Comments of Fraunhofer concerning the current draft Framework for state aid for research and development and innovation, December 2013

1. Preliminary remark

From the preliminary remark it becomes clear that the published document has still not achieved the state of a joint draft of the Commission. Obviously, different positions of the various directorates still exist in important questions. This makes a participation in the consultation procedure especially important.

2. Article 1.3, definition of "research and knowledge dissemination organization"

The definition corresponds to the provision in the current draft of the General Block Exemption Regulation of December 2013. The requirements of the last Community Framework, i.e. a separate accounting system and the proof of no cross-subsidization continue to apply. This is expressly welcome by Fraunhofer.

3. Article 2.1.1, public financing of non-commercial activities, separate accounting, point 18

The maintaining of the principles of separate accounting and the proof of no cross-subsidization within the annual financial statements allows a continuation of the well-established and proven processes of the last years.

4. Article 2.1.1, public financing of non-commercial activities, non-commercial activities, point 19,

The classification as economic or non-economic activity is still crucial. During the implementation of the current Community framework the classification of such R&D services that were provided towards public clients or other research organizations was ambiguous. With the aim of increased legal certainty and consistent application the future framework should provide an explicit rule that R&D services on behalf of public clients or other research organizations are definitely considered as non-economic activities. The listing of Clause 19 should therefore be supplemented with a new letter 19 c) as follows:

"R&D that is performed on behalf of public clients or other research organizations, provided that there is no indirect assignment of an undertaking."

This requires the correction of footnote 26 (deletion of the first part), since the provision of R&D services cannot generally be considered as dependent R&D and thus classified as economic:

"R&D that is performed on behalf of undertakings is not considered as independent R&D."

This adjustment is also in accordance with the provisions of Article 2.2.1.
5. **Article 2.1.1, public financing of non-commercial activities, point 19, a) third indent, "non-commercial activities"**

The Commission cites here examples that are considered to be non-economic. In the third indent, the *non-exclusive* dissemination of research results is mentioned. Conversely, any form of exclusive dissemination would be classified as economic activity, whereby the word "dissemination" seems to be not clear.

The way of dissemination (exclusive or non-exclusive) does not set a suitable criterion for the classification as economic or non-economic activity. This is especially the case if the term "dissemination" shall comprise any form of licensing, too. A sufficiently reliable distinction between exclusive licenses, which are usually limited in terms of time, place or content on the one hand and non-exclusive licenses on the other hand is hardly possible. Therefore point 19 a) third indent should be formulated as follows:

"19 a) wide dissemination of research results on a non-discriminatory basis."

6. **Article 2.1.1, public financing of non-economic activities, point 20**

Clause 20 now provides for a limit of 15%, below which a research and knowledge dissemination organization should not be covered by state aid rules at all, even if this organization is carrying out both economic and non-economic activities. This represents a fundamental change in the state aid rules and leads to an extremely different treatment of beneficiaries, depending on whether their share of economic activities exceeds this value or not. The wording can be understood even in such a way that a cross-subsidization up to the extent of 15% would be legal and tolerated in the future.

With the erosion of the principles of state aid law and the infringement of equal treatment (level playing field) the consequences of such an approach would be substantial. Consequently, a justification only with aspects of simplification or reduction of state aid cases seem to be insufficient.

Taking into account the principles of a level playing field all research organizations must comply imperatively with the standards of Article 2.1.1, irrespective of their share of economic activities. The requirements of separate cost accounting and the proof of evidence that there is no cross-subsidization (point 18) regarding the totality of its activities must be fulfilled by each research organization having a mix of economic and non-economic activities.

A deviating approach may be possible only on the level of a single project and its respective grant decision. In order to simplify the granting process and the setting of an certain aid intensity a minimum threshold may be useful, however, if and to the extent only, that the requirements of 2.1.1 and section 18 are completely complied with. In any case, a systematic cross-financing and thus violation of state aid law and equal treatment must be excluded.

A similar condition is foreseen in the new draft of the General Block Exemption Regulation in Article 25 and Recital 49 addressing the public funding of infrastructures. However, the draft of the General Block Exemption Regulation is based on "capacity shares", while the Union's framework is based on a "financial share". As far as aid to infrastructures is concerned, the criterion "capacity share" should be decisive.
Fraunhofer refers in this regard to its separate statement regarding the General Block Exemption Regulation.

7. **Article 2.1.1, public financing of non-commercial activities, point 21**

With respect to the title and scheme of Art 2.2.1 a concretion of the term "contract research" is required. In analogy to the other groups of cases point 21 should be modified as follows:

" .... as providing access to infrastructures by renting them out to undertakings, supplying services to undertakings or performing contract research for undertakings, public funding of those economic activities will generally be considered state aid."

8. **Article 2.2.1, contract research for undertakings, point 25, first para**

Under the scheme of point 25 industry claims the transfer of all intellectual property rights that have been achieved by the research organization in performing the contract research. Besides the fact that state aid rules must not intervene in the contractual autonomy of the involved parties, such an interpretation is also contrary to the "Recommendations of the Commission of 2008 for the management of IP" (Code of Practice) and the creation of innovation-friendly conditions on the part of research organizations. A regular transfer of IP generated by the research organization to the undertaking would easily lead to a situation where the research organization loses its independence and competitiveness. Besides, no incentives to deliver innovative solutions for the research organization. With the aim of long-term independent research organizations clause 25 should be formulated as follows:

" where a research organisation or research infrastructure performs contract research or provides a research service to an undertaking, which typically specifies the terms and conditions of the contract, owns the tangible results of the research activities and/or receives access rights to the results of the research activities and carries the risk of failure, no state aid will usually be passed to the undertaking....."

