Comments of Philips on draft state aid rules for R&D&I

In the context of the public consultation\(^1\) launched on December 20, 2013, Philips\(^2\) would like to put forward the following comments on the European Commission’s draft framework for state aid for research and development and innovation (state aid rules for R&D&I), scheduled to enter into force on July 1, 2014:

A. Summary of main comments

- We very much welcome the confirmation in point 9 that Union funding centrally managed by the Commission, either directly or indirectly, does not constitute state aid.

- The Commission’s proposal for the new framework contains some highly appreciated clarifications on contract research by and collaboration with research organisations and research infrastructures, pre-commercial procurement and the "arm’s length" notion. These improvements reflect the principles set out in the forthcoming Commission notice on the notion of state aid and in particular the general principle that we have proposed for identifying state aid in the new framework: in accordance with the Market Economy Investor Principle as the cornerstone of state aid control and in line with the 2008 State Aid Vademecum: “aid should constitute an economic advantage that the undertaking would not have received in the normal course of business”. This implies that a transaction of an undertaking with an organisation benefiting from public funding for its activities only can involve indirect state aid if the terms of the transaction with the publicly funded organisation are more favourable than the undertaking would have obtained in comparable transactions with other undertakings on a commercial basis. Nevertheless, some clarifications are still needed; see the detailed comments below.

- The number of criteria for assessing the compatibility of notified aid measures with the Treaty seems overwhelming, as well as their elaboration. Proving compliance with nearly 16 pages of - sometimes rather theoretical - conditions will be a daunting task.

- The new attention to fiscal schemes is surprising, as general fiscal measures have so far been considered non-selective and hence not constituting state aid.

- The global competitiveness of Europe’s industry is hardly getting any attention in the new framework; the state aid rules only arrange for a level playing field within the European Economic Area (EEA). Therefore the Commission should seek to establish a global level playing field through the WTO.


\(^2\) Registration ID number in Transparency register: 02341041540-74.
B. Detailed comments

1. Scope and definitions

- In the first sentence of footnote 3 the shares of the public and private sectors in total R&D expenditure have been mixed up\(^3,4\). Therefore the words “(of which roughly 2/3 are public and 1/3 private)” should be changed into “(of which roughly 1/3 are public and 2/3 private)”.

- We very much welcome the confirmation in point 9 that Union funding centrally managed by the Commission, either directly or indirectly, does not constitute state aid. Such clarity was badly missing in the public consultation\(^5\) on the first draft General Block Exemption Regulation, which in several instances even seemed to suggest otherwise\(^6\). Actually, to be fully consistent with the wording in the second draft GBER\(^7\), point 9 should be slightly rephrased to specify that “Union funding centrally managed by the institutions, agencies, joint undertakings or other bodies of the Union that is not directly or indirectly under the control of the Member State does not constitute state aid”.

- The distinction between fundamental research, industrial research and experimental development referred to in points 12a and 75, footnote 11 and Annex II reflects the obsolete linear innovation model. Although conceptually wrong, this is not leading to major problems in practice. Fortunately, footnote 43 clarifies that these R&D stages do not necessarily have to be followed in chronological order.

- The inclusion of the notion of “arm’s length” as definition (f) in point 15 is very much welcomed; see our comments on point 16. An explicit reference to the “pari passu” transactions described in point 88 of the forthcoming Commission notice\(^8\) on the notion of state aid would be helpful.

- Unlike the first sentence of point 27, definition (i) for “effective collaboration” does not include the requirement of at least two partners having to “contribute to its

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\(^7\) Recital (27) and article 8.2 of second draft GBER on http://ec.europa.eu/competition/consultations/2013_consolidated_gber/index_en.html.

implementation”. To ensure consistency and avoid confusion with contract research, it would be better to stipulate in definition (i) that in effective collaboration each partner also contributes to the implementation.

