



HOUSE OF LORDS

Select Committee on the European Union

Internal Market Sub-Committee

Corrected oral evidence—Brexit: Competition

Thursday 20 June 2019

10.10 am

Members present: Lord Whitty (The Chairman); Lord Aberdare; Baroness Donaghy; Lord German; Lord Lansley; Lord Mountevans; Baroness Randerson; Lord Robathan; Lord Russell of Liverpool; Lord Wigley.

Evidence Session No. 1

Heard in Public

Questions 58 - 66

Witnesses

I: Jonathan Branton, Partner, DWF Law LLP; Alexander Rose, Director, DWF Law LLP.

Examination of witnesses

Jonathan Branton and Alexander Rose.

Q58 The Chairman: Welcome. I should just say that Lord Mountevans is a future member of the Committee, which means he is even more important than some of us who are about to leave. He will join the Committee when we change membership next month.

We are very glad to see you. We are pursuing this issue following one of the many reports that the EU Select Committee did on Brexit, in this case on State aid, which raised some interesting issues about future trade relations with the EU, and indeed with anyone else, but also internally on whatever state regime will operate beyond Brexit, and the role of the CMA in that. We have had sessions with CMA officials on this topic.

One issue that arose was the claim by politicians, both government and opposition, that the Government were inhibited in aiding the steel industry when it ran into difficulties three years ago, and now with British Steel and its problems right now. We wanted to explore that specifically but also to draw general lessons from it, which we may follow through in future arrangements, particularly future trade arrangements with the EU.

One of the report's conclusions was that the Government should clarify as soon as possible how the state-aid regime should operate. We have now had the Trade Bill, which establishes a trade remedies body, and we now know that the CMA is taking on the role of State aid authority within Britain. We have had discussions with CMA officials both within and outside this Committee, and we have had quite a lot of information reassuring us that the CMA would at least be resourced in order to do that.

However, behind that are future policy dimensions, prioritisations and implications for problems that arise, like British Steel and the present situation within British Steel. Could you start by telling us how much we now know about the future structure and how it impacts particularly on the steel sector, which as you know is also an issue for industrial policy and regional policy, and in some cases for relations with the devolved Administrations? Could you start generally on that?

Alexander Rose: On where we are, the statutory instrument has been laid and discussed, but it is not currently finalised, which is causing enormous problems. Currently we may Brexit on 31 October 2019, but at this point the CMA is not in post as the enforcer and the regulator and is therefore not in a position to start obtaining the files that it would need to start reviewing as at 31 October 2019. It is quite feasible that there will be modifications to the rules that it will currently be asked to apply and to the role that it will have.

So from the CMA's point of view, it is in limbo. It is resourcing so that it can take on this role in future, but its recruitment has to think simultaneously about getting experts on State aid and about taking into account that it is possible that there will be no role for it, depending on

the kind of Brexit deal in future, if Brexit occurs. On the one hand, it is having to look for quite a rare level of expertise on State aid, and on the other it is trying to find staff who are generalists who can be assimilated into the organisation.

The CMA is also having to make assumptions about its resourcing. At the moment it cannot be entirely sure about its projections, which frankly look a little low. For example, the letter that was sent by Andrew Tyrie to this Committee said that the CMA was working on the basis of expecting to get about six complaints a year, of which two would be in-depth complaints that needed to be thoroughly reviewed.

The information is not published in the public domain as a regular occurrence, but the Commission revealed, through a freedom of information request that I found, that between 1 January 2013 and the middle of April 2014 there were 32 complaints to the Commission about UK measures. Although we do not know the depth of those and which ones would ultimately have transpired to be in-depth complaints, it seems to me that an expectation of six complaints, against 32 over a year and a half, is a low figure.

It is much more difficult to know the number of notifications going to the European Commission. I simply have not been able to find out that information. But we have had an informal policy on this, and certainly fewer notifications have been taken to the Commission during the Brexit negotiations.

My experience leads me to believe that that means that people will save up certain measures that are simply too difficult or too risky to take forward at this point, so come a date when they know that the Brexit negotiations are complete and we have a new state-aid regulator in place, they are more likely to bring those forward at that point.

To my mind, these are honest projections taken with a view to trying to assess the market but, just on the information that I have been able to obtain from outside, they look rather low.

On the other side of the coin, which is how the Government and the devolved Administrations deal with this situation, they are equally in limbo. From my understanding, they are not in a position to take forward any files to the CMA or to have the detailed discussions that you probably have off the record with the Commission to warm them up and make them aware of what is in the pipeline. They are just not in that position at the moment. They are having to wait for the rules to be finalised so that proper, detailed preparations can occur and those discussions can take place.

Jonathan Branton: While the uncertainty of timing in particular persists, everyone has one hand behind their back when preparing. Perhaps that is inevitable when you have a transition of this nature, but it is certainly a factor that has to be reckoned with.

It also has to be appreciated, but is sometimes lost, that it is one thing to work out how State aid will be rendered legal or enforced, but it is another to work out what government policy will be when it comes to making funds available in the first place. Certainly in our experience as practitioners, people tend to mix those concepts up, and it is as well not to do so.

We should appreciate whether the funds are being made available in the first place. In this day and age there is no large industrial fund like the regional growth fund, as there has been in previous times, which creates quite such a need for administration, and simply the amount of money that is being made available is at a lower level. Those things should be appreciated.

The Chairman: May I pick up on two points between you? First, Mr Rose, you said you thought that other developments were delaying perhaps the SI but certainly the government policy position on future State aid. The SI exists in draft and is before Parliament—God knows when it will be considered, but it is there—but of course the policy is not. Are you assuming that they will have to wait to finalise that until we know the future nature of the relationship with the EU?

Let us assume that we get through the present impasse and move into a transition period. That could still take some time. If we go into no deal, we are immediately in limbo, because the Government will have to invent something on the presumption that we will have a trade deal with the EU at some point in the future, but we do not yet know the nature of that and we will not have a transition period to sort it out.

Jonathan Branton: The current expectation as set out in the regulations effectively cuts and pastes the existing EU regime into a UK form. The assumption is that that is good for legal predictability, continuity of business, et cetera, but that it also preserves the position of being able to negotiate with the EU.

