

UK SUBSIDY CONTROL: GOVERNMENT CONSULTS ON WHAT SUBSIDIES WILL BE REFERRED TO COMPETITION REGULATOR

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Legal Briefings

Despite talk of streamlined post-Brexit subsidy control policy
Government proposals suggest intrusive review process

On 25 March 2022, the UK Government published a consultation on how "subsidies of interest" and "subsidies of particular interest" are to be defined under the UK's new subsidy control regime. These concepts are fundamental, as they determine which subsidies are referred to the UK's Competition and Markets Authority (CMA) for evaluation.

The proposed approach is based primarily on financial thresholds relating to the value of the subsidy, which are set at relatively low levels. For subsidies of particular interest, which must be referred to the CMA, the threshold is to be generally £10 million, with a lower threshold of only £5 million in certain sensitive sectors such as steel, automotive and electricity production. Certain subsidies are also to be referred regardless of value, including restructuring subsidies and relocation subsidies.

The proposed value thresholds are considerably lower than those under the EU state aid regime's general block exemption regulation (GBER). As a result, many more subsidies may be subject to CMA referral compared to those that would have had to be notified to the European Commission under the previously applicable EU state aid regime, and the new UK subsidy control regime may ultimately be more intrusive than it first seemed.

The additional scrutiny of lower value subsidies may be appropriate from a systemic perspective, given the focus of the new regime on addressing distortions to the UK's own internal market. But it will place greater burdens on public authorities and subsidy recipients in having to prepare for and navigate the CMA referral process, while also increasing legal risks should that process not be followed.

OVERVIEW OF THE UK SUBSIDY CONTROL REGIME AND THE CMA'S ROLE

The Government set out its detailed proposals for the UK's domestic subsidy control regime in its Subsidy Control Bill in June 2021. While the substantive aspects of the new model are similar to the EU equivalent, there are significant differences in process and enforcement, with a shift from forecast-based pre-approval towards a regime driven more via *ex post* enforcement by complainants through private litigation based on concrete outcomes.

The Bill does, however, provide for certain categories of subsidies to be referred to the CMA for evaluation of their consistency with the subsidy control principles, prior to the granting of the subsidy – the so-called subsidies of interest and particular interest – which are meant to represent the most potentially distortive interventions. Subsidies of interest are subject only to voluntary referral by granting authorities, whereas subsidies of particular interest are subject to mandatory referral.

While the CMA's evaluation report is formally to be advisory only and non-binding, the referral procedure may in reality become akin to a forecast-based pre-approval process, as the granting of subsidies in deviation from the CMA's findings would leave those awards vulnerable to being overturned in the event of an appeal brought by complainants. The definitions of subsidies of interest and particular interest are therefore important, as awards falling within their scope may be subject to an additional regulatory process with significant legal and practical implications.

DEFINITION OF SUBSIDIES OF INTEREST AND PARTICULAR INTEREST

The Government's proposed approach to defining subsidies of interest and subsidies of particular interest is comprised of three main elements:

- General value thresholds, which apply to subsidies in most sectors;
- A lower value threshold for subsidies of particular interest in designated sectors considered to be sensitive; and
- Subsidy type based criteria, which define certain types of support as subsidies of interest or particular interest, regardless of value.

General value thresholds

The Government proposes a general value threshold of £10 million for subsidies of particular interest and £5 million for subsidies of interest. Subsidies in excess of £10 million would therefore be subject to mandatory referral to the CMA, while subsidies between £5 million and £10 million would be subject to voluntary referral.

The thresholds are to be applied on the basis of the gross grant equivalent of the subsidy, which in the case of a subsidised loan, for example, would be the difference between the terms of the loan and the market rate, rather than the nominal amount of the whole loan.

There will also be cumulation of subsidies granted to the same enterprise during a rolling three-year period to prevent subsidies meeting the thresholds being split into smaller awards to evade referral.

Lower threshold for subsidies in sensitive sectors

The Government proposes a lower threshold of £5 million should be used to define subsidies of particular interest in designated sensitive sectors, where there is evidence of global overcapacity and an existing record of international trade disputes (or evidence this will occur in the future). An exhaustive list of such sectors and economic activities is proposed, as follows:

- Manufacture of basic iron and steel and of ferro-alloys;
- Aluminium production;
- Copper production;
- Manufacture of motor vehicles;
- Building of ships and floating structures;
- Manufacture of motorcycles;
- Manufacture of air and spacecraft and related machinery; and
- Production of electricity.

Input activities for these sectors and economic activities, eg, the production of automotive batteries, will also be included.

This list of sectors and economic activities will be kept under review and adapted if necessary in light of changes in economic conditions. Indeed, the consultation already sets out certain further sectors and economic activities that could be added in future – including the manufacture of man-made fibres and electronic components such as semi-conductors – where there has also been evidence of global overcapacity or international trade disputes.

Types of subsidies defined as subsidies of interest or particular interest irrespective of value

The Government proposes that certain types of subsidies, which are considered the most potentially distortive by nature, be defined as either subsidies of interest or particular interest, irrespective of value:

- **Rescue and restructuring subsidies:** These subsidies are among the most competitively distortive, as in their absence, the beneficiary enterprise would go out of business and exit the market.

Rescue subsidies, ie, subsidies in the form of temporary liquidity support to keep an enterprise in business while a restructuring programme can be devised, are to be considered as subsidies of interest, which are subject to voluntary referral. Because of the time-critical nature of such support, the Government proposes they may be granted before the CMA has issued its report, should circumstances demand it.