- Whereas according to the last point of definition (j) routine or periodic changes do not qualify as experimental development, even if such changes may represent improvements, experimental development according to the first point of the same definition (j) aims at developing new or improved products, processes or services. How to distinguish in practice improvements that qualify as experimental development (first paragraph) from improvements that don’t qualify (last paragraph)?

- Definition (l) refers to the possibility of licensing to the collaboration partner. It should be clarified that exclusive or non-exclusive licenses may be granted for free to participating undertakings as part of an ex ante arm’s length arrangement within collaboration contracts.

- The condition in definition (ee) for “research and knowledge dissemination organisation” that “undertakings that can exert influence upon such an entity, in the quality of, for example, shareholders or members, may not enjoy a preferential access to its research capacities or to the results generated by it” seems at odds with article 25.4 of the recent draft for the new General Block Exemption Regulation, which under certain conditions grants preferential access with more favourable conditions to undertakings having substantially contributed to the investments.

- Regarding definition (gg) on “secondment” it is not clear how to deal with the situation that seconded staff remains on payroll of its original employer, which receives reimbursement for the wage costs from an SME as the beneficiary.

- Regarding definition (ii) on “start of works” it needs to be clarified on which aspects/terms and conditions “irrevocable agreement” should have been reached. We assume that the intention here is that unconditional agreement should have been reached to conduct the project. In many situations parties may conclude a variety of types of preliminary agreements on projects that are not unconditional commitments to conduct the project. These agreements may vary from a very superficial nature to put “some stakes in the ground” for further negotiations to very detailed and fully elaborated agreement with only one or two conditions to become effective (such as the subsidy that is applied for being granted). We doubt that it is the intention that these type of agreements like letters of intent, memoranda of understanding or other types of conditional agreements should be considered as start of works.

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2. State aid within the meaning of Article 107(1) of the Treaty

- The reference made in point 16 to the forthcoming Commission notice on the notion of aid is very much welcomed, as this notice very well describes the general principle that we have proposed\textsuperscript{10,11,12} for identifying state aid in the new framework: in accordance with the Market Economy Investor Principle as the cornerstone of state aid control and in line with the 2008 State Aid Vademecum: “aid should constitute an economic advantage that the undertaking would not have received in the normal course of business”. This implies that a transaction of an undertaking with an organisation benefiting from public funding for its activities only can involve indirect state aid if the terms of the transaction with the publicly funded organisation are more favourable than the undertaking would have obtained in comparable transactions with other undertakings on a commercial basis. In our opinion it would be very worthwhile to extend point 16 with a brief summary of the most relevant general principles set out in the Commission notice on the notion of state aid, and include some explicit references to the notice, \textit{e.g.} in the new definition (f) on “arm’s length” in point 15 and the assessment of pre-commercial procurement in point 33.

- Point 19(b) basically exempts knowledge transfer activities if all income from these activities is reinvested in the primary activities of the research organisation or research infrastructure. However, in our opinion, knowledge transfer implies offering goods or services on a market and thus may be in competition with similar activities of undertakings. Therefore it is an economic activity and should be treated as such.

- According to point 20, the economic activities of a research organisation or research infrastructure may fall outside state aid rules if they are purely ancillary, \textit{i.e.} directly related to and necessary for its operation or intrinsically linked to its main non-economic use, and limited in scope. However, considering economic activities below 15% of the entity’s overall annual budget by definition as limited in scope may not necessarily prevent undue distortion of competition in practice. With the annual budget of a very large university in the order of 1 billion euro and of a very large research infrastructure in the order of 100 million euro, such entity devoting 15% of its annual budget to economic activities could well be a major player in the market and could unfairly compete with similar services offered by private organisations or infrastructures operating at commercial rates and endanger their viability. Therefore, instead of setting budgetary limitations, the ancillary economic activities of research organisations or research infrastructures should only fall outside state aid rules if no competing private sector activity is existing or commercially viable.


\textsuperscript{11} State aid framework for research, development and innovation, position paper, BUSINESSEUROPE, 2012, \url{http://ec.europa.eu/competition/consultations/2012_stateaid_rdi/business_europe_en.pdf}.

