economic policy. It is, however, questionable
whether the WTO would be an attractive proposition to the UK, with a

16 WTO rules are rather deficient as they can mainly be enforced exclusively ex
post that is once a claim is filed by one of the contracting parties before the WTO
Dispute Settlement Body for breach of the SCM Agreement. This procedure tends
to last for years. As for remedies, the subsidized industry’s product will be subject
to countervailing measures (higher tariffs), or the Member State will be subject to
a prospective recommendation to remove the adverse effects of the subsidy.
CETA, Chapter 8, instead creates an ad hoc tribunal for dispute settlement.
heavily supply based economy comprising horizontal and general measures not likely to be caught by aid/subsidy rules. This is because, with the aforementioned weaknesses in terms of efficiency, scope and enforcement, the UK and its businesses would, in my view, find it arduous to defend their interests and the competitiveness of the British economy, in a WTO context.

How will the Government’s industrial strategy shape its approach to state aid after Brexit? To what extent has the European Commission’s state aid policy limited interventions that the UK Government may have otherwise pursued?

24. In line with my expertise, I am only commenting on the legal issues and refrain from any policy/economic reconstruction. However, I would note that the UK has been one of the most successful Member States in relying on state aid rules. In an article I wrote in 2016, I reported data demonstrating that the UK has notified an increasing number of measures to the European Commission, most of which were successful. Furthermore, very few actions for recovery of unlawful aid have been ordered against the UK. Therefore, EU state aid policy did not restrict the UK’s ability to pursue certain policies. On the contrary, the UK contributed decisively to shaping this area of law. Although controversial areas, such as infrastructure or fiscal aid, proved to be as problematic for the UK as for other Member States, the European Commission’s approach to virtuous horizontal policies seemed to align with the UK’s position.

What, if any role, might the devolved institutions play in UK state aid control post-Brexit? Are there any potential implications for the UK internal market?

25. The existence of rules on the transparency and accountability in spending decisions contributes to ensuring geographical solidarity between the different areas of the UK. Rather uniquely within the EU legal order which tends to consider the ‘state’ as a unitary concept from the perspective of effective enforcement, state aid is an exception. The CJEU recently recognized the importance of sub-state entities in its case law, considering that if certain criteria are satisfied the measure adopted by a devolved institution should not be considered ‘aid’. The Court explained that if a measure has been taken by a regional or local authority that is, from a constitutional, administrative and economic point of view, separate from central government, the measure is not aid. These criteria could be considered for the future systemization of UK domestic control on state aid.

Will it be necessary for the UK and EU to agree a transitional arrangement for state aid matters after the UK’s withdrawal from the EU? If so, what transitional issues would such an arrangement need to address?

26. Transitional measures seem necessary. With regard to existing aid, granted before the UK accession and simply monitored by the European Commission, a settlement can be agreed. With regard to new aid, transitional measures should deal with the status of European Commission decisions addressed to the UK, especially where the Commission found a measure to be aid, but considered it compatible. Very frequently a Commission compatibility decision carries several conditions, the applicability of which might have to be ensured. Transitional arrangements will have to be considered in relation to cases pending before the General Court or the CJEU involving the UK and on solving possible pending recovery actions. Although the latter are rare against the UK. As to the status of aid notifications pending before the Commission and Commission investigations into UK measures, arguably these can be dealt with under either: transitional measures; through a future EU-UK trade agreement; or under the WTO rules.

27. Interesting, in its most innovative chapter on the creation of new tribunal for dispute settlement, CETA includes some provisions on subsidies. Article 8 provides that investors’ expectations would not be violated by a Party decision not to issue, renew or maintain a subsidy in the absence of specific commitments. Similarly, no breach of an investor’s expectations would occur if the discounting of the subsidy or its reimbursement was necessary to comply with international obligations between the Parties or has been ordered by a competent court, administrative tribunal or other competent authority (the EU Commission), or requiring that Party to compensate the investor. These provisions could be considering for probable future disputes.

14 September 2017