One has to assume that if you have a regime that mirrors what they have, they will be happy with it. The question then, if people want to start to tinkering with that regime, is what that means for the future EU trade deals that may be negotiated.

The Chairman: Baroness Randerson's question may tease out some of these policy issues.

Q59 **Baroness Randerson:** Good morning. You have touched on some of the challenges for the CMA in future and you might like to flesh those out a little more. Also, what opportunities do you see for it as a future state-aid-enforcement authority? In particular, I am interested in the implications that its new responsibilities might have for its relationship with the devolved Administrations.

Alexander Rose: First and foremost, I will answer in terms of broad opportunities. One of the broad opportunities that would come from this is that, if the CMA steps into the role of the Commission, it would have

the ability to update the regional aid map for the UK. That map identifies assisted areas, which are areas that are underperforming economically. There are two different strata. At the moment, one level relates to areas that are underperforming compared to the rest of Europe, and there are only a few areas that fall into that category. The other level relates to areas that are underperforming compared to the member states—in this case, the UK.

One opportunity that would seem fairly straightforward relates to the design of the UK shared prosperity fund—the fund that is supposed to succeed the RDF and other government funds in future—and is essentially about co-ordinating them, so that you could identify funding allocations, noting the areas that are most in need in line with the Government's current focus on place. That seems to be a very broad opportunity.

On the opportunities for the CMA, there is something to be said for having a closer working relationship, partly as a matter of geography, than the Commission has at the moment. Being in Brussels, it is one stage removed. The CMA, being based in London, Edinburgh, Cardiff and Belfast, will have the ability to have those off-the-record discussions. It should also be closer to what is actually happening. One issue that we often hear from the Commission is that since it moved a lot of day-to-day state-aid control into block exemptions, it is not faced with the state-aid problems faced by most businesses day to day. It sees the very distortive matters, the large juggernauts, but not the 97% of State aid that goes under block exemptions at the moment.

One hope is that the CMA will have a closer relationship when it comes to how State aid is given out. The counterpoint to that is that it has based itself in these four cities, but there is a disparity in the way it has resourced its offices. I think there is one CMA employee in Cardiff dealing with State aid, and one in Belfast, and all the rest are in Edinburgh and London. As a northern lawyer, I would naturally like an office in the north as well, because I think that local interaction is very important to being seen to be taking steps forward.

We have touched a little on the devolved Administrations. My understanding at the moment, which I have gained purely in the public domain, is that this discussion about whether it is a devolved or a reserved activity is ongoing. It does not seem to be fully resolved. I understand that there are certain concerns from the devolved Administrations about what is in the statutory instrument. I have heard on the grapevine that there is a bit of concern about the CMA's ability to give what is called an advisory opinion on parliamentary legislation coming forward. That does not apply to the devolved Administrations, and I understand that that is a concern, which needs to be resolved at some point. That is my understanding of the opportunities. Jonathan might have extra points to add.

Jonathan Branton: Again, I preface my answer by saying that there is an opportunity to change policy on how much funding is made available, or to change the rules about what is legitimate or not. If we focus on the

latter, of course in theory when we are no longer within the EU's jurisdiction there will be an opportunity to change the rules. Let us be clear about that. If the decision was taken to do that, it can be done by manipulating all sorts of different policy levers, which the Government of the day may seek to do.

The EU state-aid rules have been drawn up and have evolved over many years to facilitate the funding of certain activities. Much higher aid intensities, for example, are made available for encouraging research and development than for core manufacturing. Preference is given to small and medium-sized enterprises. There is a whole litany of things achieved by the EU state-aid rules at the moment, which have been arrived at through European-level policy over a long period of time. In theory, that can be broken apart and reassembled as the Government of the day see fit. In so doing, they would have to be conscious of the effect that might have on any future trading relationship with the EU. You can bet that the EU will not want us to do that and will want us to stick with what we have now, but obviously that will be a delicate part of the negotiation.

Part of the fear that is inappropriately held is that the WTO would stop us doing that, but that is not true. The WTO restrictions on what you can and cannot have in a state-aid law are rather limited. There are only two core prohibited types of subsidy: making subsidies contingent on using domestic goods over imported ones, and giving purely export-related aid. So long as you do not do those two, which are the only ones that are prohibited, everything else is fair game. Of course, there are certain risks that if you oversubsidise that will lead to other countries targeting your exports, if they can prove that they are subsidised. But that is rather remote and does not happen much, to be honest, so that is probably not a great fear.

The Chairman: Not until we had President Trump.

Jonathan Branton: Yes, but is President Trump countering subsidies or perceived security measures?

The Chairman: Fair enough.

Jonathan Branton: He seems to think that he does not need a subsidy instrument, but will just go for anything on security grounds. That is a bit of a side issue.

Lord Wigley: Mr Rose, can I take forward the comments you made on the relationship with the devolved Administrations, particularly Cardiff, where it appears we will have one postman, with everything happening in London?

You mentioned the shared prosperity fund. Wales benefits from some 22% of the money that comes from the European Union for regional purposes and structural funds. On a UK basis, we get 6%, based on the Barnett formula. Would you accept that there is room for some dismay in Cardiff if the UK pattern is followed, as opposed to the European Union

one?

That dismay is compounded by the fact that the CMA is answerable, ultimately, to the Government in London, which is the Government of England, where competitive arguments may arise in relation to what the Welsh Government are doing to develop industry in Wales.

Alexander Rose: As I say, as a north-east lawyer who has been heavily involved in the RDF and other European funds, it is not a dissimilar situation; I am aware of concerns about allocation. Whether the CMA changes that is a question of the link between the allocation and the rules. From my understanding at the moment, I would not want to draw too clear a link. The allocation is a concern that needs to be resolved.

From what I have seen of the CMA so far, and I have seen various public talks by the new director of State aid, I think there is an assurance that it will be even-handed. They come across as very professional. I have been seconded to work in DG Competition in the Commission, I have seen the inside approach and I have worked in government. I have had less involvement in other competition issues with the CMA, but I have seen the Commission being quietly effective. They are aware of political nuance in their approach, which is a very important aspect.

