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Dealing Effectively with State Aid in Knowledge Exchange and Innovation

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“ **State Aid**. It’s a fairly innocuous sounding term, which belies its importance and the potential consequences for those who ignore its implications.

State Aid doesn’t represent a glittering, enticing opportunity for universities and it certainly isn’t the sort of topic that animates and enthuses researchers, administrative staff and Vice-Chancellors.

That said, we suggest that the sector should be paying more attention to this issue and **an understanding of the basic principles is likely to facilitate improved decision making by academics and senior managers who are active in the innovation space**. ”

Background

Early 2014 State Aid *sounding board* session was organised by AURIL and PraxisUnico for BIS and HEFCE.

Lots of confusion, even among ‘experts’!

One outcome – how can we generate new, updated guidance for the HE sector on State Aid in an R&D context?

October 2014 AURIL, in partnership with PraxisUnico, awarded grant by HEFCE to deliver a *Guide to State Aid for Universities*. [Grateful thanks to Alice Frost, Head of Knowledge Exchange, Subjects and Skills, HEFCE.]

First step: contract expert lawyers: Christine Reid (Northwood Reid) and Emyr Lewis (Blake Morgan LLP).

Steering Group established: universities from England, Wales, Scotland and N Ireland. Also HEFCE, BIS State Aid Unit, RCUK and wider inputs from Innovate UK, JISC, devolved governments & their State Aid teams in N Ireland, Scotland and Wales and industry via CBI ICARG.

Final draft out for review in summer 2015 – socialised widely! Publication in hard copy and PDF Q4 2015.

Scope for today's session

Provide an introduction to State Aid issues.

Consider some case studies from the new Guide.

Offer you the opportunity to share your experiences and discuss any ongoing challenges relating to State Aid.

Introduction to State Aid

What is state aid?

The use of state funding or resources to support businesses (in State Aid speak, **undertakings**).

The decisive factor is not the nature of the entity itself, but the nature of what it does.

If it carries out an **economic activity**, selling goods or services on a market, it is an undertaking.

Publicly funded institutions, including universities, can be undertakings for the purposes of State Aid.

Introduction to State Aid

Universities and State Aid – Economic and Non-Economic Activities

Funding a university's core activities - teaching and non-commercial research - is not State Aid.

A university may be a recipient of State Aid and/or an intermediary through which State Aid flows to businesses.

If a university carries out an **economic activity**, e.g. it **rents equipment or lab space or supplies services** to businesses, or it carries out **contract research**, the funding of those activities by the state or an arm of the state will usually be State Aid to the university.

If a university uses state funding or resources (including funds received by it for the purpose of carrying out its core activities) to fund or assist an **undertaking** (e.g. it carries research with or for a business at less than market rate), the undertaking may be a **recipient** of State Aid.

Introduction to State Aid

What is the purpose of State Aid?

The purpose of the State Aid rules is to promote competition by preventing **Member States** of the EU subsidising businesses unfairly.

The State Aid rules are designed to help create or maintain a level playing field within the EU.

Not all aid to businesses is unlawful, but any State Aid which has an anti-competitive effect within the EU will be unlawful unless **the European Commission** authorises that aid (either specifically or through an exemption) or decides not to raise any objection to it.

Introduction to State Aid

The State Aid Tests

Test 1: Is there a transfer of state resources to an undertaking?

Are state resources provided by or through the government of a Member State, or an arm of the government, either directly or through an intermediary?

A transfer of resources will happen where money is paid, a resource is provided or an economic benefit is conferred on terms which are not market terms.

If an entity carries out an economic activity, it is an undertaking.

Publicly funded institutions, universities, charities (and even local authorities and government departments) can be undertakings for the purposes of State Aid.

Introduction to State Aid

The State Aid Tests

Test 2: Does the aid confer an advantage on the recipient/beneficiary?

An advantage is an economic benefit which the undertaking would not have received in the normal course of things.

A transaction which is on terms more favourable than normal market terms will confer an advantage.

A transaction on normal market terms will not confer an advantage

Introduction to State Aid

The State Aid Tests

Test 3: Is the aid selective?

Does the aid favour certain undertakings or the production of certain goods?

Aid is selective if only certain businesses, sectors or regions benefit from it.

