Comments on the procurement section in the ongoing DG COMP open consultation on the Draft Union Framework for State aid for Research, Development and Innovation

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Please find below several comments which may prove relevant for the purpose of the currently ongoing DG COMP open consultation on the R&D&I State aid rules. These comments regard the institution of ‘innovation partnerships’ included in the recently adopted public procurement legal framework.

Following the review of the Draft Framework for State aid for research and development and innovation ("Draft Framework"), it seems that this new procedure has not been specifically addressed there under. However, certain issues may arise in connection with it, due to its current regulation and the implications thereof from a competition perspective.

1. General considerations

The recently adopted 2014 public procurement directives¹ ("New Procurement Directives") provide for and regulate a new procedure aimed at offering contracting authorities a tool to act as demanding customers and early adopters of desired innovation, namely the innovation partnership. This new procedure allows the set-up of a structured long term partnership by the contracting authority with one or several private undertakings, with the aim to concurrently perform research and development ("R&D") activities and subsequently purchase of commercial volumes of resulting products, services or works (large deployment).

The innovation partnership procedure seems to be an alternative to the pre-commercial procurement ("PCP") for public procurers, specifically focused on direct procurement and apparently not on catalytic procurement. The difference between the two procedures rests mainly in the fact that the contracting authority may purchase commercial volumes of the resulting products, services or works aiming at large scale deployment of solutions within the same procedure in case of innovative partnerships (which is not possible under PCP procedure). Additionally, whereas the PCP falls outside the scope of the Procurement Directives, the innovation partnership falls within their scope and the contract must be awarded in accordance with the rules for a competitive procedure with negotiation regulated by the New Procurement Directives².

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¹ The 2014 Directives of the European Parliament and of the Council on public procurement (Directive on Public Procurement) and on procurement by entities operating in the water, energy, transport and postal services sectors (Utilities Directive).
Pursuant to the provisions under the New Procurement Directives, the innovation partnership procedure\textsuperscript{3} is characterized by the following:

- it is mandatory for Member States to implement and to make it available/promote it to all procurers in their countries;
- it is a long term partnership that covers the R&D phase as well as the subsequent purchase of commercial volumes of the resulting innovative products for large scale deployment (in the form of supplies, services or works);
- the R&D phase can be structured in successive stages, following the sequence of steps in the research and innovation process; however, it is not made clear what these steps are or whether they are the same as the stages entailed under the PCP procedure; also, no definition of R&D is provided but the preamble of the directive introduces the aim of the procedure as a long term partnership to provide market pull for the wide deployment of solutions (which would require companies to go beyond R&D as defined in the Draft Framework into quantity production);
- the contracting authority may decide to end the partnership or to reduce the number of partners at the end of each phase, provided this option is specifically mentioned under the tender notice;
- selection of operators is done according to the rules for a competitive procedure for negotiation:
  - the procedure is initiated with an open call which invites any economic operator within the EU to submit a request to participate;
  - in selecting the candidates, contracting authorities shall pay particular attention to criteria concerning the tenderers’ capacity and experience in the field of R&D and of developing innovative solutions;
  - only those economic operators invited by the contracting authority following its assessment of the requested information may submit research and innovation projects aimed at meeting the needs identified by the contracting authority that cannot be met by existing solutions;
  - however, there is no requirement regarding a minimum number of economic operators required to submit offers, in order to ensure competition, which means that the procedure may be conducted and the contract may be awarded to a single operator;
- the public authority may directly purchase the supplies, services or works resulting from the R&D phase under the innovation partnership procedure, provided these can be delivered at the initially agreed performance levels and maximum costs;
- the duration of the contract is not limited in time (the New Procurement Directives specifically mention 'long term' partnerships);
- the value of the awarded contract for the subsequent purchase of resulting end-products should not be disproportionate in relation to the investment in the development phase, but there is no information as to what is considered to be disproportionate from a competition perspective.