My nervousness would arise if a new regulator came in and did not recognise that State aid by its very nature is public-sector focused and did not accommodate that fact. In the statutory instrument, for example, there are dawn raid powers, which seems far beyond what is necessary when you are regulating the public sector. There must be a level of trust.

Jonathan Branton: Alex mentions an important dimension. On the first part of your question, the allocation of shared prosperity funds, I would say absolutely—I completely understand why Wales, and equally other regions, would be concerned about that. That is a policy decision about how much funding is made available in different regions.

On the question of the law and what is legitimate aid, and the CMA's role, it absolutely has to review things impartially across the UK. Any suggestion that it was not doing so would undermine it considerably. I cannot believe that anyone in the CMA would ever dream of not doing that; I am sure of that. But if the system introduces something that introduces the possibility of that allegation being made, that there is favouritism towards particular areas or other areas are deliberately kept down, that would obviously be a political time bomb.

Alex's point about State aid and its administration is extremely important, in that we are going from a European Commission regime that has been dealing with member states, and that is how it is enforced. It is the Commission dealing with member states, and there is a certain, dare I say it, gentility to it that is thoroughly different from the world of ordinary competition enforcement—mergers, anti-competitive agreements, cartels, et cetera.

That enforcement is robust, to put it mildly. If similar enforcement tactics are deployed in State aid, that will certainly upset the applecart a lot, and obviously we are expecting a competition regulator with experience of doing a certain type of competition enforcement to do a different type of competition enforcement in which it does not have that same experience.

There needs to be an understanding of that softer side of state-aid enforcement, and there may be an issue if the CMA puts particularly onerous demands on local government officers. I have been involved in merger control inquiries where everything goes at 100 miles an hour and there are short deadlines for responding to questions. These are situations where no one has been accused of doing anything wrong; they are just seeking permission for a merger to go ahead. If it is all bang, bang, bang, bang, bang in a state-aid inquiry, people will have trouble coping. That is just my personal view. That soft side of enforcement will need to find a way of evolving within the CMA, I suspect.

The Chairman: One of the conclusions of a previous report referred to this difficulty. Under the EU regime, the CMA has been responsible for ensuring that there was no unfair competition, effectively on the part of the state, within nation states, as you say. It becomes much more of a political problem when what you are trying to ensure is twofold: that there is no unfair competition within the United Kingdom as a result of different bits of the United Kingdom behaving differently, and that no bit of the United Kingdom will do something that endangers our international obligations post Brexit.

Put at a minimum, the fact that the Government allocate resources and procurement policies at different levels means that the possibility of this arising is quite high. Just to state the obvious, the UK Government, the Scottish Government and the Welsh Government are all controlled by different political parties with rather different industrial policies, and it is quite conceivable that issues will arise quite soon in this process.

Jonathan Branton: Yes, that is true. Then again, the different member states across the EU are governed by different people with different agendas, and the Commission seeks—we can all have a private view about how much it achieves it—to enforce the rules in an even-handed and fair manner across all those different nations.

I totally appreciate that dynamic. Yes, it is an obvious risk in theory, but it ought to be possible to enforce the rules even-handedly across the different parts of the UK.

Q60 **Lord Lansley:** Does that not take us rather helpfully to the question relating to the structure of the draft statutory instrument on State aid? I would be interested in your view, but on the face of it, it does not set up for the CMA a state-aid regime that relates for example to the question of competition between different parts of the United Kingdom. It sets up a state-aid regime, as it says in the SI: “in so far as it affects trade between the United Kingdom and the European Union”.

Jonathan Branton: Yes, but that is continuity as against what we know now.

Lord Lansley: Yes. It is set up on the basis of trying to create a state-aid regime that is directly comparable to what applies at present, and to do so after exit day.

Jonathan Branton: Yes.

Lord Lansley: But that means that it is not a state-aid regime that would bite on State aid that affected competition within the United Kingdom.

Alexander Rose: In fairness, normally when we do the reviews at the moment on the current test of the effect on trade between member states, we see that typically the test is met on the grounds that the relevant undertaking is operating in a pan-EU market anyway. It is quite hard to find a business that does not operate in a market that a European player is not involved in.

My view is that a business based in Newcastle is almost certain to affect trade between member states if it has any kind of online activity. Likewise you would look at whether any players could come into that market. Therefore, in practice, even if you changed it so that it was based on the relevant country, I do not think it would particularly affect the test. It would damage the ability to carry current EU case law across. There would be an erosion of certainty, and you would end up having to focus on more detailed scenarios where tests are met.

The example of a measure that is often used by the European Commission as one that might not affect trade between member states is a hairdresser on a Scottish island. Feasibly, the Scottish island could still be brought down to somewhere like Carlisle, but you would end up with an even more granular test. That would be a problem, because the Commission's theme is that it wants to concentrate on the most distortive State aids and not see the minor State aids as often. That is why it has put a lot of them under block exemptions.

In an ideal world, they would quite like the effect on trade between member states test to be a bit broader so that fewer measures fell within State aid and they would have more focused block exemptions. Then there are the notifications directly to the Commission.

Lord Lansley: As things stand, what is being asked of the CMA under the statutory instrument as it stands is for it to reproduce the EU regime, but after exit day, if we leave in other circumstances, the logical thing would be for the CMA to have, as it were, a free-standing state-aid regime that did not behave any differently in relation for example to trade between the United Kingdom and the United States from how it would treat trade between the UK and France. Why would it behave differently?

Alexander Rose: In terms of that option, you are correct: the rationale here is dynamic alignment with the EU state-aid law regime at this point.

Jonathan Branton: In practice, we certainly have not encountered situations where there is dynamic competition in a particular situation with the US or outside the EU but that falls outside the EU effect on trade with member states test. I realise that this is a bit nebulous, but in practice the test has been interpreted restrictively. That has meant in effect that there is not much relating to State aid that is not caught, but there are some purely localised issues that go on within member states that are not touched by the state-aid regime. That is supposedly a point of subsidiarity and so on.

