

**White Paper Subsidy Control Conference:
What is a subsidy?
Grey areas and the continuing relevance (or not)
of EU State aid concepts**

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- Emerging practice suggests many PAs eager, indeed straining, to conclude that transactions fall within s. 3(2) SCA:

“(2) Financial assistance is not to be treated as conferring an economic advantage on an enterprise unless the benefit to the enterprise is provided on terms that are more favourable to the enterprise than the terms that might reasonably have been expected to have been available on the market to the enterprise.” (emphasis)

- Avoids need to assess/confirm compliance with subsidy control principles – PAs often lack experience/expertise/confidence
- If the transaction is of substantial value, avoids mandatory SAU reference, which entails publicity, scrutiny and (perceived) increased challenge risk
- Case-law suggests significant margin of discretion/appreciation for PAs CMO assessment, hence potentially difficult to challenge

- CJEU and commission decisional practice applied detailed, rigorous approach to application of ‘market economy investor’ principle
- Emphasis on evidence of actual market transactions, not whether commercial terms are reasonable from PA’s perspective
- New claim recently filed at the CAT that may illuminate these issues

Weis v Great Manchester Combined Authority (“GMCA”)

- SCA challenge relating to c. £140m loans to two property development SPVs, owned by the Renaker group (to which GMCA already loaned c. £700-800m; value of balance currently o/s at present unclear)
- Renaker have received c. 80%+ of all loan funding issued by GMCA under its main housing development fund: Greater Manchester Housing Investment Loans Fund (“**GMHILF**”)
- GMHILF purpose, perhaps unsurprisingly, said to be addressing/rectifying market failures re. finance availability
- Statements by GMCA and Renaker officers acknowledging funding would not have been available to Renaker on same terms from market sources
- Weis concerned that loans are not on commercial interest rates and/or terms and that this is distorting Manchester property investment and development market

- C submitted s. 76 SCA statutory information request
- GMCA refused to provide any non-public documents/information evidencing its assessment/decisions regarding applicable interest rate/commercial terms
- Assertion that no requirement to do so based on s. 76(3) SCA *“the authority must provide such information as would enable, or assist in, the making of a determination as to whether the subsidy was given, or the scheme was made, in accordance with the requirements of Chapters 1 and 2 of Part 2.”* (emphasis added)
- GMCA’s argument is that if PA considers complies with CMO principle no *“subsidy”*, and no s. 76 duty to provide information, arises
- Significant issue for efficacy of SCA regime/CAT exercise of review function

Weis v GMCA

- The *public* report approving loans indicated GMCA's position is that the loans are *not* subsidies, on basis of asserted compliance with the CMO principle
- However:
 - GMCA decision approving the loans refers to multiple non-commercial reasons, e.g. new jobs in Manchester, additional apprenticeships in Manchester etc. as "*key reasons*" for the decision
 - GMCA meeting to approve the loans < 1 minutes
 - No indication in public documents that GMCA considered: (i) its cumulative lending/exposure to Renaker, or (ii) the availability of finance on market on comparable terms
 - No indication of regard to SCA in GMCA's public documents

Notion of State aid summarises CJEU and Commission approach at §77:

“For the purpose of the MEO test, only the benefits and obligations linked to the role of the State as an economic operator — to the exclusion of those linked to its role as a public authority — are to be taken into account. (128) Indeed, the MEO test is normally not applicable if the State acts as a public authority rather than as an economic operator. For example, if a State intervention is driven by public policy reasons (for instance, for reasons of social or regional development), the State's behaviour, while being rational from a public policy perspective, may at the same time include considerations which a market economy operator would normally not consider. Accordingly, the MEO test should be applied leaving aside all considerations which exclusively relate to a Member State's role as a public authority (for example social, regional or sectoral policy considerations).” (emphasis added)

- GMCA's primary defence is that the proposed interest rates reflect Subsidy Control (Gross Cash Amount and Gross Cash Equivalent) Regulations 2022 ("**the 2022 Regs**")
- Interesting, and important, question: does applying the methodology in the 2022 Regs entitle a PA to conclude loan complies with the CMO principle/s. 3(2) SCA?

- 2022 Regs provide a methodology for calculating a proxy value of subsidy by comparing actual interest rate vs hypothetical interest rate generated by legislative formula (*nb.* only applicable if borrower has strong , good or satisfactory creditworthiness)
- Proxy interest rate = Base rate (per Table 1, Sch 2) + Mark-up rate (Third Column, Table 2, Sch 2)
- *nb* most non-public companies are not going to have credit agency rating

Compliance with CMO principle in respect of PA loans

| Length of loan | Base rate pa |
|----------------|--------------|
| 1m | 4.3% |
| 3m | 4.3% |
| 6m | 4.3% |
| 1y | 4.3% |
| 2y | 4.3% |
| 5y | 3.8% |
| 10y | 3.4% |
| 25y | 3.1% |

- Base rate
 - Table 1, Sch 2 – range of rates based on loan duration
 - Range of durations is 1 month to 25 years
 - Range is 4.3% (1 month-2 years) to 3.1% (25 years)
 - *nb* (1) narrow range of rates, and (2) lack of sensitivity to (significant) duration changes (i.e. 4.3% for everything from one month to two years)
 - Not a realistic proxy in many market/commercial contexts

Compliance with CMO principle in respect of PA loans

| Creditworthiness | Loss if default | Mark-up rate |
|------------------|----------------------------------|--------------|
| Strong | None | 1% |
| Good | None | 1% |
| Satisfactory | Not more than 30 | 1% |
| Satisfactory | More than 30%, not more than 60% | 2.2% |
| Satisfactory | More than 60% (or not known) | 3.4% |

- Mark-up rate
 - Products of creditworthiness + Loss in event of default
 - Range is 1-3.4%
 - Again, (1) narrow range, and (2) commercially unrealistic in some contexts

- Significant scope for abuse
 - No real control on PA's assessment of “*creditworthiness*” in many cases
 - Similarly, no real control of assessment of ‘loss if default’
 - No provision to take account of other commercial terms
 - Rates produced appear likely to be low compared with reality of some market contexts

- Statutory guidance does not suggest 2022 Regs should be treated as establishing CMO principle satisfied, to contrary – see, e.g. Annex 4, §§18.49-18.50 - indicating need to consider commercial terms *actually available* on market
- If 2022 Regs do provide a ‘safe harbour’ then significant tool for ensuring loan arrangements with PAs insulated from SCA scrutiny/challenge
- Potentially raises the continued relevance of EU State aid concepts quite sharply – is the SCA regime concerned with what would happen/be likely to happen on the market, or is it focused upon/limited to assessing the rationality of market facing conduct from the PAs perspective?

Notion of State aid summarises EU approach at §113:

- 2008 ‘Reference Rate’ communication from Commission provides methodology for proxy interest rates
- Emphasises “*only a proxy*” and greater weight is to be given to real world evidence regarding comparable transactions

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