THE UK INTERNAL MARKET BILL: THE CLASH OVER STATE AID

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Introduction

With the publication of its Internal Market Bill[1] on 9 September 2020, the UK government has set itself on a potentially irreconcilable collision course with the EU over the issue of State aid. Indeed, this move is less a shot across the bows as it is a coach and horses driven through the current negotiations with the EU on an EU-UK free trade agreement ("**FTA**"), which are at a particularly delicate stage given that the Brexit transition period expires in less than 100 days.

The EU State aid rules (the so-called "level playing field" principle) are the bedrock of its internal market and, since the start of the negotiations on a future trade deal with the UK, the EU has consistently rejected any proposed arrangement which would give access to its markets without the UK signing up to this principle. However, the publication of the Internal Market Bill significantly "ups the ante" in this regard: no longer just a question of a stalemate in negotiations, the provisions on State aid (along with some other provisions in the Internal Market Bill) directly contradict commitments made under the Northern Ireland/Ireland Protocol (the "**Protocol**") contained in the UK's Withdrawal Agreement Treaty ("**WAT**") with the EU. Specifically, the UK government has empowered itself with the sole discretion to apply (and monitor) State subsidy measures applying in the **entirety** of the UK, whereas it had previously agreed with the EU that the latter's State aid rules would apply to Northern Ireland and to the movement of goods across the Irish border. In light of this, it remains to be seen not only whether any EU-UK FTA is still possible, but also what any future UK State aid regime would look like, and how closely it would tally with the EU's.

What is State aid?

State aid involves the conferring of an advantage (in any form whatsoever) on a company, industry or sector by a national government. On this basis, it can take many different guises and forms, including:

- Tax breaks or exemptions;
- State loans or guarantees;
- Renting or selling land at below market rates; and
- Promises to buy minimum values or levels of goods and services.

In the EU, the rationale behind the rules on State aid is that Member States should be prevented from granting advantages to certain "selected winners", as doing so risks distorting the EU's internal market. By choosing to

[1] United Kingdom Internal Market Bill: https://services.parliament.uk/bills/2019-21/unitedkingdominternalmarket.html.

confer advantages on (for example) certain domestic companies at the expense of others, Member States risk artificially disrupting the organic functioning of the EU common market. Such effects are not only felt domestically; companies in receipt of State subsidies may be able to undercut competitors domiciled in another Member State by offering lower prices and thus attracting more business away from these competitors. An overview of the EU State aid rules is set out at the end of this note.

In its Internal Market Bill, the UK government is not proposing anything that contradicts the EU State aid rules *per se*. Though the UK government has separately announced its general intention to follow the World Trade Organisation ("**WTO**") rules on State subsidies post-Brexit (*for which see further below*), there is nothing in the Internal Market Bill which explicitly provides for this. What the Internal Market Bill *does* state, however, is that the UK government will empower itself to (*inter alia*) disapply or modify the effects of Article 10 of the Protocol. As explained below, this effectively rejects the enforcement of the EU State aid rules in any part of the UK (including Northern Ireland).

Brexit negotiations: the clash over State aid

The Withdrawal Agreement and the Northern Ireland Protocol

The European Union (Withdrawal Agreement) 2018, as amended by the European Union (Withdrawal Agreement) Act 2020 (together "**EUWA**") enshrined in domestic UK law the UK's exit from the European Union, as set out in the WAT. This departure took effect at 11pm (London time) on 31 January 2020. The EUWA also established a transition period, ending on 31 December 2020, during which time EU law would continue to apply in the UK, and during which time the UK and EU would seek to agree their future trading relationship.

An important component of the WAT is the Protocol. In essence, the Protocol is intended to ensure that there is no hard border between Northern Ireland and the Republic of Ireland, post the end of the transition period, which it does by applying EU custom rules to the movement of goods between both countries. Importantly, Article 10 of the Protocol also requires that the **EU State aid rules** continue to apply vis-à-vis the granting of any State aid by the UK government, insofar as this may affect the movement of goods across the Irish border. Article 10 of the Protocol states:

"[The EU State aid rules] shall apply to the United Kingdom, including with regard to measures supporting the production of and trade in agricultural products in Northern Ireland, in respect of measures which affect that trade between Northern Ireland and the Union which is subject to this Protocol".[2]

Article 10 of the Protocol further states that the EU Commission ("**Commission**") continues to have jurisdiction over the enforcement of the EU State aid rules in Northern Ireland. A separate regulator – presumed to be the UK's Competition and Markets Authority – will have jurisdiction over the rest of the UK.[3] Both regulators would refer any dispute over the interpretation of EU State aid rules to the Court of Justice of the European Union.