If that is understood and translated into CMA practice in the same way, something that involves large corporate businesses trading with the US, China, India or whatever, is still likely to be caught; I cannot see a situation in which it would not. If you changed the test to one of competition within the UK, that would introduce new dynamics relating to how you define competition within the UK. Would it be within regions or only England, Scotland, Northern Ireland and Wales? You would inevitably end up catching things that currently escape the regime, and that would make it more intrusive, not less.

Alexander Rose: I understand that the current wording is similar to the Ukrainian system, where the wording effectively mirrors the state-aid regime. Ukraine is outside the EU, obviously, and it has a provision that talks about the effect on trade between the EU and Ukraine.

The Chairman: I have a couple of questions that arise partly from what you have said and partly from the still ongoing CMA consultation on procedures.

Do you anticipate that we will adopt wholesale the block exemptions which the EU operates? To take one example, the CAP is block-exempted, even though it is somewhat competition-distorting, relatively speaking. Agriculture is a devolved responsibility, so you would have differential policies. Indeed, Michael Gove has indicated that for English agriculture he wants to be more interventionist in helping the parts of the country and the parts of the sector that need it, which would be somewhat different from a land subsidy. Would you see a problem if we departed from block exemptions as they stand?

Alexander Rose: I have not been involved in the agricultural side of matters, but I have been closely involved in matters like the drafting of the general block exemption regulation, because that was when I was seconded to the Commission and that is the team that I worked in.

My understanding of the current system is that we essentially replicate the exemptions. In Europe at the moment, they are exploring an extension the general block exemption regulation, which was due to end on 31 December 2020, to 31 December 2022. My understanding is that

we are therefore locking ourselves into something very similar at the moment.

There is a question that I understand is as yet unanswered: when we put the block exemptions into domestic law, do they continue in perpetuity or end on a particular date? Likewise, what happens thereafter? To draw on your point, do we end up in lockstep, accepting whatever then comes out? At the moment the SI is not set out in that way. Do we end up essentially having to accept those block exemptions, or do we have a certain level of freedom then to design the block exemptions in our own way, presumably with some kind of regard to what the Commission has put through?

The Chairman: The other point that I wanted to follow up is that we were quite interested—Lord Russell may want to come in on this—that when the CMA wrote to us, they said that they would deal with high-profile state-aid provisions, as with mergers, with dedicated decision-making groups headed by an experienced or retired High Court judge—and Lord Tyrie has reiterated that. Lord Russell, do you want to come in on this?

Lord Russell of Liverpool: When the CMA wrote to us, they indicated that that was one of the things that they were considering. My reaction was, “That’s a great idea, but have you actually spoken to any people who might have that background and the qualifications you seek to see whether they think it’s a good idea and how attractive or unattractive the idea of taking on such a task would be?”

It was fairly obvious that they had not done that, so we gently suggested that it might be a good idea. They have been doing some follow-up, and certain noble and learned Lords have been consulted and have been trying to be helpful, so it appears that it is possible. On the basis that it might be possible, is that a sensible direction to go in?

Jonathan Branton: In a large-scale sensitive notification situation, yes, it could be. I do not think there is necessarily a one-size-fits-all way, an only way, of doing this. The European Commission, which is the yardstick that we have to go by, would not pull in a former European Court judge to rule on whether or not it should approve a measure. That is not to say that a former High Court judge cannot add a lot of value—I am sure they can—but they are not a panacea to ensuring that you have a good process.

The CMA is certainly experienced in handling large, complex cases in other dimensions. When you are in a phase 2 merger, obviously there are very high-powered people reviewing the evidence in front of them and ultimately reaching a decision that is balanced against what they see. Ultimately it is a yes/no question: “Do we approve this?” Once it has got to that level of discretion, I am sure they are more than competent to do that. If they are tapping into that sort of resource, why not?

My personal view is that the experience of doing this lies especially with the people who have been doing it in Brussels in some shape or form, and I would certainly try to tap into as much of that as was feasible.

The Chairman: Lord Lansley, do you want to ask your question?

Lord Lansley: I have asked my initial question.

The Chairman: Any follow-through from that?

Baroness Donaghy: This might be a silly question, but what if we have obeyed the rules and the statutory instrument says that we continue to do so but there is still some unfair allocation? I think you were indicating this earlier when Lord Wigley talked about 22% and 8%. Do you have any idea of the percentage gap between obeying the rules and applying policy fairly?

Alexander Rose: Sorry, can you rephrase the question so that I fully understand it?

Baroness Donaghy: The devolved regions feel that they are not treated fairly within the system. I have not quite worked out whether that is because of EU allocation or because of government funding and the attitude towards State aid. I thought you were indicating earlier that there was a possible gap where interpretation could be more generous in certain areas.

Alexander Rose: The key is that the funder has an element of discretion over the rules. Currently a lot of aid measures simply do not go to the Commission for approval, and in the future a lot of them simply will not go to the CMA. Ninety-seven per cent of State aid is awarded under the general block exemption regulation in certain areas.

If I understand it correctly, essentially we need the funders—in Scotland, for example, that might be the Scottish Government—to act in a fair manner. At the same time, when it comes to allocation, I do not think there is a direct link to whether the organisations that give out the larger amounts are any less or any more diligent in their approach. Essentially State aid kicks in and becomes a problem only when there is non-compliance, so I am not seeing that link. There is clearly a disparity in allocation across the country, in that certain areas have larger amounts than others, but I do not think that State aid is the looking glass to see that.

Jonathan Branton: The allocation question is one of policy. Clearly there can be arguments if somebody feels that more funding should specifically be made available for, say, Wales or Cornwall. Historically, if you are confining discussion to the EU structural funds, there has been a formula to work out how they are determined. There are winners and losers, and the formula is based on statistical information as presented to the Commission.

That is how it has worked, and if you are seeking to replicate it in the shared prosperity fund, there needs to be an objective mechanism that decides how that funding, or replacement funding, is split up. It is entirely open to government policy to make other funding available in whatever way it sees fit for different regions and to create its own objective test for what cash should go to whichever region. Equally, it can decide which sectors get whatever amount of cash. These are all policy decisions for making the funding available in the first place. The next question is how it then gets carved up in a legally compliant way. Those are very different things.