9. **Article 2.2.1, contract research for undertakings, point 25, second para, letter (a) und (b)**

The wording "payment of an adequate remuneration", and the illustrating case groups in letters a) and b) of this regulation are welcome. They represent an improvement in comparison to the former wording "full cost plus profit margin". Consequently, specific circumstances of the market situation can be taken better into account.

10. **Article 2.2.1, contract research for undertakings, point 26**

Referring to item 8 of this statement and in the light of the basic principles of most European legal systems - all intellectual property rights are legally assigned to the "author/originator" or his employer (not to any client) - the condition of para. 26 is legally incorrect. Furthermore, an implementation of this provision would make future
practise and the negotiation of R&D contracts difficult. Companies will invoke this scheme and request a reduction of the contract remuneration in any case where user rights, even negligible in scope, are retained by the research organization. This would also restrict the contractual autonomy, hinder research organizations to comply with their own strategy in generating and exploiting IP and contradict the objectives of the inadmissibility of indirect aid.

Clause 26 should therefore be formulated as follows:

"Where the research organisation or research infrastructure retains the ownership of, or access rights to intellectual property rights ('IPR'), this market value may be considered in the context of avoiding cross-subsidization pursuant to Article 2.1.1 para. 18 and 20."

Reference is also made to item 11.

**11. Article 2.2.2, cooperation with undertakings, point 27 und 28**

Clause 27 describes the basic principles of a cooperation. In the Commission’s view, these include particularly the independence of the partners, the provision of individual R&D-contributions and the allocation of financial and other risks. The further detailed provisions in para. 28 and 29 however contradict these basic principles and should be harmonized with point 27. This applies to the following issues:

- The case group letter d), point 28 stipulates the "transfer" of intellectual property rights. This legal term means a complete assignment of the right/ownership that is quite unusual in case of cooperation. Therefore, the provision in letter d) must not be limited to the transfer of IP, but must also apply when (only) access rights to IP will be granted, which is a typical consequence within cooperative projects. Therefore point 28 d), sentence 1 should be modified as follows:

  "the research organisations or research infrastructures receive a compensation equivalent to the market price for the IPR which result from their activities and to which access rights are granted to the participating undertakings."

- The case group letter d), point 28 states now the right to reduce the market prize compensation of the research organization due to a "non-financial contribution" of the involved undertaking. This leads to a restriction of the contractual autonomy of the partners, an undue preference of undertakings and a significant deviation from the basic principles of para. 28.

  "Non-financial contributions" cannot be measured in accordance with objective criteria. The inequitable consideration of such "soft" factors (only on the side of the undertakings) would lead to unjustified price discounts and abet inappropriate indirect aid to the benefit of commercial undertakings. Legally permissible deductions from the market prize compensation can only be foreseen when the undertaking makes a financial contribution in form of a direct payment or direct refund to the R&D costs of the research organization.

Clause 28 d) should be modified as follows:

"… the value of a financial contribution of the participating undertakings to the costs of the research organisations or research infrastructures' activities that resulted in the IPR concerned may be deducted from that compensation."
12. Article 2.2.2, cooperation with undertakings, point 29

In view of competition law, undertakings must pay a market prize compensation in case of using IP which has been generated by research organizations during the R&D-cooperation. If they do not or only partially do so, non-permitted indirect state aid is given.

The provision in para. 29 and especially the listing of examples under point a) to d) underachieve the legislative objectives of preventing illegal state aid. The listed examples are not or hardly realisable in practice. The fact that all obligations and the burden of proof are imposed on the research organizations is favouring undertakings.

IP and related access rights are fundamental elements of a cooperation and need to be fixed before its start. At this time, the IP in question does not yet exist. Therefore, three variants of para. 29 do not have any practical benefit at all. Further disadvantages exist as follows:

- The alternative via an open tendering procedure (letter a) or via the arm’s length method (letter c) would require the disclosure of the IP and the existing know-how. Such disclosure leads to a serious financial loss for the owning research organization and normally contradicts the needs of undertakings being interested in access rights. Both alternatives also hinder the research organization in implementing its own IP and exploitation policy.

- The alternative via an expert’s report in accordance with letter b) is a practical way, however only in such specific cases where already existing IP is concerned. In all other cases this alternative is estimated as too expensive in terms of time and cost.

Only the alternative right of first refusal (letter d) constitutes a practical way in case of a cooperation.

As a result, the groups of cases a) to c) are irrelevant for practice and should be deleted.

13. Article 5.5, proportionality of the aid, eligibility, point 75 and Annex I

Eligible costs are defined in point 75 of Annex 1. In letter b) inter alia costs for instruments and equipment are mentioned, however with the limitation that only the depreciation costs are eligible. This limits the possibilities of grantors to fund the full amount of the costs of acquisition or production.

The clarification of letter e), according to which overhead costs are eligible is welcome. However, the wording is inappropriate since the basic understanding of overhead costs is not in line with the requirement “directly caused by a project”. In accordance with usual principles, Annex I, point e) should be better stipulated as follows:

"Other overheads that are necessary for the implementation of the project."
Summary:

The regulation on the definition of research and knowledge dissemination organizations is welcome. The same applies to the new provisions in point 25 b and in particular for the introduction of the new arm’s length negotiations principle in Article 2.2.1, point 25, letter b, second indent.

The IPR-provisions of Article 2.2.1 and 2.2.2 are regarded very critical. They lead to further privileges for undertakings.

The combination of easing the pricing for the project implementation on the one side (or the possibility to deduct non-financial contributions) and the business-friendly IP rules regarding the results of research organizations on the other side are considered to be very critical. This applies to both the scope of user rights and the appropriateness of the compensation for such use. To maintain validity of the essential principles of competition law in future, the IP rules require significant modifications in line with the proposals made in sections 7 to 12.