Restructuring subsidies, ie, more enduring support granted on the basis of a restructuring programme, are to be considered subsidies of particular interest, which must be referred to the CMA.

- **Relocation subsidies:** Subsidies that are conditional on the beneficiary enterprise relocating economic activity from one part of the UK to another, are evidently significantly distortive of investment. While these subsidies were to be prohibited under the original version of the Subsidy Control Bill, the Government has shifted position, asserting that relocation subsidies might yet be justified if they have the effect of reducing social or economic disadvantage in a particular region.

Given their significant distortive potential, however, the Government proposes they be subject to additional scrutiny.

RECOMMENDATION TO REFER CERTAIN SUBSIDIES OF INTEREST

While subsidies of interest are subject only to voluntary referral, the Government considers that subsidies exhibiting certain features are more likely to be distortive and therefore ought to be referred to allow additional scrutiny. The Government will publish detailed guidance setting out these kinds of features, but according to the consultation, they are likely to include the following:

- Evidence of a subsidy race between public authorities;
- The same, or a substantially similar, subsidy has been repeatedly made to the same recipient;
- The subsidy is linked to the ongoing economic activity of an enterprise, rather than being a one-off activity; and
- The subsidy is only open to one firm (ie, there is no competition in granting the award).

Where one or more of these features are present, public authorities will be advised to refer to the CMA.

THE CONTOURS OF THE NEW REGIME ARE EMERGING AND IT MAY BE MORE INTRUSIVE THAN IT FIRST SEEMED

As noted above, definitions of subsidies of interest and particular interest are important, as they determine the scope of the CMA's referral jurisdiction and therefore the extent to which the UK's subsidy control regime may involve aspects of forecast-based pre-approval, rather than being determined just on ex post enforcement.

In this regard, the value thresholds proposed by the Government seem relatively low, with the result that the CMA's jurisdiction is set to have a broad reach and play a significant role in the new regime. The thresholds for subsidies of particular interest – generally £10 million and only £5 million in certain sensitive sectors – are considerably lower than the thresholds under the EU state aid regime's GBER, under which various categories of state aid fulfilling certain criteria can be granted without pre-approval from the European Commission, and under which the great majority of all aid is granted in the EU. For example, the GBER exempts state aid of up to €20 million for industrial research projects and for research infrastructures; up to €50 million for energy infrastructures; and up to €100 million for fixed broadband networks and mobile networks. Under the UK Government's proposed thresholds, however, all of these aids would require CMA review.

The lower thresholds may be justified in light of the intrinsic differences between the two regimes. The EU approach is primarily concerned with addressing distortions in competition between member states in the EU's larger internal market, whereas the new UK counterpart is focused on addressing distortions in the UK's own domestic internal market. It may therefore be appropriate also to scrutinise lower value subsidies which may still have significant local effects within the UK. The consequence of this approach, however, will be to place greater burdens on public authorities and subsidy recipients in preparing for the CMA review process while also increasing legal risks should that process not be followed.

This is exacerbated by the lower value threshold that will apply for subsidies in so-called sensitive sectors. It is further notable that these sectors have been chosen due to sensitivity from an international trade perspective rather than due to competitive conditions in domestic markets and propensity for local distortions in the UK's internal market. This suggests international trade and investment considerations will also be a key factor in the assessment under the new UK regime. Subsidies have been a major source of international trade disputes over the past years, including the long-running US-EU dispute in relation to aviation subsidies (Boeing-Airbus), and it is notable that the UK's first WTO dispute since Brexit, which was initiated by the EU last week, concerns the UK's subsidy programme for renewable energy generation – its contract for difference scheme. Indeed, it may be the Government envisages using the additional scrutiny of the CMA as a shield against complaints by international partners.

Finally, while subsidies of interest are subject only to voluntary referral, the Government's position that public authorities would be well advised to refer such subsidies to the CMA when certain features are present, may in reality turn such awards into subsidies of particular interest subject to mandatory referral. This is because if public authorities decide not to refer such subsidies, despite clear recommendations from Government, that would be an obvious ground of criticism that complainants could raise on appeal. Again, this has the effect of broadening the scope of the CMA's referral jurisdiction and the consequent burdens and risks for public authorities and subsidy recipients.

It is important, of course, to bear in mind that the UK's new subsidy control regime remains under construction and it remains to be seen where the Government will ultimately land on these issues. Various other material elements are also yet to be determined, including how the Government will use its ability to set up so-called "streamlined routes", which, analogous to the GBER, will be exempt from CMA referral.

But in sum, if the Government's proposals for subsidies of interest and particular interest are followed, the UK's new subsidy control regime may ultimately be more intrusive and intensive than initial expectations. Diligence in relation to state aid control, now subsidy control, looks set to remain as a fundamental consideration in any operation or transaction involving the state and public authorities, and subsidy recipients, counterparties and other interested parties will need to bear this in mind and act accordingly.

The consultation is open for the next five weeks, and closes on 6 May 2022. Responses can be sent using the online form, or by email to subsidycontrolconsultation@beis.gov.uk.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



STEPHEN WISKING
MANAGING PARTNER,
COMPETITION,
REGULATION AND
TRADE, LONDON
+44 20 7466 2825
stephen.wisking@hsf.com



TIM BRIGGS
PARTNER, LONDON
+44 20 7466 2806
Tim.Briggs@hsf.com



**LODE VAN DEN
HENDE**
PARTNER, BRUSSELS
+32 (0)2 518 1831
Lode.VanDenHende@hsf.com



**MORRIS
SCHONBERG**
SENIOR ASSOCIATE,
BRUSSELS
+32 477 882 741
Morris.Schonberg@hsf.com

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