As I said earlier, if we are not within the EU, we can start manipulating the rules in order to favour different types of activity. If we pursue an independent regional aid policy, we will have some discretion to calculate the basis on which we determine what is and is not an assisted area. EU State aid policy has evolved on that basis and there is a map of the UK, coloured in different shades, of the areas that are assisted and those that are not. We can work that out on a different basis if we wish. Again, there could be winners and losers, but at the end of the day that is open to political discussion.

Baroness Donaghy: That is very helpful. Thank you.

Lord Wigley: But within that structure you can find that where people have governmental power, such as in devolved regimes, they can go further than perhaps people in the north-east et cetera in devising mechanisms that help their areas, such as procurement rules; in Wales, internal procurement has increased from 35% to over 50% in the public sector, which has quite a significant effect on the employment pattern. It might be seen as detrimental to businesses from, say, Lancashire or Yorkshire that want to compete for contracts in Wales, so there is a disparity as a consequence of having devolved power.

Jonathan Branton: Yes, and that is a political discussion. Ultimately, it is not where the law is intervening in State aid administration.

Q61 **Lord Robathan:** Can I take you back specifically to the steel industry, which over recent years has had overcapacity? There are some sector-specific rules in the EU. Can you explain how the EU applies its rules specifically to the steel industry, or is it just done in the same way as everything else?

Jonathan Branton: No, it is not done in the same way as everything else. A more restrictive approach is taken to steel. That is absolutely clear and has been for a long time. It originally came out of the European Coal and Steel Community, for those with a long memory.

Fundamentally, broadly speaking the steel sector is excluded from regional aid rules, so you cannot give it manufacturing aid and you cannot go in and bail out a failing steel producer based on the rescue and restructuring guidelines, which are one of the other instruments of State aid policy.

Having said that, what you can do in the steel sector is look at other things such as research and development or environmental measures to improve your environmental performance. You can also invest in training. There are various policy instruments within the state-aid rules that you can utilise to boost the steel industry if you so wish, and that has long been the case. With some constructive and imaginative use of those facilities, there certainly are ways in which you can aid the steel industry.

Of course, subsidisation, or the lack of it, is not the only issue at play in the steel sector; there are other things going on. It needs to be allied with trade defence policy, which will be a very significant issue. The EU has been a great user of anti-dumping and anti-subsidy measures to protect the European steel industry hitherto, and there would be an important dynamic there for the UK steel industry to retain the protection that it has previously enjoyed. I know from personal experience that Eurofer, the trade lobby in Brussels, very much has the ear of the Commission in using those trade protection instruments to the full.

However, to go back to the original question, there is room for manoeuvre in the State aid rules. They are more restrictive than in most sectors, but it is not the case that you cannot do anything.

Lord Robathan: Building on that, would renationalisation be a bailout?

Jonathan Branton: It depends on the circumstances. In that situation, you would need to be satisfied that you were acting within what is known as the market economy investor principle or the market economy operator principle—they are synonymous—and it is hard to see how that test would be met in the case of an organisation that was failing. It is also worth remembering that the EU rules and block exemptions prohibit you giving the aid to firms that are failing. There is a test called “undertaking in difficulty”, which is one of the categories that excludes an organisation from receiving potential aid.

If you just have a steel sector policy hat on, it is difficult to think in advance of an organisation getting to the stage of being an undertaking in difficulty, as you will possibly be focusing more on helping it before it gets to that stage so that it does not fall into the position of being difficult, if not impossible, to help.

Lord Robathan: You have already mentioned the WTO rules and, in particular, export-related aid. I think that is one of the two things that you said were covered.

Jonathan Branton: Yes.

Lord Robathan: To what extent would we be constrained, having left the EU, by WTO rules?

Jonathan Branton: Not very is the answer. We are constrained by them now in the sense that we are an EU member. The EU is constrained by them.

Lord Robathan: But you are saying that EU rules are much more stringent.

Jonathan Branton: The EU State aid rules on what is and is not allowed are very different from the WTO rules. It is to be remembered that in the WTO context it is the agreement on subsidies and countervailing measures, which is largely about trade defence. It sets a framework within which legal subsidies are allowed—the things that can be legally done, so not the prohibited ones that I mentioned: the use of domestic goods and purely export aid—but if they result in injury to the domestic industry of a trading partner, they can be combated with the use of what are known as countervailing measures.

Countervailing measures work in the same way effectively as anti-dumping measures. You have trade defence investigations, which take a long time, and in order for them even to be started, the domestic industry in the country to which you are exporting needs to make a complaint. Various things need to be gone through and, at the end of the day, if everything is satisfied and that jurisdiction decides to combat it, it will levy an anti-subsidy duty, a countervailing measure, which is an extra tax on the importation of the specific product that has been targeted.

That does not happen much, is the point; it is very rare. The measure exists but it is cumbersome. Normally, when exported goods are causing damage to a domestic industry somewhere else, anti-dumping is the first and foremost weapon against it.

Lord Robathan: Specifically on steel, can you remind me—actually, I am not sure if I ever knew—what the WTO's position has been on the alleged, although almost certain, dumping of Chinese steel into Europe? Has it taken action?

Jonathan Branton: Basically they have been hit, and hit hard, by all sorts of different measures over the years on different steel products. They are investigated on a per-product basis from time to time, based on complaints from the European industry—Eurofer, which I mentioned. Normally that results in a positive measure being implemented, effectively erecting a barrier around the European market that creates an extra cost for steel from China, India or anywhere else before it can enter the European market. That is designed to level things up and give the domestic industry a level of protection.

Lord Lansley: We talked earlier about the statutory instrument that gives rise to the state-aid regime after exit day. In so far as it is a straightforward continuity process, the expectation is that the UK state-aid regime will replicate the steel-specific, sector-specific rules, but what triggers that happening? Is it that the CMA simply publishes that itself, or does it depend upon the Government requiring the CMA to have those rules?

Alexander Rose: The statutory instrument lists the series of regulations that have been carried over, but, as I say, some of those block exemption regulations state that, for example, steel cannot be covered. The rescue and restructuring guidelines, which are the way you can take a measure to the Commission for approval, state that they do not cover steel. There were some steel rescue and restructuring guidelines, but my understanding is that the member states, including the UK, agreed not to renew them.