\textsuperscript{12} Philips reply to Research, Development and Innovation State aid Framework Consultation paper, \url{http://ec.europa.eu/competition/consultations/2012_stateaid_rdi/philips_netherlands_en.pdf}. 
• We very much welcome the new option provided in the last bullet point of point 25 for establishing an adequate remuneration for contract research or research services on the basis of arm’s length negotiations. It is well in line with our earlier recommendation\(^\text{13}\); see also our above comments on point 16.

• Point 26 allows the market value of intellectual property rights (IPR) transferred to the research organisation or research infrastructure to be deducted from the price payable for its services. However, objectively establishing the market value for IPR is inherently difficult. Therefore, it should be possible to account \textit{ex ante} for the market value of IPR by implicitly including the corresponding deduction as an additional consideration in the arm’s length negotiation on the price payable for the services. This would also be consistent with the approach for determining the market value for IPR in the last bullet of point 33.

• Also in the collaboration projects described in points 27-30 it should be possible to determine the compensation payable for the resulting IPR prior to the start of the project, as an additional consideration in the process of negotiating the terms and conditions of the collaboration project. This is also suggested by the wording “at the moment when the contract is concluded” in point 29(c). The compensation payable would have to depend on the contribution of the participating undertakings to the costs of the research organisation or research infrastructure, just like buying an option on the stock market, with the option price depending among other things on the exercise price. Therefore, footnote 30 should be adapted to reflect that definite agreements on the compensation payable for the resulting IPR and the value of contributions to the projects can also be negotiated \textit{ex ante}.

• The sharing of risks and results described in the first sentence of point 27 is actually only well reflected in point 28(c), whereas in points 28(a), 28(b) and 28(d) the risks and/or results are not really shared.

• Whereas point 28 is about indirect state aid in collaboration projects, participating undertakings might in principle also receive direct state aid, to which normal state aid rules apply as described in point 77. To leave that possibility open, it would be better to reformulate point 28(a) as follows: “the participating undertakings bear the full cost of the research organisation or research infrastructure in the project, or”. Still, the difference of a collaboration project in point 28(a) with the contract research described in the first bullet of point 25(b) is not clear.

• According to point 28(d) only the contributions of participating undertakings to the costs of the research organisations or research infrastructures that resulted in the IPR concerned may be deducted from the compensation. We doubt whether it is always possible in practice to determine which activities and what costs related thereto have actually contributed to the IPR resulting from a project. Furthermore,

third parties could acquire the IPR basically at the same price as participating undertakings (after accounting for contributions made and related deductions), but without running the risk of investing in project activities that do not generate any IPR. Therefore, in line with the section 3.2.2(3) of the current framework, we propose that the contributions of participating undertakings to the entire project costs of the research organisations or research infrastructures should be deductible.

- In point 28(d) and in point 29 it should be clarified whether the transfer of IPR pertains only to ownership or also to access rights.

- We very much welcome the new option provided in point 29(c) for avoiding indirect state aid in collaborations with undertakings. It is well in line with our earlier recommendation\textsuperscript{14,15}, see also our above comments on point 16.

- According to point 30 the full value of the contribution of the research organisation or research infrastructure will be considered state aid if none of the “above conditions” (in points 28 and 29?) is fulfilled. But what if part of that contribution has been compensated, e.g. by paying part of the market price? We believe that only the remaining part of the contribution should be treated as state aid to the collaborating undertakings, to which the normal state aid rules apply as described in point 77.

- In procurement of research services (point 32), the Commission will “generally” consider that no state aid is involved if the procurement is carried out in accordance with the applicable directives on public procurement. Why is this only “generally” the case? Furthermore we wonder why this point refers to procurement of research services only, whereas definition (aa) of point 15 of this framework, Horizon 2020, the EU Public Procurement Directives, and the WTO Government Procurement Agreement all refer to procurement of research and development services. Moreover, with R&D&I being the scope of this framework, will also public procurement of innovation (e.g. as defined in the Rules for Participation of Horizon 2020) and the new innovation partnerships defined in the revised directives\textsuperscript{16} on public procurement scheduled to enter into force in March 2014 be considered to entail no state aid if the procurement is carried out in accordance with the applicable procurement directives?

