SQUIRE PATTON BOGGS

The Subsidy Control Act 2022:

UK Subsidy Control Regime Receives Royal Assent (Part Two)

May 2022

On 28 April 2022, the UK's new regime to regulate subsidies received Royal Assent. The Subsidy Control Act 2022 (the Act), some parts of which enter into force immediately, replaces the rules that have been in place since Brexit. Although there is substantial carry-over from the interim rules, the Act also introduces some significant changes that affect both public authorities and private businesses.

- In Part One of this note, we explained the central aspects of the new Act and highlighted the key changes
- In Part Two, below, we will discuss five important questions that the new legislation raises

1. Does the Act Give Public Authorities, Businesses and Investors Sufficient Certainty?

When it introduced the draft Subsidy Control Bill in 2021, the government described it as more "agile and flexible" than the EU state aid rules and stated that it would "empower public authorities across the UK to deliver financial support – without facing burdensome red tape".[1] The claim that the new UK rules are flexible and less burdensome may prove justified. However, that flexibility could come at the expense of certainty, which is critical if investment decisions are to be taken quickly and confidently.

As we explained in Part One, the Act makes public authorities responsible for assessing whether the subsidies they intend to award comply with seven Subsidy Control Principles. With the exception of a limited category of Subsidies of Particular Interest that will have to be notified to the Subsidy Advice Unit (SAU) (see below), authorities are free to design a subsidy and satisfy themselves that it meets the rules.

On its face, this does appear more flexible than the EU system. Under the EU rules, authorities were encouraged to design state aid measures to satisfy the prescriptive conditions of a block exemption – notably the General Block Exemption Regulation (GBER) – or face a lengthy notification process before the European Commission (the Commission).

However, this approach had some benefits. Although GBER could seem rigid and inflexible, it gave authorities and beneficiaries a clear framework. The "tick-the-box" structure of GBER enabled authorities to design an aid measure that they could be relatively certain would be safe from challenges. Moreover, GBER provided tailored criteria for more than a dozen different types of aid, from regional aid and aid to SMEs to aid for broadband infrastructure and aid for culture and heritage.

In contrast, UK authorities must now assess their subsidies against the Subsidy Control Principles. As the name suggests, these are high-level criteria: for example, a subsidy must serve a public policy objective and be proportionate. In practice, many are already finding it harder to judge whether a subsidy satisfies the Principles than it was to determine whether a state aid complied with GBER.

Just as importantly, practitioners were familiar with GBER, which had existed in some form since 2008. Interpreting the EU rules was also made easier by the state aid case law of the European Courts and the Commission's extensive history of decision-making. In contrast, the Subsidy Control Principles are unfamiliar and there is, as yet, no case law and limited guidance on their interpretation.

It is likely that the government will address these issues by providing further guidelines and support for authorities. This process has already started, with the publication of illustrative guidance on the application of the principles in January 2022. Equally, authorities, businesses and investors will gain more confidence in applying the new rules over time.

Nevertheless, it would be an unfortunate outcome of introducing the new regime if a lack of certainty in the short term delayed funding and investment decisions, particularly at a critical time for post-COVID-19 reconstruction.

1 *New subsidy system to support UK jobs and businesses, boost the economy and strengthen the union, Department for Business, Energy & Industrial Strategy (30 June 2021).*

2. Are Third Parties' Interests Adequately Protected?

As we explained in Part One, the Act provides relatively limited protection for the interests of third parties – in particular, parties that may want to challenge the award of a subsidy. What the Act gives in terms of greater transparency and access to information, it takes away in terms of limited participation and rules that make it difficult and costly to bring a challenge.

The Act does not explain in detail how the SAU will conduct its review of subsidies that are submitted by authorities. However, nothing in the Act suggests that interested parties will be consulted or be able to submit comments during the review. This may be a consequence of the tight timetable that the Act sets: the SAU is in most cases required to publish its report on a proposed subsidy within 30 working days.

This will be a concern for third parties that are opposed to a subsidy. If the SAU does not invite (or permit) comments from third parties, its review of an authority's decision will be based solely on evidence that the authority itself provides. This contrasts with the (admittedly longer) state aid investigation procedure before the Commission, in which interested parties have a right to submit comments.

The fact that the SAU's reports on subsidies will be published is helpful for potential complainants. Although such reports are not binding on the authority to whom they are addressed, one assumes that an interested party would have a relatively easy claim under judicial review to overturn a decision that was taken in the face of a negative SAU report.

The interests of third parties are also supported by the Act's transparency provisions. As explained in Part One, authorities will be obliged to publish information about any subsidy they award on a national database, with some limited exceptions. Moreover, parties that are considering bringing a challenge can request more information – specifically, information that allows them to review the authority's application of the Subsidy Control Principles – within one month of publication. This will be a useful tool for complainants, enabling them to get extensive disclosure of documents in order to build a claim for judicial review, or decide not to do so, before they incur substantial costs.

