

# TCA DISPUTE RESOLUTION MECHANISMS AND SUBSIDY CONTROL COMMITMENTS

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TOTIS KOTSONIS  
UK TRADE POLICY OBSERVATORY

## KEY POINTS

- The TCA is unprecedented amongst bilateral trade agreements in attempting to manage the delicate balance of maintaining regulatory convergence in certain policy areas without constraining future regulatory divergence. It does so by introducing the possibility of ‘rebalancing’ measures in the event of regulatory divergence leading to material impacts on trade and investment.
- Even in the absence of regulatory divergence, and even if both parties conform with the subsidy principles, there may be scope for ‘remedial measures’ where subsidies have or risk having a significant negative effect on trade and investment.
- The dispute resolution mechanisms underlying rebalancing and remedial measures are different with the possibility of introducing rebalancing measures more quickly, and with what appears to be a lower threshold with regard to impact on trade and investment, as well as arguably the possibility of justifying more significant trade defence measures.
- The resolution of disputes with regard to remedial measures, may be complicated by the difficulties of the subsidy granting authority in recovering the subsidy or reversing the effects of the subsidy.
- In the absence of an independent regulator with the power to assess TCA compliance on the UK side, UK subsidies might be more prone to challenges than EU State aid. Further development of the UK domestic control subsidy system could address this issue.
- The TCA inter-Party consultation provisions might prove crucial in limiting the risk of inter-Party disputes arising, which then lead to the imposition of unilateral trade defence measures.

## INTRODUCTION

The Trade and Cooperation Agreement (TCA or Agreement), which the United Kingdom and the European Union (together, the Parties) concluded on 24 December 2020, seems to have squared the proverbial circle. More specifically, the Agreement incorporates a set of so-called “level playing field” commitments that seek to maintain the Parties’ regulatory convergence in certain policy areas but without prohibiting their respective sovereign right to choose future regulatory divergence. Instead, continued convergence is encouraged by means of provisions which permit either Party to take certain unilateral trade defence measures when the other diverges significantly from relevant regulatory

commitments or grants subsidies that have a significant negative effect on inter-Party trade or investment. These arrangements are unprecedented in the context of a bilateral free trade agreement.<sup>1</sup>

<sup>1</sup> The approach which the TCA adopts in relation to level playing field commitments is consistent with the ideas set out in Totis Kotsonis, ‘Squaring the Circle: Level Playing Field Provisions and the Negotiation of a UK-EU Free Trade Agreement’ *Kluwer Competition Law Blog*, 3 March 2020. <http://competitionlawblog.kluwercompetitionlaw.com/2020/03/03/squaring-the-circle-level-playing-field-provisions-and-the-negotiation-of-a-uk-eu-free-trade-agreement/>

Subsidy control forms a key part of the level playing field commitments. This requires the Parties to have in place and maintain in their respective jurisdictions an “effective” subsidy control system where, subject to a small number of exemptions, regulated subsidies are granted only when certain key principles (the “Subsidy Principles”) are met. Among other things, the Subsidy Principles require that subsidies pursue a specific public policy objective, are proportionate and limited to what is necessary to achieve that objective and that their positive contributions outweigh any negative effects, in particular the negative effects on trade or investment between the Parties.<sup>2</sup> Compliance with the Subsidy Principles aims at ensuring that subsidies are not granted where they have or could have a “material effect” on trade or investment between the UK and the EU. Although the TCA commits the UK to establishing an independent authority or body with “an appropriate role” in its subsidy control regime, crucially, it does not require that subsidies should be subject to regulatory authorisation before being granted.

In terms of seeking to resolve subsidy-related disputes on an Inter-Party basis,<sup>3</sup> the TCA provides for the possibility of consultations and, subject to certain conditions being met, for the possibility of the complaining Party taking unilateral remedial measures where consultations do not resolve the dispute. Ultimately, where the dispute relates to concerns over significant divergences in the subsidy control policies of the Parties there is also the possibility for taking so-called rebalancing measures.<sup>4</sup>

These issues are discussed in more detail below, as is the question of the level of harm to trade or investment that must be established before unilateral trade defence measures may become available.

<sup>2</sup> For a detailed analysis of the TCA subsidy control commitments see Totis Kotsonis, “The Squaring of the Circle - Subsidy control under the UK-EU Trade and Cooperation Agreement”, *European State aid Law Quarterly*, (1/2021).

