Analysis

State aid under the Northern Ireland Protocol

Speed read

It is not clear that the UK government appreciated the full significance of the state aid provisions of the Northern Ireland Protocol when the agreement was concluded last autumn. The UK will be required to comply with EU state aid rules where any UK measure potentially affects trade between Northern Ireland and the EU – catching many UK-wide tax measures in consequence. The Protocol also preserves a substantial enforcement role for the Commission and the CJEU. Looking ahead, the requirement to follow these rules will complicate any attempts by the UK to set up an independent WTO-style anti-subsidy regime in future.

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Following a short inquiry into the UK's level playing field commitments and state aid regime post-Brexit, the House of Lords EU Internal Market Sub-Committee recently wrote to the Business Minister, Paul Scully MP. Setting out a series of detailed questions to the government, the sub-committee expressed particular concern about the state aid provisions of the Northern Ireland Protocol:

> 'It is troubling that no one we heard from thought that the UK government had a clear understanding of what state aid provisions it had signed up to in the Protocol, and that the regions and devolved nations we heard from were not clear on how the Protocol might affect them. How is the UK government working now to ensure that the UK-wide implications of the Protocol in a state aid context are fully understood?'

This article explains how this aspect of the Protocol will work, and explores the implications of this, in particular as regards the UK's own ambitions to develop a separate domestic 'anti-subsidy' regime once the transition period ends.

What rules apply?

As with other aspects of the Protocol, the import of the state aid rules is not immediately obvious from the face of the text: in the main body of the Protocol, the words 'state aid' only appear in the heading of article 10, which then cross-refers to two different annexes.

The general rule is found in article 10(1):

> 'The provisions of Union law listed in Annex 5 to this Protocol 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.'

Firstly, one must be clear what the provisions of Union law in Annex 5 amount to. This annex, running to seven pages, simply lists the relevant Treaty, legislative and guidance provisions that collectively amount to the panoply of EU state aid law: thus articles 107, 108 and 109 of the Treaty on the Functioning of the European Union (TFEU) will continue to apply, as will (inter alia) the general and sectoral block exemptions and the relevant Commission guidance.

Secondly, the 'trade between Northern Ireland and the Union' that is referred to is trade in goods (including electricity).

Thirdly, it is important that these rules apply to the entire United Kingdom, in so far as any UK measure (i.e. any measure of any UK public authority) may affect trade in goods between Northern Ireland and the EU. In other words, EU state aid rules do not simply bite upon acts of the devolved and local government bodies in Northern Ireland, and those measures adopted by the UK government that are Northern Ireland-specific; rather they also catch all-UK measures (or measures affecting only part of the UK), whatever UK authority takes those measures, as long as they meet the test of 'affect[ing] that trade … which is subject to [the] Protocol.'

Fourthly, that critical 'effect on trade' criterion, which determines the scope of article 10, comes straight from the 'effect on trade between Member States' test in the definition of what counts as state aid in article 107(1) of the TFEU. As those familiar with the field will be aware, this is a notoriously low bar: no detailed economic assessment is required, and many Commission decisions contain little more than a couple of lines of generic reasoning explaining, or sometimes simply asserting, how the measure in question could potentially affect trade between member states. Given the economic symbiosis between Northern Ireland and the Republic (which the Protocol aims to preserve), almost any measure which affects Northern Ireland might in principle be said to affect cross-border trade in goods too. And it is also important to note that an effect on trade may be indirect as well as direct: there is no 'remoteness' aspect to the test as long as the chain of causation between the measure and the putative effect is tolerably robust. Hence, a measure that benefited only suppliers of services (such as road haulage) could be said to affect trade in goods if it enabled, for example, NI manufacturers who were customers of those services to reduce their costs and thereby assisted their ability to sell into the EU.

Because fiscal measures are generally at the UK level, these rules may well prove especially controversial in the tax field. Suppose, for example, the UK introduces a general tax measure that benefits UK widget manufacturers. Even if there are in fact no widget manufacturers in Northern Ireland, the tax may still be caught by EU state aid rules if (for example) Scottish widget manufacturers sell their (subsidised) widgets into the Northern Irish market, thereby placing Northern Irish industries at a competitive advantage to their competitors south of the border.

Are there any exemptions or over-rides?

The only sector-specific carve-out identified in the Protocol is for agricultural products, reflecting the UK's intention to develop its own agricultural subsidy regime outside of the common agricultural policy. Under article 10(2), the rules outlined above are disapplied in respect of 'measures taken by the United Kingdom authorities to support the production of and trade in agricultural products in Northern Ireland up to a determined maximum overall annual level of support, and provided that a determined minimum percentage of that exempted support complies with the provisions of Annex 2 to the WTO Agreement on Agriculture.'

The method for determining this maximum and minimum is found in Annex 6. The two values are to be set by the Joint Committee (a body comprising representatives of the UK and EU governments, set up by the Withdrawal Agreement to oversee its implementation). The Committee's determinations are to be 'informed' by current levels of EU agricultural subsidy and the UK's intended replacement regime. These figures then have to be adjusted to reflect changes to EU subsidy levels when each new EU multi-annual budget framework is agreed. Importantly, however, if the Committee fails to reach agreement at any stage, article 10(2) will be suspended; the effect of which will be that the UK simply has to mirror the common agricultural policy in respect of Northern Irish farming.

Other than that (and contrary to what has sometimes been suggested by government ministers), the Joint Committee plays no role in determining the application or scope of the state aid rules as laid down in the Protocol.