The UK's and EU's FTA negotiating positions on State aid

Despite the fact that the Protocol only requires the UK to abide by State aid rules vis-à-vis Northern Ireland, the EU's stated negotiating position for agreeing a post-Brexit FTA with the UK goes much further than this. Due to the UK's close proximity to the EU, the EU has said that it will only conclude such an agreement if the UK, **as a whole**, commits to abiding by its State aid rules. The EU has set out this position in its negotiating directives:

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[2] Article 10(1) of the Protocol on Ireland/Northern Ireland. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/840230/Revised_Protocol_to_the_Withdrawal_Agreement.pdf.

[3] The House of Commons Library. *The UK-EU future relationship negotiations: Level playing field (Briefing Paper)*. 19 June 2020.

"The envisaged partnership should ensure the application of Union State aid rules to and in the United Kingdom."[4] Put simply, the EU sees the UK's unique geographical and historic position of access to its internal market as constituting too much of a risk that competition may be distorted (to the detriment of European businesses) if the UK does not continue to adhere to its rules on State subsidies.

By contrast, the UK government has repeatedly signalled its desire to move away from the EU's State aid rules and to establish its own system of State subsidy control. The UK government has long hinted that it will not accept any State aid measures which go beyond those agreed to by other nations with whom the EU has struck free trade agreements, such as Canada, Australia and Japan. In its published approach to negotiations, the UK government has stated that:

"The UK will have its own regime of subsidy control. The Agreement should include reciprocal commitments to transparency about the award of subsidies which go beyond the notification requirements set out in the WTO Agreement on Subsidies and Countervailing Measures. This should include an obligation on both parties to notify the other every two years on any subsidy granted within its territory, applying to goods or services, in line with EU-Japan EPA."[5]

As such, State aid has become a prominent focus (and, indeed, an impasse) in these EU-UK negotiations. As the UK has looked to draw a line in the sand with regard to subsidy control, this has been met with fierce resistance from the EU. George Peretz QC has opined that, even if the UK succeeded in establishing its own State subsidy control regime, the complexity of such a regime (insofar as it would have to interact with the obligations set out in Article 10 of the Protocol) had not been fully understood at the time the WAT was agreed.[6] This is because, even though Article 10 is stated as being limited to the movement of goods across the Irish border and appears straight-forward enough on paper, in reality it has far wider application than was initially envisaged as it will be very difficult for the UK government (or a UK public authority) to introduce any measure or policy which does *not* have an effect on Irish cross-border trade. Dr Sylvia de Mars has illustrated the conundrum in the following terms:

"If, for instance, a car manufacturer in Nottingham got a subsidy and traded its cars in Northern Ireland, that would run into the problem of aid affecting the single market, because those cars moving from Northern Ireland to the EU market would have an advantage in the sense that they had been subsidised in one way or another".[7]

Thus, the issue posed by the interaction between Article 10 of the Protocol and the UK's desire for its own State subsidy regime looks like it may have proven to be a more difficult circle to square than perhaps the UK had initially envisaged – which would explain why the UK has decided to go for the "nuclear option" as set out in the Internal Market Bill.

The Internal Market Bill

The UK's Internal Market Bill (the "**Bill**")[8] was published on 9 September 2020. In this document – which obviously requires approval by both Houses of Parliament before it can become law – the UK government has, along with

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[4] Council of the European Union. *Directives for the negotiation of a new partnership with the United Kingdom of Great Britain and Northern* Ireland. Para 96. Available at: https://www.consilium.europa.eu/media/42736/st05870-ad01re03-en20.pdf.

[5] The UK Government. *The Future Relationship with the EU: The UK's Approach to Negotiations*. 27 February 2020. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/868874/The_Future_Relationship_with_the_EU.pdf.

[6] The European Union Committee (The House of Lords). *The Protocol on Ireland/Northern Ireland – Ninth Report of Session 2019-21*. 1 June 2020. Chapter 9, paras 188-189. Available at: https://publications.parliament.uk/pa/ld5801/ldselect/ldeucom/66/6612.htm.

[7] Ibid. Chapter 9, para 190.

[8] The UK Government. *The UK Internal Market Bill.* 9 September 2020. Available at: https://publications.parliament.uk/pa/bills/cbill/58-01/0177/20177.pdf.

other deviations from the commitments made under the Protocol, signalled that it will empower a government minister with the sole ability to determine how State aid rules are to be applied post-transition.

The relevant provisions are set out in Part 5 of the Bill – specifically, sections 43 and 45. If enacted, section 43 would permit the relevant Secretary of State to make any regulations relating to Article 10 of the Protocol, including modifying or disapplying its effect. Clause 45 takes this a step further by stating that section 43, or any regulations made under it, are to take effect "*notwithstanding*" the fact that this may be incompatible or inconsistent with domestic or international law. Therefore, if enacted, this would give the UK government sole discretion under its **domestic law** to determine how State aid was to be applied in respect of Northern Ireland, which would be in violation of its **international obligations** as set out in Article 10 of the Protocol.

