

Current state of State Aid regulations.

Impact on R&D procurement.

In 2012, the Commission started to update the whole framework of EU State aid provisions.¹ Nowadays, state aid in relation to R&D&I are located in two legal texts, mainly the *Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty*, also known as the *General Block Exemption Regulation (GBER)* and the *Communication from the Commission: Framework for State aid for research and development and innovation (2014/C 198/01)*.

At this point, the problem is that when there are no solutions on the market or close to the market, a public buyer may need to procure research and development services. The reimbursements of these services may or may not fall under the scope of the State aid rules, depending on the distribution of benefits and risks and whether this compensation is in line with the market price paid for equivalent services.

In this regard, the *Commission notice, Guidance on Innovation Procurement* published in 2018 provides with some insights. Nevertheless, the problem remains that when it comes to State Aid in procurement, the Public Procurement Directives do not clarify when procurement may involve State Aid, nor do they provide with a methodology to follow, in order to avoid *ex-post* problems.

From the analysis, it is clear that in the case of open and restricted procedures, where market price is easily determined, no issues arise. However, this is not the case when it comes to procedures which entail negotiations. The problem is more acute in the case of procedures intended to buy innovative solutions, as benchmarking becomes increasingly difficult. It seems that notification to the Commission is the best course of action to avoid potential conflicts, as proper guidelines are missing.

This paper gathers not only the main documents regarding State Aid related to R&D and the basic documents addressing state aid in procurement procedures (specifically R&D procurement), but also explains when state aid is excluded (particularly when a Service of General Economic Interest is being provided).

1. Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest

Services of General Economic Interest (SGEI hereinafter) are mentioned in article 14 of the TFUE, which highlights their importance due to *'their role in promoting social and territorial cohesion'*. It also stresses that the economic and financial conditions cannot pose a problem for these services to be provided.

¹ B. von Wendland. *New Rules for State Aid for Research, Development and Innovation: Not a Revolution but a Silent Reform*. *European State Aid Law Quarterly*, Volume 14 (2015), Issue 1.

The current Public Procurement Directives also refer to this concept, and to the freedom of the member states to define what those services are and on which funding conditions do they operate:

*'(7) It should finally be recalled that this Directive is **without prejudice to the freedom of national, regional and local authorities to define, in conformity with Union law, services of general economic interest, their scope and the characteristics of the service to be provided, including any conditions regarding the quality of the service, in order to pursue their public policy objectives.** This Directive should also be without prejudice to the power of national, regional and local authorities to provide, commission and finance services of general economic interest in accordance with Article 14 TFEU and Protocol No 26 on Services of General Interest annexed to the TFEU and to the Treaty on European Union (TEU). In addition, this Directive does not deal with the funding of services of general economic interest or with systems of aid granted by Member States, in particular in the social field, in accordance with Union rules on competition.'*

It follows that SGEI is an evolving concept which differs across Member States. It depends on the needs of citizens, the technological and market developments and the social and political preferences. Member States have a wide discretion in defining a given service as an SGEI.²

Nevertheless, minimum provisions apply. Article 106(2) of the TFEU states that undertakings charged with the provision of SGEI, are under the scope of the TFEU rules, in particular under the competition provisions, as long as that doesn't prevent their performance.³ But in any case, these services must be provided as they are basic services for the citizens.

Sometimes these services can be provided without financial support. But in some cases, they might not be financially viable. That is why States support them economically, irrelevant whether such services of general economic interest are operated by public or private undertakings. This might be problematic, as this support provided by the state might fall under the scope of State Aid.

That is why this non-binding Commission Decision of 20 December 2011 '*sets out the conditions under which State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest is compatible with the internal market and exempt from the requirement of notification laid down in Article 108(3) of the Treaty*'.⁴ To do so, it clarifies the view of the Commission on the Altmark case and its four conditions when it comes to the application of the state aid rules as regards to services of general economic interest.

² See point 45 of the *Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (2012/C 8/02)*.

³ Article 106 (ex Article 86 TEC) '*2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union.*'

⁴ See article 1. Scope.

According to this Judgment of the Court of 24 July 2003 (Altmark) the granting of an advantage when providing service of general economic interest is not state aid and article 106 (2) doesn't apply *if four cumulative conditions are met*.⁵

- 1) First, the recipient undertaking must have public service obligations to discharge, and the obligations must be clearly defined.⁶ The provided services cannot be any type of service, but services of general economic interest (SGEI).⁷

According to case law, Member States have a broad margin to define what SGEI are. However, this margin is not unlimited or arbitrary, as it cannot be exercised with the sole purpose of avoiding the application of competition rules in a particular sector. I.e. in order to qualify as SGEI, the service must have specific characteristics in comparison to other economic activities.⁸

*'In particular, Member States cannot attach specific public service obligations to services that are already provided or can be provided satisfactorily and under conditions, such as price, objective quality characteristics, continuity and access to the service, consistent with the public interest, as defined by the State, by undertakings operating under normal market conditions.'*⁹

Moreover, besides the requirement that the undertaking has been entrusted to provide the public service, CJEU case law demands that the service and its obligations are clearly defined in national law.¹⁰ It does not necessarily need to be a law, as the legal instrument may vary from one Member State to another, but it should describe the undertakings in charge and what exactly does the service include, for how long and where will it be provided and if special rights are granted. It should also explain the compensation mechanism and the parameters to determine this compensation.¹¹

⁵ Judgment of the Court of 24 July 2003. Altmark (C-280/00, ECLI:EU:C:2003:415). In this case a region in Germany gave a bus line who was not viable some compensation to keep the service running. The CJEU decided that compensation for a service of general economic interest is not state aid and is not under the scope of article 106(2) of the TFEU. However, this compensation for the extra costs must be fair. If it is overcompensation it will be state aid.