Thereafter, the rights of third parties become more limited. Interested parties have just one month (from either publication in the transparency database or the receipt of supplementary information) to submit a Notice of Appeal to the CAT. This does not compare favourably to the 10-year limitation period for the Commission to investigate state aids, or even the three-month limitation period that applies to standard judicial review claims before the High Court.

A challenger will also have to show that they have standing, which requires that they are "a person whose interests may be affected by the giving of the subsidy". Direct competitors of a beneficiary should have little difficulty satisfying this test, but it will be interesting to see how the CAT views actions brought by community groups or special interest groups, or members of the public seeking a review on public interest grounds.

If a third party can show that they have standing and can make out an arguable case, their action will then be heard. Since the CAT will review subsidies on judicial review grounds, it will not assess the merits of an award decision but rather how that decision was taken. Specifically, the CAT will consider whether the decision was lawful and reasonable, subject to the high standard established in the *Wednesbury* case, i.e. whether the decision was so unreasonable that no reasonable person could have made it.

As well as overcoming tight timelines and high standards of proof, complainants must also be prepared to incur the cost of bringing an action. The costs are unlikely to deter parties challenging high-value subsidies, but they may be daunting for parties concerned by subsidies of £1 million or less.

In summary, the Act does not appear to favour third parties who may be adversely affected by a subsidy. On the other hand, the short limitation period and high standard of review will provide greater legal certainty for authorities and beneficiaries.

Finally, as regards the rights of subsidy recipients, these remain unclear. First, the Act does not specify whether the intended recipient of a subsidy will be involved if that subsidy is reviewed by the SAU. Second, the Act does not explain whether beneficiaries will have a right to be heard in cases before the CAT in the event of a challenge. However, applying the CAT's standard rules of procedure, the recipient of a subsidy should be able to intervene as a person with "sufficient interest" in the outcome of the case.

3. When Will a Subsidy Have "Negative Effects on Competition or Investment Within the UK"?

Under the Act, authorities are obliged to:

- Design subsidies in a way that achieves their specific policy objective while minimising any negative effects on competition or investment within the UK (Principle F)
- Ensure that subsidies' beneficial effects outweigh any negative effects, including in particular negative effects on competition or investment within the UK (Principle G)

Furthermore, the Act expressly prohibits subsidies that are conditional upon the recipient relocating some or all of its activities from one part of the UK to another.

As such, the Act opposes the use of subsidies in a way that could distort competition or investment within the UK. This is a purely domestic application of subsidy control rules that had no equivalent in the EU regime, which was only concerned with effects on trade between member states.

The novelty of these rules could make them challenging for authorities and beneficiaries to interpret. In particular, the requirement to ensure that a subsidy has minimal negative effects on competition within the UK would seem to oblige local authorities to consider whether their subsidies could have an adverse impact outside their town or region – and, if so, whether this has been "minimised".

There are any number of situations in which relatively uncontroversial subsidies could arguably fail this test. For example, if one town council granted funds for a new arts centre, could the neighbouring town's council complain that the subsidy will have a negative effect on the arts in its community? If the neighbouring council brought such an action, how would the Competition Appeal Tribunal (CAT) interpret Principle F? At a larger scale, these parts of the Act could prove controversial in the context of subsidies granted by the devolved governments in Scotland, Wales and Northern Ireland, or by the UK government for England, if they have exclusively regional benefits.

It is also not obvious how these provisions can be reconciled with the government's Levelling Up policy, the purpose of which is to support investment, productivity and opportunities in disadvantaged parts of the UK. By necessity, this will involve the use of targeted subsidies to benefit specific regions.

The EU state aid rules dealt with these issues by expressly permitting "regional aid", i.e. aid granted in pre-identified areas that were disadvantaged or deprived relative to EU or national averages, provided that the aid complied with a stringent set of conditions. One possibility would be for the government to introduce a similar set of rules that define when subsidies of local benefit are acceptable in the UK. There is scope for the government to do so under the Act's provisions on Streamlined Schemes (see below).

In the absence of further regulations, or at least more concrete guidance, this may be one of the aspects of the Act that is most contested in the early judicial review cases before the CAT.

4. What Subsidies Will Have to Be Notified to the CMA?

As explained in Part One, the Act introduces a system of mandatory and voluntary referral of subsidies to the new SAU that will sit within the Competition and Markets Authority (CMA):

- A "Subsidy of Particular Interest" must be referred to the SAU, and before it can be awarded the authority must either wait for the SAU's report and then observe a five-day cooling off period, or wait for the SAU's review period to expire
- Authorities can voluntarily refer a "Subsidy of Interest" to the SAU, but they are not obliged to do so and are not obliged to wait for the SAU's report before they implement it
- In addition, the Secretary of State can issue a "call-in" direction that requires a public authority to request a report from the SAU in relation to a proposed subsidy or subsidy scheme

However, the Act does not define what Subsidies of Particular Interest or Subsidies of Interest are. As such, at present, authorities and businesses are in the dark as to what types of subsidies will be subject to CMA review.