This latest move signals a significant intensification in the EU-UK showdown over State aid. It initially appeared as if the UK, regardless of its wish to establish its own State subsidy regime, was nonetheless committed to the State aid provisions contained in the Protocol. Indeed, in a policy paper published on 27 May 2020, the UK government had stated:

"The Protocol sets out that EU State aid rules will apply…to trade between Northern Ireland and the EU. This does not mean that State aid rules will apply to Northern Ireland as they do today. State aid provisions apply only to trade 'subject to the Protocol'. The Protocol is limited in scope to the movement of goods and wholesale electricity markets. Northern Ireland will therefore enjoy new flexibilities with respect to support for its service industries"[9]

It is clear therefore that, before the publication of the Bill, plans for a UK State subsidy regime were being treated as separate to the observance of the Protocol. This position was also confirmed by Michael Gove, Chancellor of the Duchy of Lancaster, when giving evidence to the House of Lords EU Committee, in response to a question as to the effect which the Protocol would have on any UK State aid regime:

"[The Protocol] should not have [an effect], because the key thing is that those provisions are to apply specifically in Northern Ireland…and it seems to me an entirely fair approach"[10]

To raise the stakes further, the UK government followed up the publication of the Bill with the announcement that it would follow the WTO rules on State aid after the end of the transition period on 31 December 2020.[11] Whilst the WTO rules are an internationally recognised standard, the UK government will be fully aware they will be unacceptable to the EU. Therefore, a UK-EU FTA will be almost impossible if the UK sticks to this position. Indeed, there are concerns as to just how viable the WTO rules would be for a UK State subsidy regime, in and of themselves. One commentator has described the WTO rules as "very weak".[12]

Next steps: the establishment of a UK State subsidy regime?

Quite apart from the constitutional and international legal issues which this latest move from the UK government has raised, and the linked question as to whether the Bill will therefore even be approved by both Houses of Parliament (an uncertain prospect, not least given the opposition of all five living former UK Prime Ministers), the UK-EU negotiation now stand on a knife edge. UK Prime Minister Boris Johnson has stated that the UK will withdraw from the FTA negotiations if no agreement has been reached by the time the EU leaders' summit takes place on 15 October 2020, whilst the EU has indicated that, if the UK government does not withdraw the Bill before

[9] The Cabinet Office. *The UK's Approach to the Northern Ireland Protocol*. 27 May 2020, para 40. The House of Commons Library. *The UK-EU future relationship negotiations: Level playing field (Briefing Paper)*. 19 June 2020.

[10] House of Lords. *Select Committee on the European Union Uncorrected oral evidence: Progress of UK-EU future relationship negotiations*. 5 May 2020. Available at: https://committees.parliament.uk/oralevidence/344/html/.

[11] See full announcement at: https://www.gov.uk/government/news/government-sets-out-plans-for-new-approach-to-subsidy-control?utm_campaign=govuk-notifications&utm_content=immediate&utm_medium=email&utm_source=23b0ca67-f93a-47be-b339-c1c7a44883fd.

[12] MLex. *EU not trying to bind UK to post-Brexit State aid regime, says Scottish Minister*. 15 September 2020. Available at: https://www.mlex.com/GlobalAdvisory/DetailView.aspx?cid=1223010&siteid=225&rdir=1.

the end of September, it will not shy away from relying on the legal remedies available under the Withdrawal Agreement.[13]

Following the publication of the Bill, on 18 September 2020 members of the UK State Aid Law Association and other leading experts published an open letter to Boris Johnson in which they offered to assist the UK government in setting up a new domestic subsidy regime based on the WTO rules and separate from the EU's State aid rules.[14] In this letter, the signatories stated that a UK subsidy regime was "achievable", although they also stated that it would need to go beyond the WTO rules which, they said, "*do not cover services or control subsidy races between the nations of the UK*". Notably, the letter does not make any comment on how it was proposed to reconcile such a subsidy regime with the legal commitments set out in the Protocol. However, as prominent lawyers drawn from across the spectrum of opinion on Brexit, it is most unlikely that they would propose a regime which was at odds with international law.

Conclusion

The UK government's decision to renege on commitments made under the Protocol and move towards applying the WTO rules on State subsidies raises many difficult questions. The EU has made its position clear and, unless the UK backtracks significantly, the likelihood of signing an EU-UK FTA (at least in the short-term) is virtually nil. In addition, a particularly interesting issue will be the form of State aid regime which the UK opts for, given its stated aim of creating a regime that "*[operates] in a way that works [for all] businesses, workers and consumers*".[15] Whether or not the WTO rules on State subsidies would provide a sufficiently comprehensive framework to satisfy this need is something which remains to be seen.