⁶ CJEU case law requires both that the undertaking has been entrusted to provide the public service and that the service and its obligations are clearly defined in national law. See also CJEU judgement of 20th September 2018. Kingdom of Spain and European Commission (C-114/17 P, ECLI:EU:C:2018:753) and GJEU judgement of 15th December 2016. Kingdom of Spain vs. European Commission (T-808/14, ECLI:EU:T:2016:734)

⁷ According to the CJEU judgement of 20th September 2018. Kingdom of Spain and European Commission (C-114/17 P, ECLI:EU:C:2018:753)

⁸ According to the GJEU judgement of 15th December 2016. Kingdom of Spain vs. European Commission (T-808/14, ECLI:EU:T:2016:734).

⁹ Point 13 of the *Communication from the Commission: European Union framework for State aid in the form of public service compensation (2011) (2012/C 8/03)*

¹⁰ Entrustment happens even if it is issued at the request of the undertaking. See point 53 of *Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (2012/C 8/02)*.

¹¹ See point 16 of the *Communication from the Commission: European Union framework for State aid in the form of public service compensation (2011) (2012/C 8/03)*: 'The act or acts must include, in particular: (a) the content and duration of the public service obligations; (b) the undertaking and, where applicable, the territory concerned; (c) the nature of any exclusive or special rights assigned to the undertaking by the granting authority; (d) the description of the compensation mechanism and the parameters for calculating, monitoring and reviewing the compensation; and (e) the arrangements for avoiding and recovering any overcompensation.'

I.e. declaring a service as SGEI by national law, doesn't necessarily imply that any undertaking providing it is entrusted with performing clearly defined public service obligations.

- 2) Second, the compensation will be calculated based on parameters established beforehand in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings. The amount of compensation can be properly calculated and checked only if the public service obligations incumbent on the undertakings and any obligations incumbent on the State are clearly set out in one or more acts of the competent public authorities in the Member State concerned.
- 3) Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the SGEI, taking into account the relevant receipts and a reasonable profit. If some activities carried out fall outside the scope of the SGEI, only the costs related to the SGEI can be taken into account.

Compliance with such a condition is essential to ensure that the recipient undertaking is not given any advantage which distorts or threatens to distort competition by strengthening its competitive position. Conversely, if the undertaking is granted overcompensation, this will qualify as state aid and not only as compensation:

*'Since overcompensation is not necessary for the operation of the SGEI, it constitutes incompatible State aid.'*¹²

- 4) Fourth, *'where the undertaking that is to discharge public service obligations is not chosen following a public procurement procedure'* to select a tenderer capable of providing these services at the least cost to the community, *'the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well-run and adequately provided with means to meet the public service requirements, would have incurred in discharging those obligations'*, taking into account the relevant receipts and a reasonable profit for discharging the obligations.¹³ If the undertaking providing this service is not chosen under market conditions (i.e. via a public procurement procedure¹⁴), the level of compensation must be determined on an analysis of the costs which a typical, well-run and adequately provided undertaking

¹² See point 48 of the *Communication from the Commission: European Union framework for State aid in the form of public service compensation (2011) (2012/C 8/03)*.

¹³ See point 70 of the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)*. See also point 19 of the *Communication from the Commission: European Union framework for State aid in the form of public service compensation (2011) (2012/C 8/03)*

¹⁴ If the undertaking is chosen following the procedures regulated under the Public Procurement Directives, it is clear that the open procedure guarantees sufficient participation and openness to competition. This is also the case of the restricted procedure. However, both the competitive dialogue and the negotiated procedure with prior publication confer the Contracting Authority a wider discretion and can only be deemed to meet all the Altmark conditions in exceptional circumstances. The negotiated procedure without prior publication does not guarantee that the provider selected provides the service with the least cost to the community. See point 66 of the *Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (2012/C 8/02)*.

would have (AKA the level of compensation will be the result of a benchmarking exercise).¹⁵

An economic or financial compensation of the SGEI which does not comply with one or more of these conditions and that meets the requirements of article 107(1) of the TFUE will be regarded as State aid.

*'Where public service compensation does not meet those conditions, and to the extent the general criteria for the applicability of Article 107(1) of the Treaty are satisfied, such compensation constitutes State aid and is subject to Articles 106, 107 and 108 of the Treaty.'*¹⁶

Moreover, it is the burden of the public authority applying the measure to prove these four conditions so that the compensation is not to be regarded as State Aid.

In this regard, the *Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (2012/C 8/02)* lists a series of services that might or might not be considered SGEI depending on how the State decides to organise them and provides with a series of examples.

When it comes to social security the classification as an economic activity will depend on the way the State structures the schemes. Mainly on the principle of solidarity or on economic schemes. Same happens with health care system and education: an activity funded and supervised by the State may be considered as a non- economic activity.¹⁷

Once it is proven that the conditions are complied with, this Decision will apply if the public service compensation falls within one of the categories defined in article 2 (Scope) of this Communication and if the period for which the undertaking is entrusted with the operation of the service does not exceed 10 years.¹⁸ If the conditions cease to be met during any time of the period of entrustment, the aid will have to be notified.

¹⁵ See points 24 to 31 of the *Communication from the Commission: European Union framework for State aid in the form of public service compensation (2011) (2012/C 8/03)* on the 'Net cost necessary to discharge the public service obligations'.