Lord Lansley: We are moving into the application of those rules to the steel case now. In so far as the Government say, "We are constrained", and indeed at present they are constrained under the EU state-aid regime, after exit day it might be put to the Government that they could cease to be so constrained if they chose to. There are consequences that might flow regarding the relationship in that industry between the EU and the UK under trade-related measures, but in terms of the state-aid regime they could choose to disapply the steel-specific constraints.

Alexander Rose: Yes.

Baroness Donaghy: I have a quick question about the steel company in northern France. What is your interpretation of how an investment by the French Government and a subsidiary of Greybull somehow conform to EU rules: that is, the rescue operation?

Alexander Rose: I am aware of the dates, such as 2 May when the deal was being done, but I did not look into it any further with regard to how it works from the state-aid point of view. It would appear that it might well be a market-economy investor-principle purchase, but I simply do not know enough of the details.

Lord German: Following on from exactly that point, I go back to Jonathan's first point about the concept of money being allocated against state-aid rules. If, in the case of British Steel, the British Government had looked at other forms of support rather than the ones that are constrained, is it your assessment that they could have intervened in a different manner from that which we see before us at present? Could it be envisaged as being a matter of the allocation of funds rather than constraint of the state-aid rules?

That links very closely to Baroness Donaghy's question. I am only quoting here, but if an ailing steelworks in northern France is about to get €47 million of support from the Government, matched by €47 million from the company, there must be some form of State aid in non-restriction that could have been applied to British Steel.

The final part of that question is: how far do you think the British Government, and Governments in general, have treated the issue of State aid as a cover for allocation?

Jonathan Branton: That is a tough one. The first point to note is that we do not know what was or was not done by the Government in respect

of British Steel—what discussions were had or what may or may not have been put on the table—so I cannot answer that. What we can say is that there are ways of assisting the steel sector, and I have certainly seen instances of that go through over the years. At the end of the day, I do not know whether the result could have been avoided, if that is what you are suggesting.

As for what is going in France, again we do not know the ins and outs, but the French are constrained by the same rules that we are at present. Whether something has been done that goes outside the rules would be the subject of scrutiny by the Commission in due course if someone wishes to complain or if that is a measure to be notified. So we do not know exactly how that French investment will have been achieved or the legal basis for doing it, but it would certainly be subject to the same ultimate enforcement.

On the final question of whether the Government use State aid as an excuse not to give funding to situations where they might if they were willing to be a bit more creative or to push the envelope a little further, yes, one might speculate. I would not like to say, obviously, although there have been situations where on a purely personal level I have felt that, but I cannot support it.

We know that statistically, per GDP, we as a nation are a very low user of State aid according to European statistics: one-third of the levels to which the Germans do so, for example. From my experience, and I have spent many years in Brussels, they are not squeamish about that in the way that I sometimes sense we are. There is more of an anti-state-aid feeling generally in the UK, in my experience, than there is in other European nations. That is a very broad observation.

The Chairman: So you think that the allegation that steelworks in Belgium, France, the Czech Republic or Italy have received greater help than in the UK is not really to do with the Commission's vigilance or otherwise but is due to the internal pressure and priorities of the member state Governments?

Jonathan Branton: I am saying that a Government deciding to make funding available for a sector or a region is a policy decision of that Government. The state-aid rules are uniform across the EU, and different Governments make more or less use of them depending on their individual priorities.

The Chairman: As you will know, the allegation for many years among those who are concerned about the steel industry is that successive British Governments have not been as supportive of the steel industry as other member states, given the situation of world overcapacity. You are saying in effect that that is not the fault of the state-aid rules, but that it is the responsibility of those closer to home. Is that right?

Jonathan Branton: We are all subject to the same state-aid rules. Does that answer the question? Unless the allegation is that other countries are breaking the rules, and that the Commission is complicit in that—

The Chairman: It sometimes gets expressed in that way.

Jonathan Branton: I have no reason to think that. Obviously, it would be naive to suggest that when big cases end up in Brussels no political lobbying goes on. Certainly my experience is that the Commission holds pretty firm on that sort of thing and is quite doctrinal, saying “Well, you may want to do this, and it may be a national champion, but the rules say this, so that’s your limit. Off you go”.

The Chairman: As in certain other policy areas, the accusation is really that British Governments have blamed Brussels when it is actually their own decision.

Alexander Rose: The UK has championed the state-aid rules because they push money towards improving competitiveness, for example. The point here is that if you plan how you are going to provide the aid, there are routes to improve the business so that it becomes more competitive. If you wait until it is in a very bad position, because you have chosen not to allocate at that point, it becomes much more difficult.

Lord Aberdare: Turning that question around for the sake of absolute clarity, is there anything that the UK Government have done so far in relation to British Steel that you think might be open to challenge on state-aid grounds?

Alexander Rose: Honestly, we do not know, because we do not know what they have or have not done. The decisions on steel, which you have obviously read, go into great detail and analyse everything that has happened. It is often the information that is simply not in the public domain at the time which is decisive.

Q62 **Lord German:** I now reverse the question I asked at the beginning. The complaint is often that we do not actually support British manufacturing, because we gold-plate the state-aid rules. Do you subscribe to that view, or are you subscribing to the alternative view emerging from your evidence this morning that in fact it is the lack of questioning about allocation which is at fault?

It seems that there might be alternative routes to using State aid and that, given the level of usage by other European member states, the alternative explanation is that we maintain the strict regime that is across the European Union but choose to use it in a manner that then throws back an allocation exercise, and we treat it as being gold-plated, which is not in fact true.

Alexander Rose: In a previous role I was a lawyer in the Government Legal Department, advising on European funds and applications coming in. Very similar claims were made about potential gold-plating and stopping projects. The reality was that only one project out of the 900 or

so I reviewed was stopped due to state-aid rules. That was in part because the route to fix that would have involved going to the Commission for approval and the timings of the fund simply did not allow that.

