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European Defence and Security Procurement: difficulties and action points

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The market for the European defence sector still is not generally characterized by openness and transparency and still is quite fragmented. The EU already has issued the specific Defence and Security Procurement Directive (2009/81/EC) to enhance competition. This directive was already transposed by all Member States into national law in March 2013, but the EU is committed to strengthen the European defence and security sector, by trying to enhance fair competition and a more efficient and more unfragmented cross-border market. One of the instruments used by the



EU to achieve this goal is the creation of a regulatory framework consisting of clear and generally applicable public procurement rules. The Commission laid down an 'Action Plan' (COM (2013) 542, 24 July 2013) and more recently a 'Road Map – A New Deal for European Defence' (COM (2014) 387, 24 June 2014) in which the EU tries to complete the Single Market for defence and security, strengthen the competitiveness of the European defence and security industry and support European defence and security research. We expect that the European Commission will provide the market with concrete tools to implement the 'New Deal' (through green papers, communications, legislative proposals, etc.) in the course of 2015. The first evaluation of this 'New Deal' by the European Council is scheduled for June 2015. After a positive evaluation, the New Deal is expected to lead to the adoption of new EU legislation to enhance the competitiveness of the defence and security market.

The European defence and security industry sector plays an important role in the overall European economy: the sector, composed of industrial manufacturers and innovative research- and development companies, is worth around 400,000 direct jobs, another 960,000 indirect jobs and generated a turnover of €96 billion in 2012¹. The defence industry sector consumes an important part of the total EU defence spending of around €200 billion. However, the sector has to deal with a difficult economic climate, cutbacks in armed forces and a fragmented market, resulting in a fall back of investments of 20 % in comparison with the year 2001 (€194 billion in 2010 vs €251 billion in 2001²).

Directive 2009/81/EC

One of the reasons of the decreasing defence budgets in Europe is the fragmentation of the defence market in smaller national markets, instead of a cross-border EU market. This situation has led to an inefficient and costly

¹ See the 'Action plan' COM (2013) 542, 'Commission Staff Working Document' SWD (2013) 279, and 'New Deal for European Defence' COM (2014) 387.

² For more numbers: see the 'Action plan' COM (2013) 542, 'Commission Staff Working Document' SWD (2013) 279, and 'New Deal for European Defence' COM (2014) 387.

duplication of procedures and administrative costs in the procurement market (both for the industry as for the government), but also led to protectionist procurement practices. This resulted in an uncompetitive and expensive situation for the EU tax payers.

By implementing the new EU procurement rules, as set forth in the Directive 2009/81/EC³, Member States now have at their disposal EU rules they can apply to complex and sensitive procurement matters⁴. This directive was fully transposed by all Member States in March 2013 and applies to the procurement of arms, munitions and war material, as well as related works and services⁵. Member States can also use the directive for procurement in certain particularly sensitive non-military areas (for example: protection against terrorism).

The Directive was intended to design a European regulatory framework for defence and security matters that Member States can transpose, replacing the variety of respective regulations by each Member State, to enhance the efficiency of the market. One of the new instruments is the possibility of a negotiation procedure for tendering authorities, allowing the authorities to negotiate the details of a defence contract with candidates. Another tool is the European publication of tenders (via TED – Tenders Electronic Daily and EBB – European Bulletin Board). After a first analysis the conclusion is that the impact of the new directives on cross-border awarding of tenders is not big as only 8 % of the contracts were awarded cross-border with only a value of 3 % cross-border award⁶.

Values (figure left) and numbers (figure right) of contracts in € million under Directive 2009/81/EC for the period 21 August 2011 until 23 March 2013 (Source: EU COM (2013) 542 brochure):