¹⁶ See point 3 of the *Communication from the Commission: European Union framework for State aid in the form of public service compensation (2011) (2012/C 8/03)*.

¹⁷ '(...) the non-economic nature of public education is in principle not affected by the fact that pupils or their parents sometimes have to pay tuition or enrolment fees which contribute to the operating expenses of the system. Such financial contributions often only cover a fraction of the true costs of the service and can thus not be considered as remuneration for the service provided. They therefore do not alter the non-economic nature of a general education service predominantly funded by the public purse.' See point 27 of the *Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (2012/C 8/02)*.

¹⁸ '(a) compensation not exceeding an annual amount of EUR 15 million for the provision of services of general economic interest in areas other than transport and transport infrastructure; where the amount of compensation varies over the duration of the entrustment, the annual amount shall be calculated as average of the annual amounts of compensation expected to be made over the entrustment period;

(b) compensation for the provision of services of general economic interest by hospitals providing medical care, including, where applicable, emergency services; the pursuit of ancillary activities directly related to the main activities, notably in the field of research, does not, however, prevent the application of this paragraph;

2. Communication from the Commission. Framework for State aid for research and development and innovation (2014/C 198/01)

This *Communication* describes the compatibility criteria for R&D&I aid schemes and individual aid which are subject to the notification requirement and must be assessed on the basis of Article 107(3)(c) of the Treaty.¹⁹

On the contrary, as we will see in section 4 the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union* explains how the Commission understands the notion of State aid in general.

Nevertheless, the subjective scope is the same, as according to the Communication and based on European case law, research organisations and infrastructures can be recipients of state aid if they qualify as ‘an undertaking’, being their main characteristic the pursue of an economic activity (offering products or services on a market), and not its legal status or its economic nature.²⁰

Section 2.3 of the Communication (*Public procurement of research and development services*) tries to shed some light on State Aid when it comes to R&D services procurement.

In this context, the Commission will generally consider that no State aid within the meaning of Article 107(1) of the TFEU is awarded, ‘as long as an open tender procedure for the public procurement is carried out in accordance with the applicable directives.’²¹

If an open procedure according to the relevant directives is not followed, the Commission will consider that no State aid is awarded where the price paid reflects the market value of the benefits and the risks.²² Four conditions must be complied with:

- 1) The *selection procedure is open, transparent and non-discriminatory*, and is based on objective selection and award criteria specified in advance of the bidding procedure.
- 2) The *envisaged contractual arrangements* describing all rights and obligations of the parties, including with regard to IPR, *are made available to all interested bidders* in advance of the bidding procedure.

(c) *compensation for the provision of services of general economic interest meeting social needs as regards health and long term care, childcare, access to and reintegration into the labour market, social housing and the care and social inclusion of vulnerable groups;*

(d) *compensation for the provision of services of general economic interest as regards air or maritime links to islands on which the average annual traffic during the 2 financial years preceding that in which the service of general economic interest was assigned does not exceed 300 000 passengers;*

(e) *compensation for the provision of services of general economic interest as regards airports and ports for which the average annual traffic during the 2 financial years preceding that in which the service of general economic interest was assigned does not exceed 200 000 passengers, in the case of airports, and 300 000 passengers, in the case of ports.’*

¹⁹ Article 107 TFEU: ‘3. *The following may be considered to be compatible with the internal market: (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest.*’

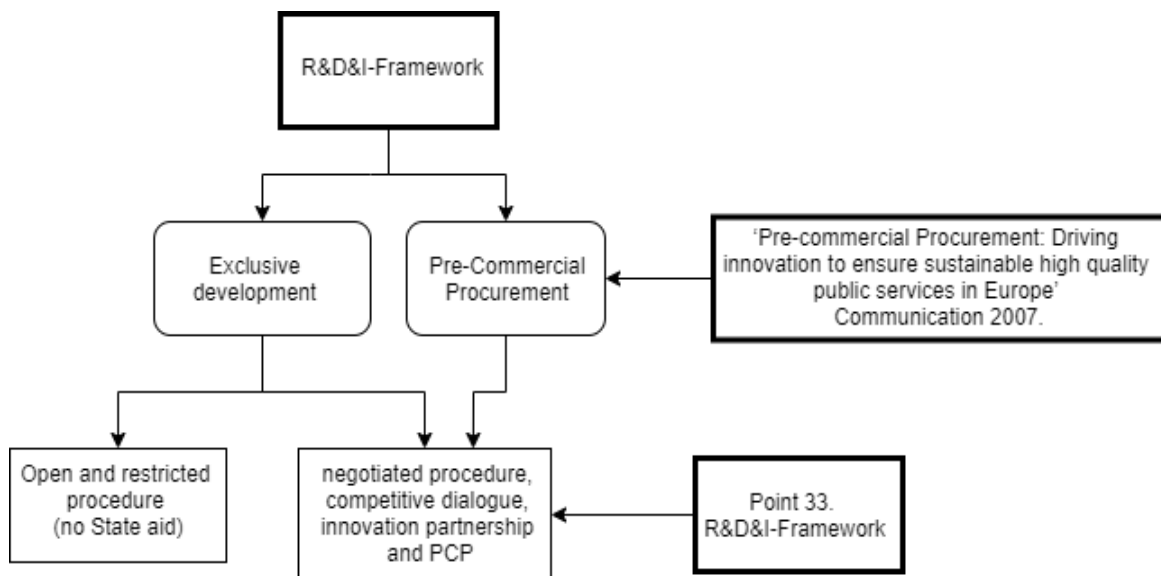
²⁰ See point 17 of the Communication.