\textsuperscript{3} Article 29 of the Directive on Public Procurement and art. 40 of the Utilities Directive.
2. **Potential competition related issues that may arise based on the current regulation of the innovation partnerships**

As mentioned above, the current regulation of the novel innovation partnership procedure may raise certain issues from a competition related perspective. Specifically, the implementation of innovation partnerships as currently regulated could trigger the closing off the market, crowding out of other R&D&I investments and foreclosing of competition, for the reasons further identified below:

- whereas in the initial proposals of the New Procurement Directives the implementation of the innovation partnership by Member States was deemed optional, the recently adopted legal texts provide for the mandatory implementation thereof and the requirement to make it available/promote to all procurers in their countries;
- private operators are selected based on selection criteria encompassing capacity and experience in the field of R&D and of developing innovative solutions and not based on criteria regarding which operator could provide the best offer/products – no operator could submit evidence regarding its ability to develop the best innovative solution/product before the start of the procedure and/or before the conduct of the R&D phase; consequently, the vendor selection is done before the commencing of R&D related activities (in other words, at a moment when no vendor has any test proof to claim that the solution he will develop will be better than the ones developed by other operators in the market);
- large deployment contracts could be awarded to a single supplier, which translates into the possibility for the contracting authority to circumvent the obligation to allow more suppliers to prove their contribution in the R&D phase of the innovation partnership and may ultimately lead to the potential closing off national procurement markets from vendors from other Member States;
- the amount of innovation results/products that public authorities are allowed to purchase from the operator(s) with whom they established the long term innovation partnership is no longer limited only to the value of the cost of the R&D and a reasonable profit margin; the purchase of large amounts of resulting end-products may be included in the procedure; however, it is not clear how the purchase shall be done when there are more entities which complete the R&D phase and develop operationally viable products; it is thus not clear whether the contracting authority will freely choose one of these companies or should organize a competitive selection to choose from among available solutions;
- the only limitation in the legislation regarding the subsequent purchase of the R&D results regards the value of the contract which should not be disproportionate in relation to the investment in the development phase\(^4\); however, it is not clear whether this provision refers to the investments made by the contracting authority within the framework of the innovation partnership or to the investments made previously by the private partner or both; in case the second or third view is envisaged, the provision allows\(^4\)

\(^4\) Art. 29(4) of the Directive on public procurement.
significant discretion to contracting authorities to award large value contracts for long
durations for the purchase of the R&D results; such an approach will give raise to many
disputes;
- the current regulation of innovation partnerships allows public authorities to ‘lock’
themselves into their preferred vendor for a large amount of products and for a long
period of time;
- the preambles of the New Procurement Directives provide that the partnership should be
structured in such a way that it can provide the necessary ‘market-pull’ instead of
foreclosing the market or preventing, restricting or distorting competition; however, the
current legal framework does not limit the commercial purchase of the innovative
products to ‘first products or services’; consequently, a contracting authority may
purchase R&D results even after their placing on the market; in such a case, the
contracting authority will not be encouraged to act as first customer and ‘pull’ onto the
market innovative products/services but, instead, it will be allowed to create long-term
obstacles to competition that also could lead to favor national based technology vendors/
industry;
- public spending should target growth-promoting policies and should make use of joined
efforts towards common European objectives\(^5\); however, public spending in the form
allowed by the innovation partnership procedure seems to have the potential to lead to a
misuse of public resources, while also endanger competition within the Single Market.
- a serious risk arises as well in terms of crowding out of the mainstream types of R&D
investments in Europe (R&D grants and private R&D investments that count for 200Bn
euro/year) as the innovation partnerships use the purchasing of R&D (that only counts
for 2.5Bn euro/year) to block off the road to the 2000Bn euro/year public procurement
market for those mainstream R&D investments. Indeed, long term innovation
partnerships only allow the company(ies) that has(ve) financed its(their) R&D through
that specific procurement contract to sell final end-products to the procurer for the large
scale deployment. Companies that are simultaneously with the R&D phase of the
innovation partnership developing their solutions through other types of R&D resources
(own company financing, R&D grants etc) will be excluded from selling to the procurer
conducting the innovation partnership. PCP followed by a new open procurement for
large scale deployment of innovative solutions allow companies that develop products
through other means then public procurement channels (e.g. internal company R&D
resources, R&D grants) to still compete for deployment contracts, avoiding issues of
foreclosing of competition and crowding out of the major sources of R&D investment
today in Europe which are not public procurement based (private investments in R&D
and public funding/grants for R&D).