	TOTAL AMOUNT	AMOUNT AWARDED CROSS-BORDER	AMOUNT AWARDED NATIONALLY	% CROSS BORDER		TOTAL CONTRACTS	AWARDED CROSS-BORDER	AWARDED NATIONALLY	% CROSS BORDER
AT	0,6	0,0	0,6	0	AT	1	0	1	0
BE	0,4	0,0	0,4	0	BE	2	1	1	50
BG	46,0	0,0	46,0	0	BG	19		19	0
CZ	20,3	0,0	20,2	0	CZ	46	10	36	22
DE	308,6	0,6	308,0	0	DE	162	1	161	1
DK	40,2	3,4	36,8	8	DK	26	11	15	42
FI	37,6	16,6	21,0	44	FI	56	33	23	59
FR	129,8	0,0	129,8	0	FR	216	0	216	0
HU	58,9	0,0	58,9	0	HU	75	1	74	1
IT	277,4	20,5	256,9	7	IT	196	3	193	2
LT	1,4	0,0	1,4	0	LT	6	0	6	0
LV	1,4	1,4	0,0	100	LV	2	2	0	100
NL	1,6	0,0	1,6	0	NL	7	0	7	0
PL	4,4	0,0	4,4	0	PL	3	0	3	0
RO	1,7	0,0	1,7	0	RO	1		1	0
SE	1,1	0,0	1,1	0	SE	4	0	4	0
SK	6,4	3,5	2,9	55	SK	5	1	4	20
UK	839,1	6,9	832,2	1	UK	45	7	38	16
Total	1776,8	53,0	1723,9	3	TOTAL	872	70	802	8

The numbers prove that there is currently no real cross-border market for defence procurement, as the vast majority of contracts are awarded nationally. We will discuss below the measures the European Commission is

³ Directive 2009/81/EC of the European parliament and of the council of 13 July 2009 'On the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security, and amending Directives 2004/17/EC and 2004/18/EC'.

⁴ The Defence and Security Procurement Directive is the logical follow-up to the Interpretative Communication on the application of Article 296 of the European Community Treaty (hereafter: 'EC Treaty'), which was adopted in December 2006 (IP/06/1703), see the 'Action plan' COM (2013) 542, 'Commission Staff Working Document' SWD (2013) 279, and 'New Deal for European Defence' COM (2014) 387.

⁵ Article 2 ("Scope") of the Directive 2009/81/EC. Contracts awarded by contracting authorities and entities in these fields which are not covered by Directive 2009/81/EC will in principle continue to be subject to Directives 2004/17/EC and 2004/18/EC.

⁶ See the 'Action plan' COM (2013) 542, 'Commission Staff Working Document' SWD (2013) 279, and 'New Deal for European Defence' COM (2014) 387.

planning to take to improve this issue⁷, after we have discussed the abuse of Article 346 TFEU to avoid the application of the directive 2009/81/EC⁸.

The abuse of Article 346 TFEU

Member States have always used Article 346⁹ of the Treaty of Functioning of the European Union (hereafter: 'TFEU') to exclude defence procurement contracts from the application of the procurement rules. Article 346 TFEU states that *"(a) No Member State shall be obliged to supply information the disclosure of which it considers contrary to the essential interests of its security, and (b) any member State may take such measures as it considers necessary for the production of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes."*

According to Article 346 TFEU, Member States could avoid public procurement procedures for defence contracts, if the application of European procurement rules would undermine the essential security interests of a member state. Last years, a real abuse of Article 346 TFEU developed: almost all defence authorities made extensive use of this article by extracting almost all defence contracts from the market, which would normally have been subject to a public procurement procedure. Also, the exception of Article 346 TFEU was used for a lot of contracts for non-military or non-security purposes. This practice reinforced the further fragmentation of the defence market¹⁰.

The use of Article 346 TFEU should be limited to exceptional cases, as confirmed by the European Court of Justice (hereafter: 'ECJ'), not to hollow the procurement regulations¹¹. One of the first concrete steps to prevent the abuse of Article 346 TFEU, was the publishing in 2006 of a Communication by the European Commission about the field of application of this Article 346¹². The Commission confirmed that *"Article 346 TFEU should not be abused to exclude non-military contracts from the applicable public procurement rules and that the Member States do not have the absolute freedom in their decision to exempt a specific procurement contract from the rules of the internal market"*¹³. The Commission confirmed that the exception of Article 346 TFEU should be interpreted restrictively and Member States should not use this article as a flexible tool¹⁴.

Also, according to steady ECJ case-law, Article 346 TFEU does not allow Member States to use the exception provided by such article by nothing more than simply referring to their security interests without other

⁷ Also, Directive 2009/43/EC on intra-EU transfers of defence-related products simplifies and harmonises the conditions and procedures for transfers of such products. Three types of licences are created: general, global and individual licences. This directive also regulates the certification of companies.

⁸ See Communication by the Commission 5 December 2007 COM (2007) 764.

⁹ Old Article 296 of the EC Treaty: there is a reference to a list of arms and munitions, drawn up in 1958, which are possibly excluded from procurement procedures.