<sup>3</sup> The TCA also incorporates provisions which enable interested parties to seek remedies for breaches of relevant subsidy control commitments in the domestic courts. These provisions are considered further in “UK subsidy control post-Brexit: access to effective judicial remedies” (1 February 2021), T Kotsonis, <https://www.pinsentmasons.com/out-law/analysis/uk-subsidy-control-post-brexit-access-effective-judicial-remedies>

<sup>4</sup> Rebalancing measures are also available in relation to significant divergences between the Parties in relation to labour and social, environmental or climate protection policies. This issue is not discussed further in this paper.

## CONSULTATIONS

Where a Party considers that a subsidy which the other has granted (or there is “clear evidence” that it will grant) “has or could have a negative effect” on UK-EU trade or investment, it has the right to request the other to provide certain information about its grant with a view to establishing that this is consistent with the Subsidy Principles. It should be obvious from the above that the threshold triggering the right to seek consultations over the grant, or proposed grant, of a subsidy is relatively low – merely requiring that the requesting Party considers that a subsidy by the other has or could have a “negative effect” on trade or investment between them.

Once a request has been made in this context, the other Party must then provide relevant information in writing within 60 days. If following the receipt of this information, the requesting Party still considers that the subsidy in question has, or could have, a negative effect on inter-Party trade or investment, it may request consultations at the level of the relevant joint committee (which the TCA establishes).<sup>5</sup> The committee must then make “every attempt” to arrive at a mutually satisfactory resolution.

If consultations at the relevant committee level do not resolve the dispute, it would appear that a Party would have the option of requesting the establishment of an arbitration tribunal, the decisions of which would ultimately be binding on the Parties.<sup>6</sup> However, it is by no means obvious whether the establishment of a tribunal can provide an effective resolution to all disputes in this regard. The reason for this is that a tribunal’s powers in this context are narrow. For example, its jurisdiction regarding “individual” subsidies (but by implication not subsidy schemes) is limited to considering whether these are consistent with the provisions that apply to certain categories of prohibited or conditional subsidies only. Other aspects of an individual subsidy’s compliance, such as compliance with the Subsidy Principles, are

<sup>5</sup> The Trade Specialised Committee on the Level Playing Field for Open and Fair Competition and Sustainable Development.

<sup>6</sup> What should happen in the event of consultations at a committee level being unsuccessful is not made as clear as it could be, with the Subsidy Control Chapter not addressing explicitly this question. However, elsewhere the TCA make provisions for arbitration where, among other things, consultations have been concluded without a mutually agreed solution having been reached. (Paragraph 1(d) of Article INST.14 [Arbitration procedure], of Chapter 1 of Title 1 of Part Six [Dispute Settlement and Horizontal Provisions]). It is arguable that these provisions should also apply when consultations in relation to the grant of a subsidy are unsuccessful.

expressly excluded from the tribunal's jurisdiction.<sup>7</sup>

If as a result of these jurisdictional restrictions it is indeed, the case that the tribunal is not in a position to resolve a dispute over the grant of an individual subsidy, it would seem that this would lead to an impasse, other than in circumstances where relevant conditions are met and enable the complaining Party to take unilateral remedial measures.

On the other hand, if it is correct that the intention here was indeed, to differentiate the position between individual subsidies and subsidy schemes, this would allow for the possibility of a tribunal issuing rulings on the compliance of the latter with the Subsidy Principles. That would render it easier for each Party to challenge the other's major subsidy arrangements than it would be the case if they can only rely on remedial and rebalancing measures alone.

## REMEDIAL MEASURES

Over and above the right of a Party to seek consultations with the other where it considers that a subsidy has or could have a "negative effect" on trade or investment between them, the TCA also provides for the possibility of unilateral remedial action in circumstances where a Party is concerned that a subsidy causes, or there is a serious risk that it will cause, "a significant negative effect" on UK-EU trade or investment (the "Requesting Party"). In such a case, the Requesting Party may issue a written request for information and consultations on that subsidy with a view to finding a mutually acceptable solution (the "Written Request").

The other Party would then have 30 days from the delivery of the Written Request to provide a response in writing to the concerns raised. At the same time, the agreement requires the Parties to enter into consultations on a confidential basis over the issue. Unless the Parties agree otherwise, the consultations will be deemed to have been concluded 60 days from the delivery of the written request.