²¹ A footnote makes it extensive to restricted procedures.

²² This includes Pre-Commercial Procurement. However, specific procurement procedures such as the negotiated procedure with (or without) prior call for competition, the competitive dialogue and the innovation partnership are not really mentioned.

- 3) The procurement does *not give any of the participant providers any preferential treatment* in the supply of commercial volumes of the final products or services to a public purchaser in the Member State concerned.²³
- 4) One of the following conditions is fulfilled:
 - 4.1. All results which do not give rise to IPR may be widely disseminated, for example through publication, teaching or contribution to standardisation bodies in a way that allows other undertakings to reproduce them, and any IPR are fully allocated to the public purchaser. I.e. the dissemination must be wide and on a non-exclusive and non-discriminatory basis.
 - 4.2. Any service provider to which results giving rise to IPR are allocated is required to grant the public purchaser unlimited access to those results free of charge, and to grant access to third parties, for example by way of non-exclusive licenses, under market conditions.

This image is an overview of the state aid regulations according to the different type of procedures.



It follows that implementing a competitive dialogue, a negotiated procedure (even more if there is not prior publication) or an innovation partnership might be challenging when trying to prove the lack of state aid.

Moreover, since the publication of the 2014 Procurement Directives, the matter has become more pressing, as these regulations have increased the scope of these procedures, as well as introducing the innovation partnership. However, they don't mention the issue of state aid.²⁴

The assessment whether state aid is involved in case of innovation partnership is even more complex, mainly because as the procurement procedure includes the commercial deployment of the solutions developed during the R&D phase, it does *'give (...) the participant providers (...) preferential treatment in the supply of commercial volumes of the final products or services to a public purchaser in the Member State concerned'*.²⁵

²³ Without prejudice to procedures that cover both the development and the subsequent purchase of unique or specialised products or services.

²⁴ See A. Sanchez-Graells, 'State aid and EU public procurement: more interactions, fuzzier boundaries'. L. Hancher & JJ Piernas López (eds), *Research Handbook on European State Aid Law* (2nd edn, Edward Elgar, 2020) forthcoming. Page 10.

²⁵ See point 33 c) of the *Communication from the Commission. Framework for State aid for research and development and innovation (2014/C 198/01)*.

This is indeed problematic, as the use of this procedure leads to a high risk of foreclosing the market and crowding out other R&D investments, which in turn leads to inefficient use of public resources. Moreover, it is impossible to demonstrate prior to the R&D phase that the selected vendor(s) will be the ones that develop, in the future, the best value-for-money solution.

As A. Sanchez Graells explains: *'To put it mildly, this would require contracting authorities to engage in impossible exercises of futurology, as well as restricting the potential application of innovation partnership to very narrow fields (perhaps only defence), as it is very unlikely that relevant innovations will not be applicable beyond the narrow needs of the contracting authority.'*

²⁶

The Commission understands that this line of reasoning has flaws and thus the Communication clarifies that: *'Where the conditions in point 33 are not fulfilled, Member States may rely on an individual assessment of the terms of the contract between the public purchaser and the undertaking, without prejudice to the general obligation to notify R&D&I aid pursuant to Article 108(3) of the Treaty.'*²⁷

In this regard, an aid measure can be considered compatible with the internal market if *'the positive impact of the aid towards an objective of common interest exceeds its potential negative effects on trade and competition'*.²⁸ This is clearly a very general statement, which is why a series of criteria help to assess whether an aid measure is compatible with the TFUE principles:

- A State aid measure must aim at an objective of common interest.
- There is a need for State intervention in order to remedy a market failure. In the assessment of a potential market failure, the Commission will specially take into account sectoral studies provided by the Member State concerned. However, the Member State is not mandated to submit those studies.²⁹
- The measure is appropriate and adequate to address the objective of common interest aforementioned.
- The measure has an incentive effect for the undertakings to which it is addressed³⁰.
- The measure is proportionate, meaning that is the minimum amount required in order to produce the desired effect
- The negative effects of the measure must be limited, so that its overall balance is positive.

²⁶ See A. Sanchez-Graells, 'State aid and EU public procurement: more interactions, fuzzier boundaries.' L. Hancher & JJ Piernas López (eds), *Research Handbook on European State Aid Law* (2nd edn, Edward Elgar, 2020) forthcoming. Page 11.

²⁷ See point 34 of the of the *Communication from the Commission. Framework for State aid for research and development and innovation (2014/C 198/01)*.

²⁸ See point 35 of the *Communication from the Commission. Framework for State aid for research and development and innovation (2014/C 198/01)*.

²⁹ See point 52 of the *Communication from the Commission. Framework for State aid for research and development and innovation (2014/C 198/01)*.

³⁰ This criterion is not easy to demonstrate, as a comparison between the outcome with and without aid is required. Member States must provide *'to the extent possible, a comprehensive description of what would have happened or could reasonably have been expected to happen without aid, that is to say the counterfactual scenario. The counterfactual scenario may consist in the absence of an alternative project or in a clearly defined and sufficiently predictable alternative project considered by the beneficiary in its internal decision making, and may relate to an alternative project that is wholly or partly carried out outside the Union.'* See point 66 of the *Communication from the Commission. Framework for State aid for research and development and innovation (2014/C 198/01)*.

- The measure must be transparent, meaning easy access to all the information and documents about the aid.³¹

It follows that to implement a competitive dialogue or innovation partnership, the best course of action would be to notify the Commission, in order to avoid state aid issues.

In any case, there is field for research on how to assess the existence (or not) of economic advantages in procedures that are not the open or restricted one.