To conclude, unless either side softens its position considerably, it is looking increasingly likely that, for the UK to achieve its goal of implementing its own subsidy control measures post-Brexit, it will have to forfeit a free trade agreement with the EU.

[13] The European Commission. *Statement by the European Commission following the extraordinary meeting of the EU-UK Joint Committee (Press Release)*. 10 September 2020. Available at https://ec.europa.eu/commission/presscorner/detail/en/statement_20_1607.

[14] The letter can be viewed at https://uksala.org/wp-content/uploads/2020/09/UK-Domestic-Subsidy-Control-letter-18-September-2020-002.pdf.

[15] The UK Government. *Government sets out plans for new approach to subsidy control (Press Release).* 9 September 2020. Available at: https://www.gov.uk/government/news/government-sets-out-plans-for-new-approach-to-subsidy-control.

Overview of the EU State aid rules

What are the EU State aid rules?

Articles 107 to 109 of the Treaty on the Functioning of the European Union ("TFEU") set out the EU's State aid rules. Article 107 of the TFEU prevents:

"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."

The key elements here are that the aid provided to an undertaking must be through state resources and the aid must distort (or have the potential to distort) competition in such a way that trade between Member States is affected. Taking the former, "state resources" encompasses any aid provided by all central and local governments as well as public bodies exercising government powers. Thus, any funding granted by, say, a local council would fulfil this criterion. In addition, the latter requirement is also easily met. The EU courts have traditionally taken the view that any aid provided by a Member State to an undertaking which in any way alleviates its day-to-day operational costs or burdens (i.e. constitutes any form of advantage) will amount to a distortion of competition. As such, this is a very low bar. Only if it can be irrefutably established that the undertaking to whom the aid is granted operates in an environment where there can be no effect on competition whatsoever will this test not be met. However, such cases are rare and difficult to proof.

The so-called "market investor principle test" (the "Test") provides further clarification on what exactly is deemed to be "aid". As outlined above, aid is something which the EU courts have interpreted broadly, and it will usually be clear when any State aid has been conferred. However, any ambiguity can be resolved by applying the Test, which poses the question as to whether a private investor would have provided such assistance under normal circumstances and normal economic conditions. That is to say, if a Member State has provided aid without the incentive or possibility of receiving any return on such investment, this will be deemed to fail the Test and constitute State aid, as no private investor would be willing to provide such assistance without any sort of quid pro quo or financial motivation.

If the above conditions are satisfied, the State aid must be notified to the Commission, who will either approve or prohibit such assistance.

When is State aid permitted?

Despite the stringent rules on State aid, there are circumstances in which national governments may confer aid on undertakings. Member States are permitted to use State aid to intervene in their national economies and promote certain policies such as regional economic development, research and innovation or investment in low carbon technologies.

Article 107(2)(b)

Under Article 107(2)(b) of the TFEU, the Commission may allow certain State aid measures enacted by Member States to remedy the damage sustained as a result of natural disasters or exceptional circumstances. For all measures taken under Article 107(2)(b), there must be a direct causal link between the aid granted and the damage resulting from the exceptional occurrence for each beneficiary, and any aid must be limited to what is necessary to make good the damage. With regard to the latter, Member States will need to demonstrate, and support with evidence, how it calculated the amount of aid it wishes to provide to any individual company or sector. Any measure enacted under Article 107(2)(b) will require prior Commission approval.

Article 107(3)(c)

Article 107(3)(c) of the TFEU allows Member States to provide loans, or loan guarantees, to all any undertaking that may be facing acute liquidity needs or insolvency. It should be noted that, in conjunction with the Commission Rescue and Restructuring Guidelines, companies need not be facing any such difficulties imminently in order to qualify for such support, so long as they pay market rates for any such loan. Any such loan granted

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by a Member State may cover any company's operating needs for a full six-month period. Any measure enacted under Article 107(3)(c) will require prior Commission approval.

The 'de minimis' regulation

Where Member States provide aid to an undertaking which amounts to less than €100,000 over a period of three years, it is presumed that there will be no appreciable effect on trade between Member States and, as such, this form of aid is permissible.

The General Block Exemption Regulation ("GBER")

The GBER declares some prescribed forms of State aid as compatible with Article 107 of the TFEU. The GBER covers (inter alia): (i) regional aid; (ii) investment in small and medium-sized enterprises; (iii) aid for environmental protection; and (iv) aid for R&D and innovation.

COVID and State aid

On 19 March 2020, the EU published a Temporary Framework to allow for a wide range of State aid measures to be passed by Member States to address the systemic economic shock brought by the COVID-19 pandemic.

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