European and UK Critical Raw Materials (CRM) Supply Chains – State Aid, Subsidies and Rebalancing

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In our four previous articles on non-Chinese rare earth elements (REE) to permanent magnets supply chains (NCSC) (available here) we outlined western governments' policy responses to China's dominance of the REE sector and some of the challenges posed by current and proposed laws and policies of the UK and the EU to the development of resilient supply chains to meet the demand for permanent magnets for their industrial ecosystems, including EV and wind turbine industries.

In this article we consider the impact of the "level playing field" provisions of the Trade and Cooperation Agreement (TCA) between the EU and the UK concerning state aid (or subsidy as it is termed in the UK) control and "rebalancing".

The significance of state aid and subsidies to CRM supply chains including NCSC

On 15 March 2021, the first debate on critical minerals was held in the UK Parliament. In the course of his speech, Alexander Stafford MP, the vice-chair of the all-party parliamentary group for critical minerals outlined the priorities in terms of the government's policy in this area:

"The Minister will not be surprised that I have some policy asks of the Government. The first is to support the development of potential critical minerals by supporting upstream mining capability throughout the UK. The second is the development of a critical mineral midstream. The global supply chain bottleneck is at the midstream section. When the rest of the world focused on bulk mining, China looked to the future of the industry and cornered the market for the minerals we need now. It is a monopolised sector and therefore free market forces do not work. As a Government, we must find innovative ways to fund the right projects to ensure we overcome this global bottleneck. Our regional competitor for critical minerals, the EU, has already started a finance programme looking to raise £16 billion off the back of an institutional £6 billion investment. Unless we find a way to compete, companies will be attracted to where the investment exists." [Emphasis added]

On 5 May 2021, the International Energy Agency released its special report – "The Role of Critical Minerals in Clean Energy Transitions" (IEA Report).

"Today, the data shows a looming mismatch between the world's strengthened climate ambitions and the availability of critical minerals that are essential to realising those ambitions. The challenges are not insurmountable, but governments must give clear signals about how they plan to turn their climate pledges into action. By acting now and acting together, they can

Simon Salter | Solicitor, Independent Legal Advisor
Flora Pitti-Ferrandi | Competition Partner, V&A

significantly reduce the risks of price volatility and supply disruptions". [Emphasis added] Fatih Birol, Executive Director of the IEA.

If the UK and EU are to establish resilient CRM supply chains, government support, including in the form of state aid and subsidies will be essential.

State aid rules in the EU

The EU rules generally prohibit state aid provided by national Member States unless it can be justified by reasons of general economic development. To qualify as state aid, under EU law, a national government support measure needs to have the following features:

- an economic intervention in a company by the state or its agencies;
- which gives the company an advantage on a selective basis;
- which has or may distort competition; and
- the intervention is likely to affect trade between Member States.

The EU rules recognise that despite the general prohibition of state aid, in some circumstances aid is necessary for a well-functioning and equitable economy and so leave room for a number of policy objectives for which state aid is considered acceptable e.g. it might be necessary and justifiable to achieve policy goals such as regional economic development and environmental protection or to encourage investment in the development of advanced, environmentally friendly technologies.

The EU rules require that legality must be established before the aid is provided. In addition to state-to-state enforcement, the EU rules also provide remedies for businesses and individuals, including repayment of the aid.

EU state aid rules only apply to national governmental measures and do not apply to EU funds which are granted directly to undertakings without coming under the control of a public authority of a Member State.

TCA Part 2 Title XI: Level Playing Field for Open and Fair Competition and Sustainable Development (the LPF)

The TCA requires the UK and the EU to have effective systems of state aid/subsidy control with independent oversight and the right to impose remedial measures if a dispute is not resolved by consultation.

The TCA includes provisions that will enable domestic courts to order recovery of subsidies that have been granted improperly under domestic law. For the UK, this will only be available at the end of a successful judicial review into the legality, process and rationality of the decision rather than its merits. The TCA also allows for unilateral 'remedial measures' if a subsidy granted by the other party causes, or there is a serious risk it will cause, a significant negative effect on trade or investment between the parties.