¹⁰ European Study on the industrial implications in Europe of the blurring of dividing lines between security and defence (contract. No. SI2.516182, 15 June 2010, p. 118).

¹¹ Case law: see reference below. In the words of the EU authorities: *"Up until now, the vast majority of defence procurement contracts have been exempted from the rules of the Single Market on the basis of Article 296 of the Treaty. This practice stands in contrast to the case law of the Court of Justice and hampers the openness of defence markets between Member States."*

http://ec.europa.eu/internal_market/publicprocurement/rules/defence_procurement/index_en.htm.

¹² See Interpretative Communication on the application of Article 296 of the EC Treaty in the field of defence procurement, COM (2006) 779 final, and European Study on the industrial implications in Europe of the blurring of dividing lines between security and defence (contract. No. SI2.516182, 15 June 2010, p. 118-120).

¹³ See Interpretative Communication on the application of Article 296 of the Treaty in the field of defence procurement, COM (2006) 779 final, p. 6.

¹⁴ ECJ 16 September 1999, C-414/97 and Interpretative Communication on the application of Article 296 of the Treaty in the field of defence procurement, COM (2006) 779 final, p. 7.

motives¹⁵. According to the interpretation of the ECJ, a Member State who wishes to use the exception of Article 346 TFEU to award a contract, must ensure that the use is necessary to protect its essential security interest¹⁶. The evaluation thereof is based on a case-by-case assessment where the following questions should be asked: (a) which essential security interest is concerned? (b) what is the connection between this security interest and the specific procurement decision? (c) why is the non-application of the EU Public Procurement Directives¹⁷ in this specific case necessary for the protection of this essential security interest?¹⁸

In addition to the jurisprudence of the ECJ and the communications from the Commission, also the Directive 2009/81/EC, which created the regulatory framework for defence and security procurement, still allows Member States to use article 346 TFEU. The Directive not only covers military equipment, but also works, services and supplies directly related to military equipment, as well as certain particularly sensitive non-military matters¹⁹: *“the award of contracts which fall within the field of application of this Directive can be exempted from the latter where this is justified on grounds of public security or necessary for the protection of essential security interests of a Member State. This can be the case for contracts in the fields of both defence and security which necessitate such extremely demanding security of supply requirements or which are so confidential and/or important for national sovereignty that even the specific provisions of this Directive are not sufficient to safeguard Member States’ essential security interests, the definition of which is the sole responsibility of Member States.”*²⁰

This, however, does not imply a blank cheque for the use of Article 346 TFEU: the application of Article 346 TFEU is limited to a list²¹ of arms, munitions and war material according to recital 10 of the Directive 2009/81/EC. Military equipment should also cover products which, although initially designed for civilian use, are later adapted to military purposes to be used as arms, munitions or war material²².

The ECJ further recently clearly confirmed, in several benchmark judgements²³ that a contracting authority can only use the exception of Article 346 TFEU if the material ordered by the contract, by virtue of its intrinsic characteristics, is regarded as having been specially designed and developed for military purposes. If the material ordered by the contract will be used for civilian applications, the exception of Article 346 TFEU cannot be invoked to extract the contract from the public procurement procedures.

It thus seems that the abuse of Article 346 TFEU should be restricted in the future by the Directive 2009/81/EC combined with the jurisprudence of the ECJ. The European Commission will follow up on this matter, as one of the action points of the ‘New Deal’ for European Defence²⁴.

¹⁵ See steady jurisprudence of the ECJ: ECJ 7 June 2012, C-615/10, ECJ 15 December 2009, C-239/06, ECJ 15 December 2009, C-409/05, ECJ 15 December 2009, C-294/05, ECJ 15 December 2009, C-372/05, ECJ 15 December 2009, C-461/05, ECJ 8 April 2008, C-337/05, see also: S. VAN GARSSE and B. SCHUTYSER, CDPK, 2014, 105-111 and Directorate General Internal Market and Services, Guidance Note - Field of application.

¹⁶ ECJ 15 December 2009, C-239/06.

¹⁷ Directives 2004/17/EC, 2004/18/EC (to be replaced from 1 April 2016 by Directives 2014/24/EU and 2014/25/EU) and 2009/81/EG.

¹⁸ See Interpretative Communication on the application of Article 296 of the EC Treaty in the field of defence procurement, COM (2006) 779 final, p. 8, nr. 5, and European Study on the industrial implications in Europe of the blurring of dividing lines between security and defence (contract. No. SI2.516182, 15 June 2010, p. 118-120).