The Requesting Party has the right to take unilaterally appropriate and proportionate remedial measures, generally (there are some exceptions) 60 days from the date of the delivery of the written request where there is evidence of a significant negative effect on inter-Party trade or investment or a serious risk of

<sup>7</sup> At the same time, the wording of Article 3.13 suggests that a subsidy scheme's compliance with the requirements of the subsidy control chapter might in fact be subject to the tribunal's jurisdiction. Article 3.13[Dispute Settlement] of Chapter 3 [Subsidy control] of Title XI [Level playing field for open and fair competition and sustainable development] Heading One [Trade] of Part Two.

such harm arising.

As to the evidential burden in this context, the TCA provides that a Party's assessment of the existence of a subsidy, a significant negative effect, or serious risk of this arising, must be based on facts "and not merely on allegation, conjecture or remote possibility" whilst in addition, the realisation of the alleged risk must be "clearly predictable".

At least 45 days from the delivery of the Written Request, the Requesting Party must notify to the other the remedial measures that it intends to take, providing all relevant information in relation to them with a view to enabling the Parties to find a mutually acceptable solution. Assuming that this has proved impossible, the Requesting Party may take the remedial measures at least 15 days from the date of the delivery of the notification of those measures to the other Party.

It is important to note that the right to take remedial measures is not subject to a limitation period. Indeed, it is possible that a subsidy's effects might not become sufficiently apparent, and hence capable of evidencing appropriately for the purposes of justifying remedial measures, until long after this has been granted.

Separately, it is not clear how a Party's concerns about a subsidy granted by the other could be addressed so as to avoid the imposition of unilateral remedial measures where the relevant harm on trade or investment has been evidenced appropriately. In theory, a subsidy grant agreement could incorporate provisions that allow the granting authority to require the recovery of the subsidy or, at least, the prospective cancellation of any outstanding grant obligations where the UK Government (or an independent regulator) has concluded that the EU has met the evidential burden of harm which would allow it to impose unilateral remedial measures under the TCA. At the same time, it is obvious that such contractual provisions will import legal uncertainty into the grant of a subsidy and could lead to would-be beneficiaries being reluctant to accept it.

Within five days from the imposition of remedial measures, the other Party may request the establishment of a tribunal.<sup>8</sup> A request for the establishment of a tribunal, does not have a suspensory effect on the remedial measures. The powers of the tribunal in this context are once again limited. More specifically, the tribunal does not have the power to consider the compliance of the subsidy with the Subsidy Principles or the conditions that

<sup>8</sup> Such a request is also possible outside this five-day period but in such a case, a different and longer dispute resolution procedure applies.

apply to prohibited and conditional subsidies in this context. Instead, its jurisdiction is limited to deciding issues such as whether in taking the unilateral remedial measures that Party complied with relevant procedural requirements and met relevant evidential standards (for example, when assessing the existence of a subsidy or of a significant negative effect) and as regards the proportionality of the remedial measures.<sup>9</sup> The tribunal must deliver its decision within 30 days of its establishment.

Where the tribunal finds against the Party that has taken unilateral remedial measures, that Party must notify the other within 30 days from the delivery of the arbitration ruling the measures that it has taken to comply with the ruling. Within the same 30-day period, the complaining Party may ask the tribunal to determine an appropriate level of suspension of obligations under the TCA (or a supplementing agreement), so as to counter the harm caused by the application of the unilateral remedial measures, where the tribunal finds that the inconsistency of those measures with relevant requirements is “significant”. The complaining Party may then proceed to suspend obligations in line with the tribunal’s ruling at least 15 days following that ruling.

It is important to note that whilst the decisions and rulings of the arbitration tribunal are binding on the Parties, they do not create any rights or obligations with respect to natural or legal persons.<sup>10</sup> Separately, the Agreement prohibits the Parties from applying simultaneously a remedial measure and a rebalancing measure to remedy the impact on trade or investment caused directly by the same subsidy.<sup>11</sup> The issue of rebalancing measures is considered below.

## REBALANCING MEASURES

A Party has the right to apply appropriate and proportionate “rebalancing” measures in cases where there are significant divergences in, among other things, the subsidy control policies of the Parties which give rise to “material impacts” on trade or investment between them. As with remedial measures, the TCA makes it clear that a Party’s assessment of these impacts must be based on reliable evidence and not merely on conjecture or remote possibility.

<sup>9</sup> Article 3.12(9) [Remedial Measures] of Chapter 3 [Subsidy control] of Heading One [Trade] of Part Two.

<sup>10</sup> Article INST.29(2) [Arbitration tribunal decisions and rulings], Chapter 4 [Common procedural provisions], Title I [Dispute Settlement], Part Six [Dispute Settlement and Horizontal Provisions].