For the EU, state aid rules, enforcement authorities and judicial review are already in force for national governmental measures. The LPF provisions of the TCA will however imply a review and assessment of EU measures that previously escaped the application of any state aid rules. For the UK, the LPF provisions of the TCA require the establishment from scratch of a subsidy control regime regulated by an independent body. The regime must establish and maintain certain general principles applicable to subsidies that are set out in the TCA. The UK's future regime will take effect when the relevant legislation comes into force and will not apply retrospectively to subsidies awarded in the interim. Until then the UK will continue to follow its international commitments on subsidy control under the World Trade Organisation Agreement, the TCA and other Free Trade Agreements.

In early February 2021 the UK government released its consultation paper - "Subsidy control – Designing a new approach for the UK" (Consultation Paper) - seeking responses to 43 questions. Consultation closed on 31 March 2021. In the Queen's Speech delivered on 11 May 2021 the government announced its intention to legislate in the following terms "measures will be introduced to ensure that support for businesses reflects the United Kingdom's strategic interests and drives economic growth" – the Subsidy Control Bill.

The Consultation Paper describes a subsidy "in general terms, [as] a financial contribution using public resources which confers a benefit on the recipient".

To qualify as a subsidy under the proposed UK regime, a support measure needs to have the following features:

- it must constitute a financial contribution provided by a 'public authority';
- it must confer a benefit on persons supplying goods or services which would not be available under commercial terms;
- it must be selective to support a particular company, sector, industry, or region; and
- it must or could have, a harmful or distortive effect on trade or investment within the UK or internationally.
- Article 3.2 of the LPF lists subsidies which may be made without infringing the TCA:
- subsidies to compensate the damage caused by natural disasters or other exceptional non-economic occurrences;
- subsidies of a social character that are targeted at final consumers;
- subsidies that are granted on a temporary basis to respond to a national or global economic emergency that are targeted, proportionate and effective in order to remedy that emergency;
- subsidies where the total amount granted is below €380,000 over 3 years;
- subsidies for agriculture and fish and fish products; and
- subsidies related to the audio-visual sector.

In addition, Article 3.3 excludes subsidies granted to providers of services of "public economic interest" if the application of the TCA rules would obstruct them from performing their particular task.

The Consultation Paper refers to three "exceptional circumstances" which will be exempt from the UK and EU regimes under the terms of the TCA:

- relief to compensate for exceptional non-economic occurrences such as drought, flood, severe storms, wildfire or compensating businesses for the immediate economic impact of a pandemic;
- subsidies granted temporarily to address a national or global economic emergency such as a financial crisis; and
- public services that would not be supplied without intervention such as social housing or rural public transport services.

None of the exemptions provided for in Articles 3.2 or 3.3 of the LPF or the "exceptional circumstances" described in the Consultation Paper would appear to have any application to the provision of state aid or subsidy to a CRM supply chain (including a NCSC). That being the case, the presumption will be that government support for such chains in both the EU and the UK will constitute state aid or a subsidy and the giving of it will require to be legally certain before it is given.

However, if similar levels of reciprocal controls will apply to subsidies provided at national level on both side of the Channel, there are some particular exceptions of a type that may limit the ability of the UK to challenge subsidies provided at an EU-level to a CRM supply chain. Accordingly, contrary to nationally granted subsidies, subsidies financed by the resources of the UK or the EU at a "supranational" level will not be submitted to the control of the independent authority that each Party will have to establish or maintain, which authority shall have an appropriate role in its subsidy control regime and be subject to cooperation obligations with the cross-Channel authority. Thus, EU-level subsidies will be subject to less scrutiny than national subsidies. Also, "large cross-border or international cooperation projects" for transport, energy, the environment, research and development, including first deployment projects to incentivise the emergence and deployment of new technologies (excluding manufacturing) — which may typically include EU programmes in support of sustainable and resilient CRM supply chains for the deployment of the EV industry – are presumptively allowed provided they entail wide benefit and relevance through spill-over effects – which may well be the case of financial support of NCSC.

Furthermore, at the UK level, paragraph 56 of the Consultation Paper provides:
"The Government intends to implement an exemption for subsidies where they are required for the purpose of defence or self-guarding national security". [Emphasis added]

The expression "required for the purposes of safeguarding [sic] national security" is used in the Freedom of Information Act (FOIA).