Aid which is available to all businesses wanting to take it up is not selective.

Introduction to State Aid

The State Aid Tests

Test 4: Does the aid distort competition (actually or potentially) and does the aid affect trade between Member States?

In almost all cases of selective aid, competition will be distorted, and there will be an effect on inter-state trade.

Competition is distorted if the aid strengthens the competitive position of the beneficiary/recipient of the aid in relation to its competitors.

The beneficiary's share of the market and the size of the distortion are irrelevant.

It is sufficient to affect trade between Member States if the beneficiary is involved in an economic activity and operates in a market in which there is trade between Member States.

Most products and services are traded between Member States.

Introduction to State Aid

The Interplay of Charity Law and State Aid Law

Charity law and State Aid law involve different considerations and compliance with one body of law is no guarantee of compliance with the other.

Carrying out charitable research for the public benefit will usually not be an economic activity so there will be no aid to the university when it receives and uses state funding for that purpose.

The public funding of a university's economic activities (including contract research) will usually be State Aid.

A university investing in a spin-out company must comply with both charity law and state aid law - to avoid the spin-out company and other investors being recipients of State Aid, the university should invest on the same basis as a market or private investor would.

Introduction to State Aid

Establishing the Market Rate

If the recipient of goods or services pays the full market rate for them, it will not be in receipt of State Aid.

So there will be no aid to an undertaking where the university charges a market rate for its services.

While Full Economic Costing is a helpful method of establishing a baseline cost for charging, it is not necessarily the equivalent of market rate.

For bought in goods/services, the market rate is usually established by competitive tender.

When providing services or facilities, unless in response to a competitive tender, the university should try to establish the market rate for the provision of similar services or facilities.

Introduction to State Aid

The Market Rate – Collaborative Research

The Commission deems the price received by the university to be the equivalent of the market price if **one** of the following conditions is met:

The price has been established by means of an open, transparent and non-discriminatory competitive sale procedure.

An independent expert valuation confirms that the price is at least equal to the market price.

The university can demonstrate that it effectively negotiated the price, at arm's length, to obtain the maximum economic benefit when the contract was concluded.

Where there is a right of first refusal in relation to IPR generated by the university, the university solicits more economically advantageous offers from third parties so that the undertaking has to match its offer.

Introduction to State Aid

The Market Rate – Contract Research

The university should charge the market price.

If the market price cannot be established the European Commission will usually accept that the market price has been charged where the price is the result of arm's length negotiations in which the university negotiated to obtain the maximum economic benefit when the contract was concluded, and at least the university's marginal costs are covered.

If there is no market price, the price charged by the university should reflect the full costs of the service **and include a margin established by reference to those margins commonly applied by undertakings active in the same sector**.

If the university provides a specific service for the first time on behalf of a given undertaking, on a trial basis and during a clearly limited period of time, the European Commission will normally consider the price charged to be the market price where that contract research is unique and it can be shown that there is no market for it.

Introduction to State Aid

Approved State Aid Schemes

The European Commission can approve schemes put forward by EU Member States to allow State Aid to be given without prior notification to the Commission and without being unlawful.

There are few approved schemes in England, but Innovate UK has an approved scheme which covers its grants for R&D.

The Commission encourages the use of the GBER and the *de Minimis* Regulation rather than the submission of new schemes for approval.

Introduction to State Aid

‘Exemptions’

The Commission has issued regulations, notices, communications, frameworks and guidelines which exempt some forms of State Aid from notification to the Commission before being granted.

Those which universities are most likely to find useful are:

- the *de minimis* Regulation;
- the General Block Exemption Regulation (the GBER); and
- the Research and Development and Innovation (the R&D&I) Framework.

Introduction to State Aid

The *De Minimis* Regulation

The Commission takes the view that small amounts of aid (*de minimis*) do not have a potential effect on competition and trade and are therefore not State Aid.

It is generally lawful for an undertaking to receive aid not exceeding €200,000 (€100,000 in the road transport sector) over a period of 3 fiscal years.

Before granting any *de minimis* aid, you should carry out a due diligence exercise to ensure that the aid (together with any other *de minimis* aid received by the undertaking) does not exceed this threshold.