³¹ See point 36 of the *Communication from the Commission. Framework for State aid for research and development and innovation (2014/C 198/01)*.

3. Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty. The *General Block Exemption Regulation (GBER)*

In this regulation, the Commission declares specific categories of State aid compatible with the TFUE under certain conditions, thus exempting them from the requirement of prior notification and Commission approval.³²

In particular, aid for research and development projects is compatible with the internal market and is exempted from the obligation to notify the Commission beforehand, as long as the funds are allocated to fundamental or industrial research, experimental development or feasibility studies, the aid intensity for research and development doesn't surpass a certain percentage and it is under certain thresholds established in article 4 (notification thresholds):

(i) if the project is predominantly fundamental research: EUR 40 million per undertaking, per project; that is the case where more than half of the eligible costs of the project are incurred through activities which fall within the category of fundamental research;

(ii) if the project is predominantly industrial research: EUR 20 million per undertaking, per project; that is the case where more than half of the eligible costs of the project are incurred through activities which fall within the category of industrial research or within the categories of industrial research and fundamental research taken together;³³

(iii) if the project is predominantly experimental development: EUR 15 million per undertaking, per project; that is the case where more than half of the eligible costs of the project are incurred through activities which fall within the category of experimental development;³⁴

(iv) if the project is a Eureka project or is implemented by a Joint Undertaking established on the basis of Article 185 or of Article 187 of the Treaty, the amounts referred to in points (i) to (iii) are doubled.

(v) if the aid for research and development projects is granted in the form of repayable advances which, in the absence of an accepted methodology to calculate their gross grant equivalent, are expressed as a percentage of the eligible costs and the measure provides that in case of a successful outcome of the project, as defined on the basis of a reasonable and prudent hypothesis, the advances will be repaid with an interest rate at least equal to the discount rate applicable at the time of grant, the amounts referred to in points (i) to (iv) are increased by 50 %;

(vi) aid for feasibility studies in preparation for research activities: EUR 7,5 million per study.³⁵

³² See B. von Wendland. *New Rules for State Aid for Research, Development and Innovation: Not a Revolution but a Silent Reform*. European State Aid Law Quarterly, Volume 14 (2015), Issue 1, Page 36.

³³ One important modification of the new GBER is that the development of laboratory scale prototypes is now explicitly included in the category of industrial research, whereas in the regulation of 2006, aid for prototype development was relegated to experimental development. The reasoning behind it was that certain prototypes could be commercially deployed, and the risk was considered as low. Nevertheless, it has been proved that certain prototypes can definitely not be commercially deployed and are indeed necessary to obtain proof of concept. See B. von Wendland. *New Rules for State Aid for Research, Development and Innovation: Not a Revolution but a Silent Reform*. European State Aid Law Quarterly, Volume 14 (2015), Issue 1, Page 27.

³⁴ Please bear in mind that for the purposes of the notification obligation is very important to take into account that 'predominantly' means that more than half of the eligible costs of the project are allocated in fundamental research, industrial research and experimental development respectively.

³⁵ See article 25. Aid for research and development projects.

*'3. The eligible costs of research and development projects shall be allocated to a specific category of research and development and shall be the following: (a) **personnel costs**: researchers, technicians and other supporting staff to the extent employed on the project; (b) **costs of instruments and equipment to the extent and for the period used for the project**. Where such instruments and equipment are not used for their full life for the project, only the depreciation costs corresponding to the life of the project, as calculated on the basis of generally accepted*

4. Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)

In this Communication, the Commission tries to clarify key concepts of the State aid notion, such as undertaking and economic activity, state origin of the resources, advantage, selectivity (i.e. favouring ‘certain undertakings or the production of certain goods’) and distortion of competition. Each one of these concepts will be addressed in detail in this section:

3.1. Subjective and objective scope of the notion of State aid as referred to in Article 107(1) of the TFEU

According to its provisions, State aid rules only apply where the beneficiary of a measure is an ‘undertaking’, which is any kind of entity, regardless of their legal status and the way in which they are financed, engaged in economic activity. Therefore, the main factor that characterizes an ‘undertaking’ is the nature of their activities:

- 1) An ‘undertaking’ has to engage in an economic activity (offering goods and services on a market).³⁶
- 2) Its legal status is not relevant (private company, association or club, public entity). This means that the classification that the National Law does of the entity and the profit or non-profit seeking of the entity are of no relevance.

accounting principles are considered as eligible. (c) Costs for of buildings and land, to the extent and for the duration period used for the project. With regard to buildings, only the depreciation costs corresponding to the life of the project, as calculated on the basis of generally accepted accounting principles are considered as eligible. For land, costs of commercial transfer or actually incurred capital costs are eligible. (d) costs of contractual research, knowledge and patents bought or licensed from outside sources at arm's length conditions, as well as costs of consultancy and equivalent services used exclusively for the project; (e) additional overheads and other operating expenses, including costs of materials, supplies and similar products, incurred directly as a result of the project;

4. *The eligible costs for feasibility studies shall be the costs of the study.*

5. *The aid intensity for each beneficiary shall not exceed: (a) 100 % of the eligible costs for fundamental research; (b) 50 % of the eligible costs for industrial research; (c) 25 % of the eligible costs for experimental development; (d) 50 % of the eligible costs for feasibility studies.*