The term "national security" is not defined in the FOIA although it would appear in that context to be concerned with the protection of democracy and the legal and constitutional systems of the state, as well as military defence.

As we noted in our 4th article in this series (access here) the term "national security" is not defined in the National Security and Investments Act (NS&I) although it is quite clear that a

NCSC will clearly be considered as a matter of "national security" for the purposes of the NS&I and so certain changes in control of certain parties to the NCSC could justify the Secretary of State issuing a call-in notice to examine the circumstances and effect of that change and its risk to national security.

It is likely that the Government would consider the term "national security" in the context of its subsidy policy in much the same way as it is considered in the NS&I ie in terms of the risk to the economic system of the state rather than as a threat to democracy and its institutions.

The Information Commissioner's Office has issued guidance on the expression "required for the purpose of" self-guarding national security for the purposes of the FOIA:
"Required" is defined by the Oxford English Dictionary as "to need something for a purpose" which could suggest the exemption can only be applied if it is absolutely necessary to do so to protect national security. However, the Commissioner's interpretation is informed by the approach taken in the European Court of Human Rights where interference to human rights can be justified where it is "necessary" in a democratic society for safeguarding national security. Necessary in this context is taken to mean something less than absolutely essential but more than simply being useful or desirable. Therefore, we interpret required as meaning reasonably necessary".

The Consultation Paper makes it abundantly clear that the Government's "own bespoke subsidy regime should work for the specific need of the UK economy while meeting our international commitments. It should facilitate strategic interventions to deliver Government priorities such as levelling up and achieving net zero carbon…" [Emphasis added]. To emphasise the point the highlighted sentence is repeated a further two times in the Consultation Paper.

The Consultation Paper suggests that a NCSC into the UK is likely to find itself in an enviable position as the potential beneficiary of UK Government support on the grounds that such support is reasonably necessary for the purpose of safeguarding national security.

Nations have had to resort to massive support for their economies twice over the last decade to address the effects of the financial crisis of 2012-2016 and the Covid pandemic and will need to continue to do so for as long as the pandemic continues.

It is probably not overstating the position to say that both the UK's and the EU's plans to transition their economies from fossil fuel dependency to green energy (including through REE to permanent magnet supply chains such as NCSC that are vital to EV and wind turbine technologies) are either already at a critical point or soon will be either in securing adequate sources of the REE themselves or in developing the necessary critical mineral infrastructure to refine and process the REE, or both. In these circumstances state aid or subsidies will almost certainly be necessary to accelerate the establishment of industries and supply chains to manufacture the necessary equipment and infrastructure to power the technologies that will transition societies and industries to a greener energy system.

Whilst the IEA Report strongly encourages international cooperation, competition between governments to establish and maintain resilient critical raw material value chains (such as

NCSC) including processing know-how and technologies that will be required to ensure the clean energy transition of their economies, cannot be ruled out.

In these circumstances a UK policy that allows subsidies that will put the UK in a better position than its nearest competitor may be seen by that competitor as an example of support which will cause or run a serious risk of causing a significant negative effect on trade and investment between the UK and the EU and justify remedial action by the EU under the terms of the LPF. In the context of the global financial crisis the European Commission issued the following statement:

"In times of crisis, there may be a temptation to relax competition rules to accommodate short term problems that businesses face. History shows that such relaxation actually prolongs and worsens the impact of the crisis and prevents healthy recovery. So it is vital for competition rules to be fully maintained in the current environment. Consumers, taxpayers, workers and businesses - everyone is better off overall when competition exists in our markets. The Commission and national competition authorities continue to enforce competition rules to guarantee this outcome".

The proposed UK regime will require public authorities to apply a "domestic test" to ensure that "a subsidy does not unduly favour one firm to the detriment of a competitor or new entrants to the UK market, or unduly reduce competition within the UK market" and to assess whether the positive contributions of a subsidy to achieve an objective may outweigh any negative effects on "domestic competition". If critical raw material supply chains are to be exempt from the UK subsidy regime, private companies will presumably have no right to challenge subsidies under the UK's domestic law and will need to invoke directly the incompatibility of the aid with the LPF, which may present a more uncertain course of action.