Accurate records of all *de minimis* aid awarded must be kept and procedures followed to inform the recipient of the nature of the aid

Introduction to State Aid

The General Block Exemption Regulation (the GBER)

This regulation permits 13 categories of aid without the need to notify the proposed aid to the Commission in advance, provided certain conditions are met.

It includes aid for research and development and innovation in section 4.

The Commission must be notified within 20 days after the grant of aid under the GBER unless the aid is awarded under an approved GBER scheme.

Introduction to State Aid

The General Block Exemption Regulation (the GBER)

The aid must be transparent - if the aid is not in the form of a cash grant, the gross grant equivalent must be calculated.

There must be an incentive effect.

Only eligible costs may be funded.

Only a specified percentage of the eligible costs (known as the aid intensity) may be funded.

Aid over a certain amount (the maximum amount) must not be granted.

The beneficiary must not be an undertaking in difficulty or subject to an active order for the recovery of unlawful State Aid.

Introduction to State Aid

The General Block Exemption Regulation (the GBER)

The categories of aid include:

Aid to SMEs (investment aid, aid for consultancy, aid for participation in fairs and aid for costs incurred on participating in European Territorial Cooperation).

Aid for access to finance for SMEs (risk finance aid, aid for start-ups)

Aid for research and development and innovation (including investment aid for research infrastructures, aid for innovation clusters and aid for R&D projects).

Training aid.

Introduction to State Aid

The R&D&I Framework

The Framework does not create any exemptions as such.

The Framework's main purpose is to explain the approach that the European Commission will take when assessing proposed aid for RD&I which is not covered by the GBER.

The Framework is also helpful in that it sets out the Commission's thinking on State Aid and universities, particularly in the areas of collaborative and contract research.

Case studies

a) Postgraduate research studentships under the RCUK CASE model

b) Licensing technology to a University spin-out company

c) Providing consultancy advice to SMEs

d) A collaborative industrial research project with part funding from Innovate UK

e) Establishing a major research infrastructure for shared use by universities

Case study a)

Postgraduate research studentships under the RCUK CASE model

Scenario: The Department of Engineering has secured an industrial partner for a PhD studentship in aerospace materials. Project mainly funded from the University's EPSRC Doctoral Training Account. Industrial partner cash support equivalent to one third of the EPSRC funding.

Industrial partner has background intellectual property in broadly the same technology area as the studentship and is requesting ownership of project results. The original idea for the PhD project was generated by the university academic supervisor.

The PhD student will be entitled to publish the project results in the form of academic papers and in PhD thesis.

Case study a)

CASE is a long-established and successful model for university-industry collaboration. No public money flows to the industrial partner but resources funded by the state (student time, access to IPRs) provide competitive advantage.

For CASE, there is no specific State Aid scheme in place which has been approved by the European Commission. Article 25 of the GBER (R&D Projects) allows for '*effective collaboration*' between an undertaking and a university. Effective collaboration tales place where at least two independent parties undertake a project where they pursue a common objective, jointly defined, they both contribute to implementation and share financial, technological, scientific and other risks, as well as results.

Key considerations: legal arrangements which govern the studentship should be equitable and reflect the funding proportions. Avoid disproportionate benefit to the collaborating company.

Note: same recommendations apply to Industrial CASE awards.

Case study b)

Licensing technology to a University spin-out company

Scenario: An exclusive licence of patented technology is granted by a university to a spin-out company.

The technology was developed by the Department of Engineering and was funded from a mixture of sources, including the UK Research Councils. The lead academic and investigator on the RCUK awards will remain an employee of the university and will be a shareholder and non-executive director of the spin-out company.

The licence to the spin-out is provided on terms that are favourable to the company, i.e. no royalties are payable and the company will have the right to take a licence to future IPR (and the development of that IPR will be funded by Research Councils and other public sources).

Case study b)

The arrangements are highly beneficial to the spin-out company, which is a recipient of State Aid. it is receiving an advantage while not paying a market rate. Unlikely that an independent company which was interested in acquiring the rights would be granted a licence on equivalent terms.

Outside investors in the spin-out company also receive an indirect advantage and State Aid as the value of the company will be enhanced.

If the university had developed the technology solely using funding from the private sector there would be no State Aid. However, possible problem under charity law - misuse of charity resources and not in furtherance of the university's primary, charitable purposes.