6. *The aid intensities for industrial research and experimental development may be increased up to a maximum aid intensity of 80 % of the eligible costs as follows: (a) by 10 percentage points for medium-sized enterprises and by 20 percentage points for small enterprises; (b) by 15 percentage points if one of the following conditions is fulfilled: (i) the project involves effective collaboration: — between undertakings among which at least one is an SME, or is carried out in at least two Member States, or in a Member State and in a Contracting Party of the EEA Agreement, and no single undertaking bears more than 70 % of the eligible costs, or — between an undertaking and one or more research and knowledge-dissemination organisations, where the latter bear at least 10 % of the eligible costs and have the right to publish their own research results; (ii) the results of the project are widely disseminated through conferences, publication, open access repositories, or free or open source software.*

7. *The aid intensities for feasibility studies may be increased by 10 percentage points for medium-sized enterprises and by 20 percentage points for small enterprises.’*

³⁶ The Court of Justice of the EU defined the concept of undertaking as “every entity engaged in an economic activity, regardless of the legal status of the entity, and the way it is financed”. See judgement of 23rd April 1991. Klaus Höfner and Fritz Elser v Macrotron GmbH (C-41/90, ECLI:EU:C:1991:161). The activity must consist in the offering of goods or services on a given market. See judgment of 12 September 2000. Pavel Pavlov and Others v Stichting Pensioenfonds Medische Specialisten (Joined cases C-180/98 to C-184/98, ECLI:EU:C:2000:428). A market will exist or not, depending on how the provision for those goods and services is organised in a Member State. Nevertheless, an economic activity may exist where economic operators would be willing and able to provide the service in the market concerned, even if the public authorities do not to allow third parties in the provision of the above-mentioned service.

- 3) Nor the way in which they are financed (it does not depend on whether the entity is set up to generate profits).³⁷

The important thing is if the entity is offering goods and services on a market. However, a market may or may not exist depending on how each member states organises those services. Moreover, the fact that a Contracting Authority decides to provide a service in-house, doesn't exclude the existence of a market.³⁸

On the other hand, State aid within the meaning of article 107(1) of the TFEU does not include activities in which the State exercises public powers. This in turn means that if a public entity engages in an economic activity differentiated from the exercise of public powers, that entity will be considered as an undertaking in relation to that activity.

3.2. Cumulative conditions for State aid to exist

Two cumulative conditions related to the public origin of a measure are the basis for State aid:

- 1) The granting of an advantage directly (via a public authority) or indirectly (via autonomous institutions designated by public authorities) through State resources.

*'Only advantages granted directly or indirectly through State resources can constitute State aid within the meaning of Article 107(1) of the Treaty.'*³⁹

It is true that resources from private bodies may strengthen the position of certain undertakings, but they do not fall within the scope of article 107 of the TFEU. However, under certain circumstances these resources of private bodies can be considered state resources:⁴⁰

*'57. The origin of the resources is not relevant provided that, before being directly or indirectly transferred to the beneficiaries, they come under public control and are therefore available to the national authorities, even if the resources do not become the property of the public authority.'*⁴¹

In this regard, see the Judgment of the Court of Justice of 16 May 2000, *France v Ladbroke Racing Ltd and Commission*:⁴²

'Article 92(1) of the Treaty covers all the financial means by which the public sector may actually support undertakings, irrespective of whether or not those means are permanent assets of the public sector.'

Same conclusion emerges from paragraph 67 of the Judgment of the General Court of 12 December 1996, *Air France v Commission*:⁴³

³⁷ The classification of an entity as an undertaking is related to a specific activity. If an entity carries out economic and non-economic activities, it will be considered an undertaking only regarding the former.

³⁸ See *Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (2012/C 8/02)*.

³⁹ See point 47 of the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)*.

⁴⁰ See point 48 of the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)*.

⁴¹ *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)*.

⁴² C-83/98 P, ECLI:EU:C:2000:248. Paragraph 50.

⁴³ T-358/94, ECLI:EU:T:1996:194. The case regards an aid granted by the *Caisse des Dépôts et Consignations* which was financed with the voluntary **deposits of private citizens**. The funds were considered State resources because the Caisse was able to use them from the balance produced by deposits and withdrawals as if they were permanently at its disposal.

*'67 The Court considers that **the investment in question**, financed by the balance available to the Caisse, **is liable to distort competition** within the meaning of Article 92(1) of the Treaty⁴⁴ in the same way as if that investment had been financed by means of revenue from taxation or compulsory contributions. **That provision therefore covers all the financial means by which the public sector may actually support undertakings, irrespective of whether or not those means are permanent assets of the public sector.'***

- 2) The imputability of such a measure to the State:⁴⁵

'where a public authority grants an advantage to a beneficiary, the measure is by definition imputable to the State, even if the authority in question enjoys legal autonomy from other public authorities. The same applies if a public authority designates a private or public body to administer a measure conferring an advantage.'

In the case of a public undertaking granting the measure, proving the imputability might be challenging. Third parties can resort to indicators arising from the particular circumstances of the case, such as factors linking the public undertaking to the State (integration of the public undertaking into the structures of the public administration, nature of the public undertaking's activities and their exercise on the market in normal conditions of competition, degree of supervision that the public authorities exercise over the management of the undertaking and so on).

3.3. Nature of the measures that can be considered as State aid

For state aid to take place, a positive transfer of funds does not have to occur. Direct grants, loans, guarantees, direct investment in the capital of companies, tax credits and benefits in kind can also constitute state aid.⁴⁶

3.4. Notion of advantage and cumulative conditions from the Altmark case that rule it out

An advantage in the context of article 107(1) takes place if as a result of State intervention changing the normal conditions of a market, the financial situation of an undertaking is improved. The cause or objective of the State's intervention is not relevant. Therefore *'it is irrelevant whether the advantage is compulsory for the undertaking in that it could not avoid or refuse it.'*⁴⁷

In this regard it is important to keep in mind the four cumulative conditions of the Altmark case that we have analysed in the section 1, that exclude the compensation for a SGEI of the State Aid regulations.⁴⁸

3.5. Selectivity

Only measures that favour certain economic operators or certain sectors fall within the scope of article 107(1) of the TFEU. General measures that do not advantage some undertaking or the production of certain goods do not qualify as state aid.