<sup>11</sup> Article 3.12(15) [Remedial measures] of Chapter 3 [Subsidy Control] of Heading One [Trade] of Part Two.

Before rebalancing measures may be implemented, the concerned Party must notify the other of its intention to adopt these, providing all relevant information. The Parties must then commence consultations with a view to finding a mutually acceptable solution within a 14-day period. If this period expires without an agreement, rebalancing measures may be adopted five days after the consultations have been concluded,<sup>12</sup> unless the notified Party requests the setting up of an arbitration tribunal. The tribunal must then decide on whether the rebalancing measures comply with relevant requirements, such as whether they are appropriate, proportionate and limited to what is strictly necessary to remedy the situation. The tribunal must deliver its finding within 30 days from its establishment. If it fails to do so, the concerned Party may adopt the rebalancing measures three days after this period has expired. If so, the other Party is also permitted to take proportionate countermeasures pending the delivery of the tribunal’s ruling but must cease these measures once the ruling has been delivered.

The concerned Party may adopt the rebalancing measures (or presumably confirm them where it had the right to implement them provisionally as noted above) where the tribunal confirms in its ruling that these comply with relevant requirements. On the other hand, where the tribunal concludes that the measures are inconsistent with such requirements, the concerned Party has to notify the other Party of the measures it intends to adopt to comply with the ruling. These may include, withdrawal or adjustment of the rebalancing measures.

In terms of substance, there would not appear to be any material differences between what might count as a “remedial” or “rebalancing” measure; both might involve the imposition of tariffs or quotas or the suspension of certain other preferential access commitments. However, on the basis that significant divergences in subsidy control policies would herald a systemic divergence in the way in which Parties approach subsidy control, this is likely to lead to longer-term and wider distortive effects on level playing field conditions than the grant of any one or more time-limited subsidies. Accordingly, where a rebalancing measure is justified, this would seem to permit, in principle, the adoption of more draconian trade defence measures than that which would seem justifiable in the context of a remedial measure. Also reflecting the potentially more serious nature of rebalancing measures is perhaps the fact that, as noted earlier, the establishment of a tribunal would

<sup>12</sup> A different and longer procedure applies where the other Party has failed to seek the setting up of a tribunal within this five-day period.

mean that the measures cannot normally be adopted unless the tribunal has confirmed that these are consistent with relevant requirements. In contrast to this, as also noted earlier, the request for the setting up of a tribunal does not have a suspensory effect on remedial measures.

Whilst rebalancing measures would generally be expected to be temporary, four years after the entry into force of the Agreement, a Party may request a review of trade-related and, subject to mutual agreement, also other commitments. Such a review may also commence earlier than four years, where rebalancing measures have been frequent or applied for a period of 12 months or more. The purpose of such review would be for the Parties to consider whether there is a need to amend the Agreement, in the light of the significant regulatory divergences that have emerged and rebalancing measures that may have been taken, so as to ensure an “appropriate” balance between rights and obligations on a more permanent basis. There are specific rules as to how often a Party may request the review of the Agreement in this context but, in general, a review may be repeated at least every four years following the conclusion of the previous review.

If, following the review, a Party considers that there is indeed, a need to amend the Agreement the Parties will commence negotiations with a view to agreeing on the necessary amendments. If, following a year of negotiations, the Parties are still unable to agree on an amending agreement, either Party may give a three-month notice of its intention to terminate the trade-related (and potentially other) parts of the Agreement.

## THE TCA TAXONOMY OF HARM

As it should be obvious from the above, the availability of remedial or rebalancing measures is not necessarily dependent on whether the other Party has complied with the Subsidy Principles in granting a subsidy. Instead, justification for the imposition of such measures requires reliable evidence demonstrating that a certain level of harm has arisen or that there is at least a serious risk that it will arise (in the case of remedial measures) or that it is “arising” (in the case of rebalancing measures).

Accordingly, that might mean that unilateral remedial measures are available where there is evidence that a subsidy has given rise to a significant negative effect on UK-EU trade or investment, for example, despite the fact that the subsidy in question is deemed to comply with the Subsidy Principles. Equally, where the grant of a subsidy is inconsistent with the Subsidy Principles that will not of itself entitle the other Party

to take remedial measures, unless there is also evidence that non-compliance has led to the relevant level of harm having been established (or where appropriate, evidence of a serious risk of such harm arising).