¹⁹ Article 2 (“Scope”) of the Directive 2009/81/EC.

²⁰ Recital 16 of the Directive 2009/81/EC. See also recitals 10 to 15.

²¹ Adopted by the Council in its Decision 255/58 of 15 April 1958.

²² Recital 10 of the Directive 2009/81/EC.

²³ ECJ 8 April 2008, C-337/05 and ECJ 7 June 2012, C-615/10 (*et al.*).

²⁴ See ‘Action Plan’ and ‘Roadmap’ COM (2013) 542, 24 July 2013 and COM (2014) 387, 24 June 2014.

The 'New Deal' for European Defence

The European Commission is taking the lead in strengthening the European defence and security sector, by trying to enhance fair competition and a more efficient and more unfragmented cross-border market. The Commission laid down an 'Action Plan' (COM (2013) 542, 24 July 2013) and more recently a 'Road Map – A New Deal for European Defence' (COM (2014) 387, 24 June 2014) in which the future measures and deadlines are set. The 'New Deal' consists of this 'Action Plan' and this 'Roadmap' which contain deadlines.

The following are the main action points and deadlines of the 'New Deal'²⁵:

1. *Ensuring market efficiency*: The Commission will monitor the openness of the defence markets via TED. The Commission will coordinate its market monitoring activities with those of the European Defence Agency in order to exploit potential synergies and avoid unnecessary duplication of efforts. The Commission will also check the concrete application of Directive 2009/81/EC by the Member States via an evaluation report ultimately in August 2016.
2. *The Commission will clarify the limits of certain exclusions*. It will provide, in consultation with Member States, specific guidance for the Member States for (a) the sales to other governments (a guideline in the beginning of 2015) and (b) purchasing via international treaties or international organisations (a guideline by the end of 2015).
3. *Tackle market distortions*: Since the adoption of the Defence and Security Procurement Directive, all Member States have withdrawn or revised their national offset legislation. The Commission will verify that these revisions comply with EU law. It will also ensure that these changes in the legal framework lead to an effective change in Member States' procurement practice.
4. *Controlling the application of Article 346 TFEU*: The Commission will ensure that all necessary conditions are fulfilled when Article 346 TFEU is invoked to justify state aid measures. The Commission is planning to install an advice group on this matter.
5. *Improve Security of Supply*: The Commission will try to optimise the defence transfer regime in June 2015 by: (a) supporting national authorities in their efforts to raise awareness of it within the industry; (b) establishing a central register on general licences and promote their use; and c) promoting best practices in managing intra-EU transfers. The Commission would issue a Green Paper (to be expected soon) on the control of defence and sensitive security industrial capabilities. It will consult stakeholders on possible shortfalls of the current system and explore options for the establishment of an EU-wide monitoring system.
6. *Standardisation*: The Commission will promote the development of standards for products which can have both military and civilian applications.
7. *Certification and raw materials*: the Commission will assess the different options for setting up a standard for certification of military products. The Commission will evaluate Directive 2009/43/EC from the beginning of 2015. The Commission will also screen raw materials that are critical for the defence sector within the context of the EU's overall raw materials strategy and prepare, if necessary, targeted policy actions by mid-2015.

²⁵Short summary copied from and based on the 'Action Plan' COM (2013) 542, 24 July 2013 and 'Roadmap' COM (2014) 387, 24 June 2014.

8. *Export control:* The Commission will make a communication outlining a long-term vision for EU strategic export controls and concrete policy initiatives to adapt export controls to rapidly changing technological, economic and political conditions. This may include proposals for legislative amendments to the EU export control system.
9. *Measures to support small and medium enterprises (SMEs):* SMEs are a cornerstone of the European defence market. The Commission will present to the European Council in June 2015 initiatives and measures to enhance the entrance to the market for SMEs.
10. *Miscellaneous:* besides the above mentioned measures, the Commission will also take measures to reskill workers cooperation (with a fund of €74 billion), support R&D, try to establish civil-military cooperation (with a fund of €140 billion) and has put forward some proposals to support the space programme and executing the European energy policy.

The first evaluation of this 'New Deal' by the European Council is scheduled for June 2015. At that moment, there will be some first indications whether the evolution towards a more competitive and open defence and security market has been effective. We expect that some of the conclusions of the evaluation could lead to new European procurement legislation in the near future.

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