Though the EU has historically been relatively quick and efficient in approving emergency state aid when required (notably for distressed UK banks during the financial crisis of 2008 and in approving Covid-19 related aid now), if approval did prove problematic, the UK might (in extremis) be able to grant subsidies under the 'safeguard' clause of the Protocol. Under article 16:

> 'If the application of this Protocol leads to serious economic, societal or environmental difficulties that are liable to persist, or to diversion of trade, the Union or the United Kingdom may unilaterally take appropriate safeguard measures.'

However, such safeguard measures have to be strictly limited in scope and duration, and must be notified to the other side one month in advance for consultation, other than in exceptional circumstances. Moreover, article 16(2) allows the other party to take 'proportionate rebalancing measures' as necessary – which in the case of a subsidy granted by the UK government would likely take the form of retaliatory anti-dumping duties on the EU side.

Enforcement

Potentially the most controversial aspect of the Protocol will be the role it envisages for EU institutions in terms of enforcement. Rather than referring all disputes to the Joint Committee, article 12(4) of the Protocol instead gives oversight to the EU institutions, who as regards the state aid and customs provisions of the Protocol are given all their usual powers under EU law. This explicitly includes a role for the Court of Justice of the European Union.

The practical effect of this is that, where for example the UK government wished to introduce the widget tax measure described above, it would have to notify the Commission if this was liable to represent state aid under EU law. If it failed to do so, the Commission would be empowered to investigate, and ultimately could require the beneficiaries of the measure to repay the tax saved to the UK government. If the UK government nevertheless maintained that the Commission had been wrong to characterise the measure as state aid under EU rules, it would have to challenge the Commission's decision in the European Courts – all of which would likely prove highly unpalatable for a government committed to ending any role for Luxembourg in the UK's future affairs.

However, enforcement of the Protocol's state aid rules is not left to the European institutions entirely. Of significance for UK tax and legal practitioners is the right of private enforcement that will remain, flowing not directly from the Protocol itself, but rather from the European Union (Withdrawal) Act 2018 (as amended). Under the new s 7A(1):

> 'The rights, powers, liabilities, obligations, restrictions, remedies and procedures concerned [those in the Withdrawal Agreement] are to be —
> (a) recognised and available in domestic law, and
> (b) enforced, allowed and followed accordingly.'

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In other words, these rights will be directly effective in UK law. Thus, just as it has hitherto been possible to challenge a public body for failures to comply with EU law in the domestic courts (notably by way of judicial review), UK individuals and businesses will continue to be able to bring claims on state aid grounds in so far as they can show the provisions of the Protocol are engaged. This may be a significant avenue for future litigation. If, for example, the UK government were to grant tax relief to prop up an ailing and uncompetitive widget manufacturer in one part of England, other UK widget manufacturers might find this just as objectionable as Irish businesses who were concerned about subsidised widgets in the Northern Irish market. The Protocol's state aid rules might then offer the most convenient form of private challenge, if the UK's own anti-subsidy regime did not provide an equivalent means to object.

Future relationship: subsidies versus state aid

What then will that future regime be? During the last election, the Conservative Party promised to abolish EU state rules and replace them with a WTO-based anti-subsidy regime, which (it was claimed) would allow greater governmental discretion and offer greater certainty to investors. This ambition is reflected in a recent command paper explaining the government's negotiating position ahead of talks with the EU on the future relationship. However, it is wholly at odds with the EU's current stance: the Council directive setting out the EU's position envisages 'the application of Union State aid rules to and in the United Kingdom', albeit subject to enforcement by an independent UK authority in cooperation with the Commission, rather than by the Commission directly (although with the CJEU remaining as the final arbiter).

However, the Northern Ireland Protocol gives the situation added complexity: if UK public bodies remain committed to following state aid rules in so far as measures affect Northern Ireland/EU goods trade and thereby have to follow the EU rules to a significant degree anyway, it becomes questionable how efficient it will be to overlay this with a separate system of domestic anti-subsidy control, with its own set of approval processes and the like. Nor is it clear what the substantive benefits of the new WTO-based regime will be: given the paucity of WTO case law, introducing a new regime is likely to reduce legal certainty. Furthermore, the basic definitions of 'state aid' and 'subsidy' in the EU and WTO rules are very similar, with a wide approach to what counts as an aid or subsidy (including tax breaks), so in substance the new regime might turn out to be little different to the old.

The main difference between the WTO and EU systems instead lies in their enforcement mechanisms. Whereas EU rules are supervised by a supranational body (the Commission) and actionable before domestic courts, enforcement under the WTO takes places only at a state-to-state level; hence why WTO rules are so rarely deployed in practice.

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However, the UK will presumably wish to continue to have an independent subsidy-monitoring authority, in particular (from a Westminster perspective) to prevent the devolved administrations from lavishing assistance on favoured local industries to the detriment of other parts of the UK. If so, then the UK's vaunted new WTO-style subsidy regime may turn out to be little different to what exists at present.

However, if the UK government does now wish to renegotiate the state aid aspects of the Protocol (as the House of Lords Sub-Committee has recommended), it may be easier to reach agreement if the UK accepts that it should be required to maintain the substance of the rules and focuses its efforts on the question of enforcement.

What the EU is (quite understandably) seeking to avoid is a position where the UK is able to subsidise its industries to undercut EU competition, while at the same time free-riding on EU state aid rules that prevent EU countries from doing the same. The UK therefore needs to reassure the EU that it does not intend to engage in a 'race to the bottom' of this kind, and will do this most straightforwardly by agreeing in principle to match the EU rules, at least in substance if not in form. Once this commitment is made, the EU side may be more willing to allow the UK to enforce these rules for itself, with a more limited role for the Commission and the European Courts accordingly. ■

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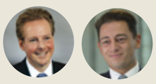

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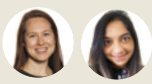

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