Separately, it is not clear whether the need to demonstrate that “material impacts” on trade or investment are arising for the purposes of rebalancing measures should be distinguished in any way from the need to demonstrate that a “significant negative effect” exists, or that there is a serious risk of it arising in justifying the need for unilateral remedial measures.

It is tentatively submitted that such distinction should be made with “material impacts” constituting a comparatively lower threshold of harm than a “significant negative effect”. This interpretation would seem appropriate on the basis that, in line with earlier comments, significant policy divergences are likely to have longer-term and wider distortive effects on the level-playing field conditions for trade and investment between the Parties, than the grant of time-limited subsidies. On that basis, requiring a comparatively lower standard of harm to be established before rebalancing measures may be taken would seem reasonable and proportionate. This view is also supported by the fact that, as noted earlier, the TCA caters for the possibility of rebalancing measures being applied frequently and incorporates provisions that give rise to certain rights in those circumstances.

The fact that the TCA makes reference to material “impacts” rather than “impact” should not negate this conclusion. This is on the basis that, as noted above, significant regulatory divergences are likely to have wider competition distortive effects than time-limited subsidies, the effects of which are likely to be limited to the specific market (or, in certain circumstances, markets) in which the beneficiary is active.

In addition, it is not entirely clear as to whether over and above reliable evidence demonstrating material impacts on trade or investment it is also necessary to demonstrate separately that the material impacts in question are arising specifically as a result of “significant” policy divergences. It is submitted that this interpretation would seem incorrect. Instead, where there is reliable evidence that regulatory divergences are giving rise to material impacts on trade or investment, these should be deemed, by implication, to be “significant”. Any other interpretation would risk allowing material impacts on trade or investment and, by extension, distortions of the level playing field, to persist, merely on the basis of arguments that the regulatory divergences should

not qualify as “significant”.<sup>13</sup>

Ultimately, whilst the respective thresholds of a “significant negative effect” and “material impacts” might not be fully identical there is no doubt that both thresholds are considerably higher than the relatively low threshold of “effect on trade” that applies under EU State aid rules.<sup>14</sup> At the same time, it must also be the case that these thresholds cannot be so high as to render the remedial measures and rebalancing provisions devoid of any practical application. Again, any other interpretation would have the effect of weakening substantially the incentives for maintaining regulatory convergence which these provisions were designed to provide and disturb the delicate balance in the TCA between respect for each Party’s regulatory autonomy and fair competition as the basis for preferential access to each other’s markets.

For completeness, it is noted that the reference to “material” rather than “significant” effect on trade or investment in the context of the Subsidy Principles, would seem of lesser importance. This is on the basis that, the question of whether relevant domestic law remedies are available is determined, not by reference to evidence of a particular type of harm having been caused but, instead, by reference to the question of whether a subsidy complies with the Subsidy Principles. Indeed, where a court or tribunal concludes that the grant of a subsidy does not comply with the Subsidy Principles, a “material” effect on trade and investment between the Parties must, by implication, be assumed.

<sup>13</sup> It is for the same reason that the question of whether changes in the regulatory policies of one Party should be deemed to constitute “divergence” rather than “divergences” should be immaterial for the purposes of giving rise to the right to apply rebalancing measures where there is reliable evidence of material effects on trade or investment arising as a result.

<sup>14</sup> Article 107(1) TFEU.

## CONCLUDING REMARKS

The extent to which the Parties might have recourse to remedial or rebalancing measures would depend on the extent to which they are minded to maintain full compliance with TCA commitments and keep broadly in step with each other in the development of their regulatory policies which are subject to the level playing field commitments. In this regard, a potential concern might arise from a UK perspective in the context of subsidy control. More specifically, in the absence of a prior authorisation system that requires an independent regulator to assess the TCA compliance of at least the larger or more complex subsidy measures before their implementation, UK subsidies might be more prone to challenges, whether at the vertical or horizontal level, than EU State aid measures which have been notified to, and authorised by, the European Commission before implementation. Indeed, there must be some doubt as to whether each and every granting authority in the country has the resources and relevant expertise to carry out the kind of detailed and complex legal and economic analysis that could be required in determining a subsidy’s compliance with the Subsidy Principles.