- We very much welcome the new provisions on pre-commercial procurement in point 33. These are well in line with our earlier recommendation\textsuperscript{17}; see also our comments

\textsuperscript{17} Philips reply to Question 29 in the Consultation Paper on Research, Development and Innovation State aid Framework,
on point 16. However, in line with points 91-99 of the forthcoming Commission notice on the notion of state aid, we believe that basically the conditions of point (d) are unnecessary since conditions (a) – (c) should already sufficiently ensure that the price sufficiently reflects benefits and risks at market value and market conditions since generally undertakings will take the terms and conditions for IPR into account in the pricing of the R&D services they offer. Moreover, in the last bullet of point (d) the public purchaser should only get unlimited access to the results free of charge for use in the conduct of its own affairs. The proposed broad license rights will potentially limit the attractiveness for undertakings to participate in tenders; as a consequence there will be much less competition between undertakings. This should be clarified in point 33, in line with the wording in definitions (g) and (aa) in point 15.

3. Common assessment principles

- The number of criteria listed in point 36 for assessing the compatibility of notified aid measures with the Treaty seems overwhelming, as well as their elaboration in sections 4-5. Proving compliance with nearly 16 pages of sometimes rather theoretical - conditions will be a daunting task.

5. Compatibility of aid under Article 107(3)(c) of the Treaty

- Regarding the presence of market failures in points 49 and 50 we would like to remind that Europe is still not meeting its 3% R&D objective. As in particular private R&D investments in Europe are lagging with respect to other parts of the world, the general framework conditions for R&D and innovation are apparently less favourable in Europe than elsewhere, as otherwise business would invest more in R&D here. To increase private investment in R&D, a wide range of policy measures is needed; see the Innovation Union Flagship, the very existence of which is evidence for the existence of market failures. One of the measures required is state aid, which lowers the net costs of R&D and makes it more affordable.

- The presumption regarding the necessity of state aid in case of projects or activities that are also financed by the Union should apply not only for individual aid, but also in general; therefore, point 54 should be moved from section 5.2.2 to section 5.2.1.

- In practice it is very difficult to quantitatively prove the incentive effect (point 62), see earlier position papers of BUSINESSEUROPE (formerly known as UNICE)

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and DIGITALEUROPE (formerly known as EICTA). Furthermore, in addition to increases in size, scope, amount spent or speed, also collaboration should be taken into account as an indication of "behavioural additionality".

- According to point 63 a project will not be eligible for aid if the works begin before submitting the application. Beware, however, that the notion of a project as a self-contained activity is a fallacy.

- We are quite surprised by the new attention to fiscal schemes in point 65 and footnote 39. However, according to the 2008 State Aid Vademecum, general measures “which apply without distinction across the board to all firms in all economic sectors in a Member State (e.g. most nation-wide fiscal measures)” are not selective and therefore do not constitute state aid. This principle can also be found on the Commission’s state aid website and is being applied in a current case.

- In the absence of evaluation studies, footnote 40 is presuming the incentive effect only for incremental fiscal schemes. Unless it would be acceptable to provide *ex post* evaluation studies after a few years of operation, this requirement would *de facto* make it impossible to establish any new volume-based fiscal schemes. However, volume-based and incremental schemes each have their advantages and disadvantages, with most countries currently moving towards volume-based schemes.

- In point 81 it is not clear whether a successful outcome (as a condition for repayable advances) should be defined in technical or commercial terms.

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Except for point 92, the global competitiveness of Europe’s industry is not getting any attention in the new framework; the state aid rules only arrange for a level playing field within the European Economic Area (EEA). In general, other countries than EU Member States and EFTA States don’t have any constraints on state aid that are comparable to the EU state aid rules. Therefore the Commission should seek to ensure a global level playing field through the WTO.

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