My personal experience has been that there are often references to gold-plating, and that it is easier to point at firm rules that are outside the control of the department or funder than to say that a decision is based on allocation and budgets.

Jonathan Branton: Put simply, if the money is not available, whether it is state-aid compliant or not is irrelevant.

Lord German: Except to the public.

Jonathan Branton: But if the Government are not prepared to put cash on the table, there is no point in even looking at this state-aid analysis.

Lord German: But using the argument that has been used with British Steel—going back to the original question—that additional financial support could not be provided because it was constrained by EU rules, and given the position in northern France, your attitude is not that it is constrained but that it does not use the full bag of tools.

Jonathan Branton: Yes, but that could be an element of timing. At a point at which a firm is in difficulty, that becomes a particularly difficult scenario in the steel sector.

Lord German: Even though it is in the same position as France?

Jonathan Branton: I do not know the individual facts, so I cannot rule on the legality of that. I can speculate, but I cannot rule on it. We said that earlier on in that cycle there are things that you can do in the steel sector. One can speculate about whether that was looked at as much as it might have been.

Alexander Rose: There was very similar speculation back in 2016 with SSI, when state-aid rules were mentioned, and then later with Port Talbot, where there was a route forward. We see the same situation coming forward again.

The Chairman: Both of you seem to be saying that, on occasion, the issue is not whether the Government believe they could pass the European state-aid rules or not, but that it would take so much time to go through that that you would not be able to deal with the immediate situation.

Jonathan Branton: That is sometimes a consideration. Obviously procedures have to be gone through in order to render something legitimate, but if it is important enough, experience suggests that the UK Government would do that. The banking crisis is an example of that, so it is not that that can never be done, but a case-by-case analysis will be used.

There may be considerations such as, "We could do this, but for it to be legal we would need to notify Brussels. The chances are that would turn into a long inquiry that might even go into a phase 2 and we would be stuck arguing it for 18 months". Sometimes when that is being considered, people say, "You know what? We've got better things to do". The mere procedure can be dissuasive. What we have understood anecdotally is that the approach, certainly since the referendum, has been to avoid that where possible, unless it is a particularly important project.

Q63 Baroness Donaghy: The tipping point of course was the decision by the Government not to give the £30 million loan, which took the company into administration. The accounting officer of the department has said that it did not demonstrate the necessary commerciality. However, they have gone on to indemnify the company to keep it open while it is with the official receiver. Those were elements of choice, I assume. Now that it is in liquidation, what requirements would have to be met for the Government to act as an investor in British Steel, if they chose to?

Alexander Rose: Again, it is this market economy investor principle. To bring it back into the legal realm, Article 345 of the treaty states that public and private ownership of property rules have to be equal. This essentially allows the state to step outside the state-aid rules, if it acts exactly like a private, commercial investor. In this situation, you would look at—

Jonathan Branton: It is not stepping outside them, it is acting within them.

Alexander Rose: Yes, sorry. I meant stepping outside the scope of them.

Jonathan Branton: It is not State aid if one behaves as a private investor.

Alexander Rose: Thank you for the clarification. Essentially, provided it can show that it is acting like a commercial investor when purchasing a company in this situation, that would be consistent.

Jonathan Branton: There is quite a wide margin of appreciation for reaching that conclusion.

The Chairman: I see. So the fact that the company is in liquidation and there is no private investor anywhere on the horizon does not necessarily rule it out?

Jonathan Branton: Yes, but in many situations, leaving aside the role of the state, companies are bought out of administration on a pre-pack basis because certain debts are cleared. What you are then purchasing, or at least think you are purchasing, is a phoenix from the ashes, so you cannot exclude the possibility of that kind of thing happening. If you are to act in accordance with the market investor principle, you have to have a business plan and a rationale for what you are doing that is thought

through and that projects, "If we do this, this and this, there's a good chance that this will make a return over time".

Lord Lansley: What constitutes a commercial judgment on the part of the Government in those circumstances? Are the Government allowed to take into account the financial consequences to the Government themselves of the business not being supported, or invested in, in the way that is proposed? I am thinking of things like redundancy costs, welfare payments and community consequences.

Jonathan Branton: It is economic and financial considerations only, rather than social or political. An ordinary market investor would not be thinking, "Well, I've got to fund redundancy payments. We're going to be paying out the dole".

Lord Lansley: Yes. They have to demonstrate that they are thinking only in the same terms as a market investor would, not in the terms in which a Government would. It is not a public accounting issue; it is a commercial accounting one.

Q64 **Lord Wigley:** I would like to go back and pick up something that you have already touched on to some extent: the relationship between the state-aid rules and the trade defence policy. As I understand it, after DIT's investigation over the last couple of years, in May it published its conclusions indicating that it is going to consider terminating trade measures, including the steel sector, unless producers submit applications to maintain them.

I want to ask a general question. What are the relative objectives of these policy areas? Are they both needed? If so, to what extent should they interact?

Jonathan Branton: Sorry, do you mean the objectives of the trade defence measures?

Lord Wigley: Yes, and the overlap, given the DIT's suggestion that it may terminate trade measures.

Jonathan Branton: One obvious reason for that is that the measures that exist now have been determined on a pan-European level and with reference to a pan-European industry. For a range of the measures that are involved, and which currently receive protection, there may well be no current UK domestic industry, and that the domestic industry at European level may exist somewhere else but not here. If that is the case, there is no domestic industry to protect, so by imposing the measures you are purely adding an extra tax on consumers. If you do not have a domestic industry to protect, why would you keep the measure?

The sense behind that statement is that you would invite your domestic industry to say what measures are out there for which there is currently a UK manufacturing industry that is interested in being protected—after all, they may not be. If they are, and certainly I am aware of some that are sticking their hand up and saying, "Yes, please keep the protection", they would be expected to substantiate that.

The whole rationale of the trade defence measures is the protection of domestic industry against unfair competition, and unfair competition generally means dumped—sale for export at less than sale in the domestic market—or subsidisation, which is the link in to State aid.

There is the additional factor of safeguard measures, which are a little more exceptional and deal with massive surges in goods, often caused by international events that create distortions.