In light of the above, whereas innovation partnership procedure may appear appealing to the
public authorities which will thus be able to directly purchase the innovative results of the R&D
effort without the need to organize a new competitive procedure to this end, the implementation

of the innovation partnership procedure as currently regulated may pose a significant threat on a good functioning of the internal market and the compliance with fair competition principles among vendors active in the market.

The main threats potentially jeopardizing its effectiveness and allowing room for distortion of competition within the internal market include the likely lack of competitive pressure during the R&D stages by creating a 'closed user group', the related possibility for the contracting authority to enter into a long term partnership with only one supplier from which the former would be bound to buy large volumes of products and the possibility to purchase the developed products long after they have been developed and even commercialized.

Making the innovation partnership procedure a mandatory default procedure for acquiring the development and deployment of innovative solutions across all Member States represents thus significant dangers and drawbacks, especially since there is evidence that reopening of competition for deployment contracts after the R&D phase is better from competition and public sector budget optimization point of view. Evidence from US defence procurements shows that compared to long term vendor partnerships that provide up front commitment for procuring R&D and large scale deployment, significantly higher quality products and on average 20% cost savings on the first deployments are obtained when reopening competition after PCPs by tendering out the large deployment contracts separately (remaining competition for the deployment contracting phase is what keeps companies focussing on producing best value for money products and avoids supplier lock-in)\(^6\).

3. Suggested recommendations

Based on the above considerations and the provisions under the Draft Framework regarding the compatibility of state aid measures with the functioning of the internal market, the following recommendations could be taken into consideration:

- innovation partnership procedure should also be given due consideration under the Draft Framework, together with the PCP and exclusive R&D procurement procedures;
- the cases in which the innovation partnership procedure could be employed (from a competition compliance perspective), without creating an unacceptable risk of foreclosing competition or crowding out of other types of R&D&I investments, should be specifically identified in order to ensure compliance with competition and state aid rules;
- in cases where the innovation partnerships could be used, a strong proof of the rationale for employing this procedure should be provided for, so that it is indeed only used when R&D is really still needed and no solutions already exist on the market to meet the procurer's needs. It is recommended that contracting authorities publish in a transparent way that they have conducted a thorough ex ante European and if needed an international market search, including a patent search, as a conditio sine qua non, for employing the innovation partnership procedure. The results thereof could be published

in the formal announcement form to be used by the contracting authorities for announcing the start of the innovation partnership procedure;

- in cases where the innovation partnerships could be employed, specific rules should be provided as regards the sequence of stages there under, as well as the potential need for the contracting authorities to open the testing stage within the R&D phase to competition, therefore allowing other operators in the market that finance their R&D through other means the chance to prove that they could provide equally good or better products than the ones offered by the vendors in the partnership; this could be a way to ensure fair competition among vendors in the market and prevent the foreclosure of competition; should the result of such an open testing competition show that other vendors in the market could provide equally good or better products than the operators in the partnership, the public authority would need to end the partnership (as the current legislation allows for it) and further open the competition by starting a new procurement for the deployment phase of the project;

- in order to measure the effects of the use of innovations partnerships on the internal market, contracting authorities should be obliged to provide an annual report to the Commission, regarding the specifics of the used innovation partnerships.