Rebalancing TCA Part 2 Title X1 – Article 9.4

In the third article in this series (available here) we considered the impact of the proposed EU law requiring parties wishing to access its market to undertake ESG due diligence of their supply chains.

Under Article 9.4, the EU and UK recognised their respective rights to determine their future policies and priorities with respect to labour and social, environmental or climate protection, or with respect to subsidy control, in a manner consistent with their international commitments, including those under the TCA. At the same time, they acknowledged that significant divergences in these areas can be capable of impacting trade or investment "in a manner that changes the circumstances that have formed the basis for the conclusion of the TCA."

If material impacts on trade or investment (based on reliable evidence and not merely on conjecture or remote possibility) "are arising as a result of significant divergences" in these areas, either Party may take appropriate rebalancing measures restricted to what is strictly necessary and proportionate in order to remedy the situation.

Once the proposed EU ESG law is the subject of a Directive, the EU may consider that its effect on EU CRM supply chains may raise costs and so put the EU at a relative disadvantage to the

UK if the UK does not enact similar legislation in respect to UK CRM supply chains. Ensuring a level playing field among companies active in the EU is a clear objective of the proposed ESG Directive that cites this specific concern several times. In its March 2021 Resolution, the European Parliament notes that such Directive will benefit businesses and stakeholders in terms of "a level playing field and mitigating unfair competitive advantages of third countries that result from lower protection standards as well as social and environmental dumping in international trade".

If the EU had reliable evidence of material impacts on trade or investment arising because of the divergence between the UK and the EU in terms of CRM supply chain ESG due diligence, the EU could respond with "appropriate rebalancing measures" e.g. the imposition of tariffs or trade barriers.

Assuming that the UK did not accept the EU's rebalancing measures the dispute will be subject to a fast-track arbitration process. This provides for a 14 day consultation process, followed by arbitration with the ruling to be delivered within 30 days of the establishment of an arbitration tribunal.

However, proving "material impacts" on trade and causality from the EU ESG provisions is likely to require a very high standard of proof. Estimating costs related to ESG value chain due diligence requirements is recognised as a difficult task – a study on supply chain due diligence of January 2020 commissioned by the EU Commission reported that, "available impact assessments indicate that the potential financial cost burden of reporting requirements varies widely across companies depending on size, value-chain complexity and other sector characteristics" and "impact assessments also stress that companies not directly affected by the regulations are likely to be impacted indirectly through supply chain effects". Demonstrating the effect of such costs on trade will certainly be another challenge, when, as reported by Professor Holger Hestermeyer (King's College London), the only known decision as to the impact of labour-related actions on trade is that of the US-CAFTA legal case, where the arbitral panel concluded that, although the Guatemala government had failed to enforce its own labour laws, the impact on trade was not proven.

Section 30 National Security and Investment Act

Finally, a word on the impact of the TCA on the NS&I.

Article 3.11 of the LPF requires each party to have an effective mechanism of recovery in respect of subsidies, unless the subsidy is granted on the basis of an Act of the UK Parliament, of an act of the European Parliament and of the Council of the European Union, or of an act of the Council of the European Union.

Section 30 of the NS&I enables the Secretary of State, with the consent of the Treasury, to give "financial assistance" to, or in respect of, an entity in consequence of the making of a "final order". A final order is one made under section 26 (3) of the NS&I where the Secretary of State is satisfied on the balance of probabilities that a change of control has occurred, or will occur, giving rise to a risk to national security and reasonably considers that the provisions of the final order are necessary and proportionate for the purpose of preventing, remedying or mitigating

that risk. A final order may include provision requiring a person to do or not to do, particular things.

Such financial assistance extends to loans, guarantees or indemnities or any other kind of financial assistance, actual or contingent and would therefore satisfy the definition of both subsidy and state aid and, consequently will not be subject to recovery.

Simon Salter,
Solicitor,
Independent Legal Advisor

Flora Pitti-Ferrandi,
Competition Partner,
Vivien & Associés, Paris