In this context, the TCA inter-Party consultation provisions might prove crucial in limiting the risk of inter-Party disputes arising, which then lead to the imposition of unilateral trade defence measures. As we have seen, the consultation provisions enable either Party to require the other to provide explanations as to the compliance of a subsidy with the Subsidy Principles. It is notable that the level of harm that can trigger these consultation mechanisms is low, merely requiring that a Party considers that the grant of a subsidy by the other has or could have a “negative effect” on inter-Party trade or investment. If the explanations received do not allay initial concerns the concerned Party may initiate consultations. Every attempt must then be made to arrive at a mutually satisfactory resolution. This, together with the overarching good faith principle which underlies all TCA commitments<sup>15</sup> should mean that the Parties remain mindful of any legitimate concerns that the other expresses in relation to the grant of a particular subsidy.

<sup>15</sup> Article COMPROV.3 [Good faith] of Title I [General Provisions], Part One [Common and Institutional Provisions].

At the same time, it is submitted that a “mutually satisfactory resolution” is likely to prove difficult in circumstances where concerns are raised after the subsidy has been granted. For example, where a resolution involves an acknowledgement that a subsidy measure should be adjusted or otherwise amended to ensure compliance with the Subsidy Principles, it is not clear how such changes could be effected legally under domestic law once the subsidy has been granted and in the absence of a domestic court decision declaring the subsidy incompatible with relevant subsidy control requirements.<sup>16</sup> In line with earlier comments, the possibility exists for grant agreements to incorporate provisions which permit the UK Government (or the independent regulator) to require that changes be made to the subsidy measure, with a view to averting the escalation of the dispute and the risk of a vertical challenge or unilateral remedial measures by the EU. However, again, this creates legal uncertainty and it is unlikely to be acceptable to would-be subsidy beneficiaries.

Ultimately, a domestic subsidy control system which provides for a combination of “safe harbours” (which could, in principle, be simpler and more generous than the block exemptions available under EU State aid law)<sup>17</sup> and the requirement, or at least the option, to notify the larger, more complex and otherwise higher risk subsidies before implementation can strike the right balance between flexibility and legal certainty. This should then render the domestic subsidy control system more robust and less prone to inter-Party disputes

<sup>16</sup> Effecting such adjustment or other changes to a subsidy that has already been granted can prove problematic not only for UK but also the EU. Indeed, once the European Commission has authorised a State aid measure, absent a challenge in the EU General Court by an interested party, there is no mechanism under EU law that would permit the European Commission to revise its original authorisation decision (other than where there are changes to the State aid measure as originally notified to it). At the same time, it might be that, from an EU perspective, this risk is deemed to be remote on the basis of a view that a State aid measure which the European Commission has deemed compatible with the internal market under EU State aid rules is unlikely to raise any substantive concerns from the perspective of compliance with the comparatively more flexible Subsidy Principles.

<sup>17</sup> Safe harbours provisions could set out the conditions which certain type of subsidies must meet in order to be deemed consistent with UK subsidy control requirements

and challenges than it might otherwise be the case.<sup>18</sup>

It is to be hoped that this possibility is given favourable consideration by the Government as it investigates further how best to develop the UK subsidy control system in the context of a Subsidy Control Bill.<sup>19</sup>

<sup>18</sup> For further details on a how the UK subsidy control regime can strike a balance between flexibility and legal certainty, see Professor Andrea Biondi, Anneli Howard QC, Dr Totis Kotsonis, Professor Stephanie Rickard, Dr Luca Rubini, Dr Oana Stefan, and Kelly Stricklin-Coutinho (see in particular, response to question 22), <https://uksala.org/further-response-to-beis-consultation-on-subsidy-control/>

<sup>19</sup> On 19 May 2021, the Government announced, in the context of the Queen’s Speech, its intention to introduce a Subsidy Control Bill.

## ABOUT THE AUTHOR

**Dr Totis Kotsonis** is a competition, EU & trade law partner at Pinsent Masons, the international law firm. He heads the firm's subsidies, procurement, trade agreements and trade remedies practice, covering both compliance and contentious matters. He has been advising on Brexit-related issues since 2016 and more recently on the implications of the Northern Ireland Protocol and the UK-EU Trade and Cooperation Agreement.

Totis writes and speaks regularly on trade, subsidies and public procurement law matters and has been involved in the drafting of national and international laws. He has a PhD from the London School of Economics.

## FURTHER INFORMATION

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For further information on this theme or the work of the UK Trade Observatory, please contact:

**Professor Michael Gasiorek**  
Director  
UK Trade Policy Observatory  
University of Sussex, Jubilee Building,  
Falmer, BN1 9SL  
Email: [uktpo@sussex.ac.uk](mailto:uktpo@sussex.ac.uk)

**Website:** <https://blogs.sussex.ac.uk/uktpo/>

 **Twitter:** @uk\_tpo

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