



Draft Statutory Guidance on the United Kingdom Subsidy Control Regime

**Consultation response from
Lawyers in Local Government (LLG)**

August 2022

Introduction and general comments

About us

Lawyers in Local Government (**LLG**) is a not for profit membership body, formed in April 2013. We are the largest public sector membership body for lawyers in the UK, with over 4,500 members. This includes in-house lawyers working at all levels of local government in England and Wales.

LLG's primary purpose is to represent, promote and support the interests of those members. We provide an extensive member network with active grassroots involvement and participation, producing guidance, training, and commentary. This includes a dedicated partnership and procurement law grouping, which includes members advising on funding and subsidy control (formerly State aid). We are also supported by a number of corporate partner law firms with specialisms in subsidy control.

Our members' role in advising on subsidy control

Our members provide legal advice to hundreds of public bodies across England and Wales. This encompasses:

- Local authorities (including county councils, district councils, unitary authorities, metropolitan districts and London boroughs);
- Combined authorities; and
- Council owned companies

This includes both where those public bodies are the recipient of funding (for example from Homes England or MHCLG), and also where they are themselves the granting body.

As such, LLG's members possess a collective breadth and wealth of experience on funding projects and State aid/subsidy control law. As in-house legal teams, they also operate very much on the frontline - where law intersects with practice. Working closely with funding officers and client departments, they advise on State aid/subsidy control compliance across a broad spectrum of projects. This ranges from multi-million pound regeneration schemes, to low level grants to local community groups.

This unique position, we would submit, means our members are particularly well informed to comment on the consultation. As the success (or otherwise) of the UK's new subsidy control regime will be determined not by theoretical legal considerations, but rather how it operates in practice.

Our response to the consultation

LLG welcomes the draft guidance, and the level of detail contained within it. Our response primary deals with consultation question 3:

‘Would you prefer to see additional information or advice put into any sections of the guidance? If necessary, please explain why the suggested additions would aid your understanding of the regime’

We would advocate for the inclusion of further detail in a number of key areas. In particular, local government lawyers would welcome confirmation of the continued availability of:

- The “flow through” principle; and
- The German land decision

In our experience these compliant models, not currently contained in the draft guidance, are utilised in a range of local authority projects. We have set out below further details regarding the specific facts of each route. Confirmation within the statutory guidance of the availability of these routes would provide welcome clarity for local authorities (and other funders and recipients). It would also assist those organisations to fully embrace the new domestic subsidy control regime, rather than the current need to look back to the previous State aid regime to seek to justify compliance when adopting either of the above models. As set out below, we would also welcome further information and guidance for Councils (and other funders) in conducting a ‘7 principles’ assessment for those awards which are subsidies.

‘Flow through’ principle

Under the State aid regime the so-called ‘flow through’ principle was developed, including via the R&D&I Framework¹ and case law². The logic of the flow through principle is that no ‘selective advantage’ accrues to an organisation that can demonstrate the totality of aid it has received has been directed towards third parties rather than itself. As such, that intermediary organisation (whom the aid is simply “flowing through”) is not in receipt of State aid.

A ‘selective advantage’ is a key characteristic of State aid and therefore when this is absent, the European Commission concludes that ‘no aid’ is present. The concept of ‘selective advantage’ reappears in the new UK subsidy control regime, as limb b of the subsidy test (as set out in the draft guidance) requires that:

‘financial assistance confers an economic advantage on one or more enterprises.’

Further, limb c of the test requires that:

‘financial assistance is specific, such that it benefits one or more enterprises over one or more enterprises with respect to the production of goods or services.’

¹ See for example the proviso to Article 2.1.2 of the R&D Framework OJ C 198 of 27.06.2014, p.1 which provides: "However, the Commission will not consider the research organisation or research infrastructure to be a beneficiary of State aid if it acts as a mere intermediary for passing on to the final recipients the totality of the public funding and any advantage acquired through such funding."

² Cases where flow through and ring fenced accounting have implicitly been followed include N497/2001 UK Scotland Grants for Owner Occupiers, and R&D flow through cases like Danish Green Labs and Lithuania Science & Technology Parks.

As such, given the similarities in the test for aid and subsidy, there would appear to be clear scope to apply the flow through principle to the new subsidy control regime also.