Lord Wigley: So there can be a need for both in parallel, because there may be circumstances in which the intervention is not by the state but by dumping and so on from overseas, and there need to be measures to deal with that.

Jonathan Branton: Yes, we are talking about totally different things. When it comes to how the state would determine a subsidy policy relating to the allocation of funds or when and where it intervenes to support industry, that is State aid and funding policy, although even those two are different things.

Thereafter, there is another issue again to deal with trade defence, which is essentially a reactive defence mechanism in the event that your market is damaged by unfair behaviour from exporters from outside your jurisdiction. I am sure that if the steel industry were in the room it would say, "We absolutely need that. India, China or wherever else will just keep producing the stuff without regard to cost or anything else, and we can't compete with that unless we have a level playing field". The trade defence measures provide that. It is a safety valve.

The Chairman: Of course, it would be the trade remedies body that carried that out, but as I understand it the DIT is still in consultation over exactly what the regime and procedure will be for trade remedies.

Jonathan Branton: That is far more constrained by WTO rules, because there are precise agreements—

The Chairman: I was going to get on to that, but at the end of the day state remedies are a political decision by the Secretary of State. It is not the same as the CMA, which is an independent judge in its area of State aid. It is a Secretary of State decision, is it not?

Jonathan Branton: Ultimately it will be, but at the moment it is a decision of the European Council that is voted on by the member states. I am a little out of date on this now.

Lord Lansley: The structure of the Trade Bill, which is in the other place, is that if the trade remedies authority concludes after investigation that no remedy should be applied, the Secretary of State cannot apply one.

The Chairman: Oh, right.

Lord Lansley: It makes a recommendation as to the remedy that should be applied, which then requires the Secretary of State to agree.

Jonathan Branton: That mirrors what happens now: the Commission makes a recommendation and the Council adopts it. There have been situations historically where the Commission has recommended the imposition of measures and the Council has decided not to do so for lack of political will. Basically, it is voting, and it can get voted down. That is rare but it has happened.

Lord Lansley: And that could happen under the proposed regime in the Trade Bill.

Jonathan Branton: Historically the UK has a reputation as being the free-trade member state, voting no against trade protection measures in certain circumstances.

The Chairman: Can you recall an example of that?

Jonathan Branton: It is not made public knowledge. I am only aware of it from inside our work.

The Chairman: That is interesting in itself. I have one last question, but do other colleagues have anything to ask?

Lord Lansley: I have a question, if I may. The steel sector-specific State aid regime is based on long-standing oversupply in the steel industry. That is on an EU basis. Just in the same way as you described different hypothetical circumstances in the United Kingdom, viewed in isolation from EU, at some point, if not now, will the EU look again at the extent of oversupply in the steel sector and might come to a different view about the continuing application of extra constraints on State aid to steel companies?

Presumably it will be open to the UK Government after exit day to take their own view of the extent of oversupply of steel product in the United Kingdom and to draw their own conclusions about the applicability of the State aid rules.

Jonathan Branton: Yes. The UK, when free of having to comply with EU law, will be able to take its own view on whether or not it should maintain the current especially restrictive attitude on State aid for steel. However, in doing so, it will have to have an awareness of what that would mean for broader discussions. If the UK did that, I dare say that would feature in the negotiations over an agreement with the EU.

Lord Lansley: But under the proposed regime would it not be the Government rather than the CMA that took that view? It would be an industrial policy issue in the first instance.

Jonathan Branton: Yes. The CMA would just enforce what the Government decided was the law, in the same way as the Commission now enforces what has been decided is the law at a superior level in the EU.

Q65 **The Chairman:** My last question is this. We have talked about extracting

ourselves from the EU and establishing our own system. We have talked tangentially about how an EU-UK arrangement would still have to be compatible. We have also talked about the WTO in part.

Do you have a view on other trade agreements, between the EU and third countries or elsewhere, where there would be a constraint on State aid, procurement rules et cetera that would be constraining or helpful, depending on how you look at it, if the UK were to conclude free trade agreements with other third parties such as Korea, Japan, America?

Jonathan Branton: The short answer is no, I am not aware of that. At the moment, the trade agreements which the UK benefits from are EU trade agreements. They are entered into with third parties in such a way as to allow the EU to keep determining its own state-aid policy. That State aid policy obviously has regard to the WTO agreement. In the context of all these trade agreements it is understood that if the EU subsidised its industries in a way that damaged third-country markets by exporting to them, those third-country markets could target the EU with anti-subsidy measures if the circumstances merited it, in the same way as the EU reserves the right to do the same to exports into the EU.

I would expect that to continue to feature in any trade agreement with third-party Governments, wherever they might be, who recognise the existence of the WTO arrangements. They have to do that anyway, so I do not think that it would be a big sticking point, but it will be because it is an important issue for the EU in particular, having the UK on its doorstep.

The EU absolutely does not want the UK to start departing from existing policy. I do not think that it expects the UK to do that because, from my personal experience, it thinks that we are more reluctant users of State aid than it is, and the stats bear that out. However, the EU will want to make sure that that is legally nailed down just in case we ever go off on a frolic and decide to do something contrary to it in future, which the EU would not want to happen.

Alexander Rose: It needs to be emphasised just how wedded the European Union is to these rules. For example, Michel Barnier's Article 50 task force consists of 15 people, including a State aid lawyer. That is crucial to them. Jonathan mentioned previous trade deals. I understand that there are 30 EU trade deals, and the closest two—the EEA and the Swiss one—both have State aid front and centre.

The Chairman: Although some of the other EU agreements which we are currently in the process of rolling over have somewhat weaker provisions. They might be slightly stronger than those under the WTO, but Korea and even Canada are less strong than the EU agreements. This Committee is due to consider the Korean treaty at some point. There are different situations, even within the EU's dealings and certainly within any inherited or future arrangements that we might make with third countries.

This session has been very useful and helpful to us. Is there anything

else that you have not touched on that you think we should register?

Alexander Rose: No, other than to thank you for this opportunity.

The Chairman: Thank you very much. This Committee gets reconstituted fairly rapidly and we will decide whether to take this issue significantly further, but we will use it as the basis for such a decision, and it has provided us with a good start. Thank you very much for your time and expertise.