In January 2022, the government issued a Policy Note that gave a broad indication of what these definitions may look like, however, these are drafts and will need to be developed further. In particular, the value thresholds in the Policy Note were not specified but were given in indicative ranges:

Subsidies of Particular Interest are:

a. All subsidies that concern a sensitive sector in excess of £[1 to 5]m per enterprise

b. All subsidies regardless of sector in excess of £[5 to 10]m per enterprise

c. All subsidies for restructuring ailing or insolvent enterprises, including insurance companies and deposit takers

Subsidies of Interest are:

a. All subsidies between £[1 to 5]m (regardless of any design features) which do not fall within the Subsidies of Particular Interest definition

b. For subsidies between these values, guidance will set out the design features that – where present – public authorities would be encouraged to make use of the referral option, i.e., public authorities should typically not refer a subsidy to the SAU unless one or several design features are present

c. All subsidies for rescuing ailing or insolvent enterprises, or for liquidating or providing liquidity support to deposit takers or insurance companies

"Sensitive Sectors" are listed in the government's Illustrative Regulations and cover the manufacture of various metals, the production of motor vehicles, ships, aircraft and spacecraft, and the production of electricity. They are, therefore, limited in scope. As a result, the value of a subsidy is likely to determine whether it must (or can) be notified. Based on the indicative ranges given in the Policy Note, the thresholds for notification could be relatively low, starting at £1 million.

This is another area in which more clarity is needed urgently. Public authorities and businesses must be told what subsidies will face prior review, not least because some larger subsidies may already be in the planning stage that could be caught by the new rules. In addition, the scope of the SAU's powers will have to be made clear before it can start to perform its monitoring role.

5. What Subsidies Will Benefit From Streamlined Routes?

The Act enables the government to create so-called "Streamlined Routes" to allow authorities to grant certain types of subsidies more quickly, and with more certainty. The government will introduce Streamlined Routes for categories of subsidies that are at especially low risk of causing market distortions and that promote strategic policy objectives. An authority will be able to decide whether a subsidy it plans to grant meets the conditions of one of the Streamlined Routes and, if it does, the authority can go ahead with its award without assessing compliance with the Subsidy Control Principles.

A subsidy granted under a Streamlined Route will also not need to be referred to the SAU for review and cannot be called in for review. However, the transparency obligations still apply and a subsidy awarded on this basis can still be challenged before the CAT. At that point, the CAT would review whether the authority was correct to conclude that a Streamlined Route applied – if it was, the challenge should end there.

The government has published two illustrative examples of Streamlined Routes, for clean heat and research, development and innovation respectively. These suggest that Streamlined Routes will be similar to EU block exemptions. The examples specify the types of project and beneficiary that can receive subsidies under each Streamlined Route; the way in which the subsidy should operate; and the maximum amount of subsidy that can be awarded, as either a percentage of costs or a total amount (despite one of the government's criticisms of GBER being that it "[set] hard limits on how much could be granted").

Streamlined Routes have the potential to ease significantly the compliance burden that authorities will face under the Act. An obvious question, however, is which categories of subsidies will benefit, since the Act does not specify.

As noted above, GBER exempted more than a dozen categories of state aid from notification to the Commission. In practice, it was even more extensive as each category contained several sub-categories. For example, GBER exempted four different types of aid for SMEs, and a further four types of aid for access to finance for SMEs.

There may be calls for the government to use Streamlined Routes to replace GBER in full, not least because it could create a competitive disadvantage if certain subsidies had to be notified to the SAU if awarded in the UK, which would not have to be notified to the Commission if awarded in the EU. The government might also consider using its new ability to operate independently of the EU to allow streamlined support in even more areas. For example, Streamlined Routes could be used to support policy objectives in the digital sector, or in relation to the roll out of 5G infrastructure.

This, however, will take time. Designing an exemption that allows unproblematic subsidies to be granted quickly, while ensuring that subsidies that could distort competition or investment still receive scrutiny, is a difficult task. Doing so in many different areas, some of which are sensitive and complex (e.g., green energy subsidies), and making sure that all of the conditions are easy to understand, will be even harder.

In summary, although Streamlined Routes are an area in which the Act creates a promising framework, considerable work lies ahead to deliver upon this promise.

Contacts

Diarmuid Ryan
Partner, London, UK
T +44 20 7655 1310
E diarmuid.ryan@squirepb.com

Oliver Geiss
Partner, Brussels, Belgium
T +32 2 627 1112
E oliver.geiss@squirepb.com

Brian N. Hartnett
Partner, Brussels, Belgium
T +32 2 627 1101
E brian.hartnett@squirepb.com

Francesco Liberatore
Partner, London, UK
T +44 20 7655 1505
E francesco.liberatore@squirepb.com

Martin H. Rees
Partner, London, UK
T +44 20 7655 1137
E martin.rees@squirepb.com

Will Sparks
Partner, Brussels, Belgium
T +32 2 627 7610
E william.sparks@squirepb.com

The opinions expressed in this update are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

squirepattonboggs.com

© Squire Patton Boggs. All Rights Reserved 2022

51488/05/22