Universities need robust policies which address the conflicts of interest which can arise in relation to innovation and commercialisation activities. Academic staff and researchers who have an equity stake or other personal interest (e.g. consultancy) in a spin-out should not be in a position to influence the terms between the university and company.

Case study c)

Providing consultancy advice to SMEs

Scenario:The university's Business School has established a High Performance Programme to advise SMEs on lean thinking methodologies.

Programme funded by a grant to the university from the regional government and covers project staff and other direct costs. The project's targets require the university to visit 100 SMEs and to provide them with a report analysing their production processes. The university will follow up with 25 SMEs via a further agreement, implementing lean methodologies and improving productivity.

In neither phase will the Programme provide cash support to the SMEs.

The Programme is not research and will not generate new knowledge. However, it will demonstrate Impact of research, possibly a REF case study.

Case study c)

Typically, the university will be alerted to the possibility of State Aid issues by the conditions of funding from the regional government. Both the university and the SMEs may potentially be recipients of State Aid.

Aid to the university: In providing consultancy services, the university is engaging in an economic activity. If payment by the regional government is at market rate or less, there will be no State Aid to the university (market rate could be established if the contract was awarded by tender).

Aid to the SMEs: Although they receive no money, the SME's will receive an advantage (and therefore State Aid) through the university report analysing their production processes. The value of that report is low and could come within the de minimis Regulation (< €200,000 over 3 years).

The consultancy provided to the 25 SMEs could be handled in in one of two ways: i) by charging a market rate; or ii) within Article 18 of the GBER at up to 50% costs.

Case study d)

An Innovate UK collaborative R&D project

Scenario: The university's Department of Geology has links with a company in the oil and gas industry. The company has established a consortium to develop new software tools to support the discovery of new oil reservoirs and subsequently led a successful bid to Innovate UK for Collaborative R&D project funding.

The companies in the consortium receive cash funding directly from Innovate UK, based on a % of eligible R&D costs which they each incur. The university receives gov't funding at 80% of fEC (hence the university makes a quantifiable contribution to the costs of the project).

The results of the project will be owned by the company, which will pay a royalty to the university on sales of any resulting software product.

The academic PI will be entitled to publish the project results.

Case study d)

The Collaborative R&D Scheme from Innovate UK operates under the provisions of the R&D&I State Aids Framework. Approved by the European Commission through the General Block Exemption Regulation (GBER) hence these grants constitute State Aid but are offered under a notified exempt permission. The single scheme covering the whole of the Innovate UK portfolio is State Aid SA.40761.

Aid intensities are defined under the scheme (for fundamental research, industrial research, experimental development and feasibility studies). The expectations around how a collaboration is structured vary according to the type of R&D carried out, as detailed under the scheme.

The expectation is that the parties should receive benefit commensurate with their input to the project and that the results should be disseminated and published by the academic partners (with due regard to confidentiality and protecting commercial interests). The arrangements proposed in the scenario would meet these requirements.

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Case study e)

A major research infrastructure for shared use by HEIs

Scenario: A university is awarded a gov't grant of M£20 to procure supercomputing facilities which will be available to the wider HE community for the support of research projects.

This aligns with expectations that universities should work together to deliver and make best use of shared access facilities, often on a regional consortium basis (Wakeham agenda, maximising utilisation rates).

The university carries out a full OJEU tendering process and awards a contract for supply, installation and commissioning of the equipment.

The computing facilities will be made available to other universities for carrying out fundamental research, supported by government grants through RCUK, the EC and research funding charities. The university is considering making the facilities available to the private sector.

Case study e)

The supplier: Selected following a full tender process, hence will not be paid more than the market rate; will not be a recipient of State Aid.

The university: Operates the facility in pursuit of a primary purpose activity (charitable research), the results of which are widely disseminated. Therefore not be a recipient of State Aid in the form of the government grant.

If the university allows undertakings to use the facilities, the university may be carrying out an economic activity. Aim should be to make any economic activity purely ancillary (≤ 20% of the facility's annual capacity.)

Other universities: If using the facilities for non-economic activities, there is no State Aid. (And State Aid has no bearing on the basis on which the university charges the other universities for access.)

The companies: No State Aid if access is at market rate or if there is *effective collaboration.*