3.6. Distortion of competition

According to article 107(1), public measures only qualify as state aid if they distort competition and as far as they affect trade between Member States.⁴⁹ For a measure to be disruptive of competition it doesn't need to have an actual effect on trade between Member States. It only needs to potentially have such an effect.

⁴⁴ Current article 107 (1) TFEU.

⁴⁵ See point 39 of the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)*.

⁴⁶ Waiving revenue which would otherwise have been paid to the State also qualifies as State resources that may constitute state aid under article 107 (1).

⁴⁷ See point 67 of the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)*.

⁴⁸ Judgment of the Court of 24 July 2003. Altmark (C-280/00, ECLI:EU:C:2003:415).

⁴⁹ See points 185 and 186 of the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)*.

At this point there is a presumption that if the rest of the criteria are fulfilled, this one is fulfilled too. In any case, the State granting the aid, or the beneficiary of the measure have the burden to proof that it does not distort competition.

Nevertheless, distortion of competition is excluded when four cumulative conditions are met:

- 1) A service is subject to a legal monopoly (established in compliance with EU law). This has to do with the fact that distortion of competition generally presupposes the existence of a market open to competition, and when there is a market, state aid rules apply. If there is no market, they don't.
- 2) This legal monopoly excludes the possibility that any competitor becomes the exclusive provider of the service in question (it excludes the competition *within* the market and *for* the market). Conversely, if there exists a market, but the Member State has decided to reserve the market to a single undertaking (which is an option when it comes to SGEI), the compensation is subject to state aid control.⁵⁰
- 3) The service is not in competition with other services.
- 4) If the service provider is active in another (geographical or product) market that is open to competition, cross-subsidisation has to be excluded.

Another condition that rules out a potential distortion of competition is the amount of the aid. If this amount is under the thresholds established in the *Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid*, the aid is not under the scope of article 107(1) and is exempt from the notification requirement in Article 108(3) of the TFEU.

If we combine the outcomes of this Communication with the *Communication from the Commission. Framework for State aid for research and development and innovation (2014/C 198/01)* (explained in section 2), the conclusion is that economic transactions carried out in line with normal market conditions by public bodies (including public undertakings) do not confer an advantage on its counterpart, and therefore do not constitute aid.

The underlying idea is to assess whether the public buyer is behaving as a market operator. I.e. in this same situation, would an economic operator on that market have done the transaction?

Moreover, the Member State arguing that it acted as an economic operator has the burden to provide with evidence that *'the decision to carry out the transaction was taken on the basis of economic evaluations comparable to those which, in similar circumstances, a rational market economy operator would have had carried out to determine the profitability or economic advantages of the transaction.'*⁵¹

Conducting a SOTA, following a Market Consultation, elaborating a Business Case and thoroughly documenting these steps, prior to the decision of starting the procurement, can work as a future justification against state aid suspicions.

⁵⁰ See point 37 of the *Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (2012/C 8/02)*: 'In fact, where economic activity has been opened up to competition, the decision to provide the SGEI by methods other than through a public procurement procedure that ensures the least cost to the community may lead to distortions in the form of preventing entry by competitors or making easier the expansion of the beneficiary in other markets.'

⁵¹ See point 79 of the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)*.

Generally speaking, the procedures regulated in the Public Procurement Directives are in line with market conditions and with the principles of the TFEU on public procurement, as long as they are:⁵²

- Competitive, allowing all interested and qualified bidders to participate.
- Transparent, allowing all interested tenderers to be equally and duly informed at each stage of the tender procedure. This means that a tender has to be published well in advance, making the selection and award criteria widely known. Moreover, the degree of publicity (Europe or international level) will depend on the requested products, services or supplies.
- Non-discriminatory, meaning objective selection and award criteria is specified in advance and enables tenders to be compared and assessed objectively, ensuring thus that the resulting transaction is in line with market conditions.
- Unconditional, in the sense that *'if there is a condition that the buyer is to assume special obligations for the benefit of the public authorities or in the general public interest, which a private seller would not have demanded the tender cannot be considered unconditional'*.

To summarize: sufficient transparency (which includes the prior publication of all rights and obligations of the parties) enhances competition, which in turn guarantees a market price. This clearly defines the open and the restricted procedure.

*'A transaction's compliance with market conditions can be directly established through transaction-specific market information in the following situations: (ii) where it concerns the sale and purchase of assets, goods and services (or other comparable transactions) carried out through a competitive, transparent non-discriminatory and unconditional tender procedure.'*⁵³

However, both Communications distrust the negotiated, more flexible procedures that the 2014 Procurement Directives promote in order to acquire innovation: negotiated procedure (with or without prior publication), competitive dialogue and the 'novel' innovation partnership.

*'Using and complying with the procedures provided for in the Public Procurement Directives can be considered **sufficient** to meet the requirements above provided that all the conditions for the use of the respective procedure are fulfilled. **This does not apply in specific circumstances that make it impossible to establish a market price**, such as the use of the negotiated procedure without publication of a contract notice. If only one bid is submitted, the procedure would not normally be sufficient to ensure a market price, unless either (i) there are particularly strong safeguards in the design of the procedure ensuring genuine and effective competition and it is not apparent that only one operator is realistically able to submit a credible bid or (ii) the public authorities verify through additional means that the outcome corresponds to the market price.'*⁵⁴

In these cases, a proper cost/price benchmark guarantying that the price is according to market standards seems to be the Commission's preferred approach.