Flow through requirements

We have previously had sight of external legal advice from a specialist lawyer in this field, which suggests that the key requirements for the flow through justification to apply under the State aid regime are:

- each of the intermediaries must demonstrate that they are directing the totality of the grant received to benefit others and these activities are in the common interest;
- the intermediaries shall deliver the support on a not-for-profit basis (i.e. at cost) throughout the term of the project. In the relevant case law, a ring-fenced account was used to demonstrate that the support flowed through to the end beneficiaries. The purpose of this was to ensure the public funding could be demonstrated not to impact any other activities of the intermediary, for instance any commercial activity, and this segregation was maintained for 15 years (the "Flow Through Period");
- if a profit or surplus were somehow to occur, then the intermediate bodies shall commit to perpetuate the project for longer (i.e. for the same common interest activity) or identify and allocate the surplus to another common interest activity on a non-commercial basis;
- any assets purchased for the project using state funds should be capable of being shown to be purchased at a market rate value and used for the project purpose;
- salaries and other administrative costs in administering the programme should not be excessive which can be demonstrated by appropriate benchmarking (against a reasonably efficient comparator private sector body or drawing upon the rates used in similar projects);
- where third parties are paid to deliver support, reasonable steps should be taken to ensure overcompensation is avoided (e.g. by open and transparent procurement or benchmarking); and
- the benefit to the end beneficiaries must be tracked and, where state aid arises, compliance managed by the flow through vehicle through an appropriate State aid exemption route.

As such, you may wish to consider including such detail in the statutory guidance (amending the terminology as necessary to reflect the subsidy control regime). You may also wish however to consider if these requirements can be further streamlined under the UK regime, to provide as much simplicity and clarity as possible for awarding bodies.

German land decision

The so-called 'German land decision'³ was an important State aid decision, which has subsequently been relied on by many Councils. Under this decision, limited actions to revitalise land are regarded as non-economic activity, recognising that such activities are within the normal, public duty functions of the state. The decision set an important precedent, allowing land development on a "no aid" basis in certain circumstances.

The logic underpinning the German land decision is that bringing public land back into use is not an economic activity, provided the conditions of the decision are followed. Again, we have previously had sight of external legal advice from a specialist lawyer in this field, which suggests that the salient facts of the German land decision were that:

- the sites were State owned;
- public funding was applied towards site preparation activities to allow the land to be brought back into use;
- the works were not so specific as to be tailored to the needs of a future purchaser;
- contractors were paid market rate determined through OJEU procedures; and
- upon the site preparation works being completed the site was sold to a developer at market value, determined through a procurement exercise.

The objectives of the German land scheme were that the site preparation works would:

- contribute to the improvement of infrastructure in the areas in question;
- strengthen of the regional economic potential; and
- increase the productivity and competitiveness of undertakings.

The European Commission in finding 'no aid' approved the following activities as within the scope of the decision:

- groundworks for making land ready to build;
- construction costs for streets, street lighting, anti-noise barriers, landscaping;
- connection costs to the mainframe for water, electricity, gas and sewage;
- environmental protection measures and decontamination, provided that the polluter pays principle is respected, that there is a direct technical link to the measure in question, and that they are essential for its implementation as well as economically justifiable; and
- removal of constructions that exist on industrial and commercial sites (old factories, military buildings or supply facilities)

³ Case SA.36346 (2013/N) – Germany – GRW Land Development Scheme

Again, we would encourage you to codify this decision within the statutory guidance for the new subsidy control regime, permitting a 'no subsidy' approach where the salient facts (as above) are mirrored. This would provide helpful clarity and confidence to both funders and recipients alike.

'7 principles' assessments – further guidance needed

The experience of our members to date has been that many Councils have found it difficult to complete the current '6 principles' assessments. This is particularly true of smaller Councils, who may often lack the relevant financial/economic/legal expertise to undertake these complex assessments, which were not needed under the State aid regime. To address this problem and improve the new regime, we would advocate for greater detail within the guidance on what must be considered for each principle. This could be accompanied by practical real-life examples to offer indicative guidance to funding bodies. We would also suggest that this information should be presented in such a way (perhaps a table?) that funding bodies are aware precisely what needs done for each individual principle. This is not immediately clear within the current draft guidance at Chapter 3. As before, this suggestion would improve the confidence of Councils and others in applying the requirements of the new subsidy control regime.

Thank you for taking the time to consider our consultation response. Please do not hesitate to get in touch if we can be of any further assistance.

Kieran McGaughey
Director

**For and on behalf of
Lawyers in Local Government (LLG)**



For further comment please contact Helen McGrath, Head of Public Affairs at Helen@llg.org.uk