However, whereas this is relatively easy in off the shelf purchases where the public buyer acquires a relatively mature product, service or supply; it is not that simple when it comes to the purchase of innovative solutions.

The communication already hints this:

'it is useful to distinguish between situations in which the transaction's compliance with market conditions can be directly established through transaction-specific market data and situations in which,

⁵² See points 89 to 92 of the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)*.

⁵³ See point 84 of the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)*.

⁵⁴ See point 93 of the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)*.

due to the absence of such data, the transaction's compliance with market conditions has to be assessed on the basis of other available methods'.⁵⁵

These other methods are mainly benchmarking and other assessment methods.

- Benchmarking is to compare the transaction to similar operations carried out by private economic operators. This method might not be useful when the prices have been distorted by significant public interventions. The end result will be a range of values to which the measure can be compared to.
- Other assessment methods, such as the calculation of the Return On Investments (ROI), the Internal Rate of Return (IRR) or the Net Present Value (NPV), are widely known as standard assessment methodologies. To guarantee that the analysis is valid, a sensitivity analysis, assessing different business scenarios, preparing contingency plans and comparing the results with alternative evaluation methodologies should also be implemented. The best course of action is to combine different methods to ensure that the transaction is under no state aid.

Nevertheless, the implementation of these methods might prove difficult, depending on how much R&D development is needed (i.e. how close to the market is the desired solution). If it is close to the market, benchmarking won't be that complicated. This analysis of the market can become impossible when it comes to innovation partnership, as the goal of this procedure is to acquire a solution that doesn't currently exist on the market.⁵⁶

⁵⁵ See point 83 of the *Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)*.

⁵⁶ A. Sanchez-Graells, State aid and EU public procurement: more interactions, fuzzier boundaries. L. Hancher & JJ Piernas López (eds), *Research Handbook on European State Aid Law (2nd edn, Edward Elgar, 2020)* forthcoming. Pages 10 to 12.

5. Commission notice. Guidance on Innovation Procurement. C(2018) 3051 final

If there are no solutions on the market or close to the market, a public buyer may need to procure R&D services. According to the 2014 Public Procurement Directives, if the public buyer reserves for itself all the benefits of the research and development, R&D services procurement fall under their scope. Whereas if the public buyer does not reserve all those for itself, the procurement is exempted from the Public Procurement Directives.⁵⁷

In the latter case, to avoid distortion of competition that may lead to state aid, the supplier must pay compensation equivalent to the market price of the intellectual property rights.⁵⁸

4.1. Pre-Commercial Procurement

Pre-commercial procurement is an R&D services procurement where the public buyer does not reserve all the benefits but shares them with the economic operators under market conditions. Therefore, it falls under the exemptions of procurement Directives, which means that contracts have to be awarded paying '*particular attention to point 33 of the research and development and innovation State Aid Framework*' to ensure compliance with State aid rules.⁵⁹

4.2. Procuring research and development supplies

Procurement of research and development supplies can be done by means of any public procurement procedure. Using a negotiated procedure without prior publication is allowed as long as the products or services are intended for the sole purpose of research, experimentation, study or development.

Nevertheless, from a purely state aid's perspective, this procedure doesn't abide with any of the conditions regulated in point 33 of the research and development and innovation State Aid Framework.

4.3. Innovation partnership

Innovation partnership is a new procedure regulated in Directive 2014/24/EU and may be used when R&D is needed to find a solution for a public buyer's needs. The difference with PCP is that Innovation Partnership covers the research and development phase, as well as the commercial purchase of the solution to one of the participating partners.

This absence of a separate procurement procedure for the purchase of commercial volumes of final products or services means that State aid is only avoided if the procurement does not give any of the partners any preferential treatment in the supply of commercial volumes of the final products or services. If the innovation is very novel or disruptive, making sure that there is no state aid due to preferential treatment is even more important, as there is a high risk of foreclosing the market crowding out other R&D investments.

Innovation Partnership is under no state aid presumption if:

- 1) The products or services purchased are so unique or specialised that the public buyer is the only potential buyer.

⁵⁷ See in particular articles 25 of Directive 2014/23/EU, 14 of Directive 2014/24/EU and 32 of Directive 2014/25/EU.

⁵⁸ The actual market value of the intellectual property rights resulting from the bidding procedure may be determined ex-post.

⁵⁹ See the four conditions listed in section 2.

- 2) There are *'no other potential providers on the market outside of the innovation partnership that could be disadvantaged'*.⁶⁰ This would be the same condition as the one allowing the negotiated procedure without prior publication for technical reasons. The procurement is so specialized that no other providers other than the partners in the procedure can supply the service or product.

This implies that the public buyer has a good knowledge of the market and that it has conducted a thorough research to identify potential partners well before starting the procedure. This research may well refer to benchmarking and other assessment methods mentioned in 3.6. *Distortion of competition*. However, as already mentioned in that section the implementation of these methods when it comes to Innovation Partnership is very likely to be extremely complex, as the goal of this procedure is to acquire a solution that doesn't currently exist on the market and a high degree of R&D development is needed.

Authors

Ms. Ana Lucia Jaramillo Villacís

Dr. Ana Isabel Peiró Baquedano

⁶⁰ See *Commission notice. Guidance on Innovation Procurement. C(2018) 3051 final*. Page 51.