REVIEW OF THE EUROPEAN UNION'S REGULATION REGARDING DEFENCE PROCUREMENT

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***Abstract**: Although the EU legal framework applicable to defence procurements is – given its very nature – of particular importance, very little structured information is available about it. Defence procurements have special status within the European public procurements, given their potential impacts on the essential (national) security interests of the Member States. The European regulation sets forth a legal framework for Member States, and it is the Member States that are liable for meeting the basic intentions of this regulation. The European Commission (if necessary, together with the Court of Justice of the European Union) ensures the compliance of the national legislations with the EU law, just as well the proper application of the aforementioned rules. The present article summarises the European legal framework specifically applicable to defence procurements, examines the transposition of the relevant EU directive, and certain additional interesting aspects. Due to obvious constraints, the detailed analysis of the laws of each Member State with regard to defence procurement is not possible – even though this is a very important further aspect to the topic. Also, one should be conscious about the fact that in case of defence procurements there are even more factors to be considered, such as international law or the security of supply.*

Keywords: defence procurement, Europe's defence sector, EU regulation, Electronic Bulletin Board

1. Preface

The national security is the first element of a trinity – hand in hand with the public order and health – on which field the Member States of the European Union conserve their powers and are very vigilant not to delegate their competences in any area having a reasonable point of contact with the above mentioned elements of the trinity. The regulation of defence procurements is a representative example for retained powers, as in the European Union the most of the defence procurements are exempted from Internal Market rules. Instead, these are regulated by the Member States, as it is their competence to define and protect their own security interests. As a result, the rules governing the defence sector's procurements are divergent, and this has a negative impact on the competition as the lack of transparency may jeopardise the operation of the market participants. The European Union adopted several measures to facilitate the competition (and also the cooperation) within the defence sector of the Member States, and in particular to increase the market share of the small and medium-sized enterprises. The fragmentation also causes duplication of capabilities (e.g. the United States has 30 types of weapon systems and only 1 type of main battle tanks, while the EU has 178 weapon systems and 17 main battle tanks), which *per se* decreases the efficiency not just of the sector's procurements, but also of the suppliers. [1] The European decision-makers agree with this and believe that the competitiveness of the technological and industrial base within the defence sector would increase as a result of opening the internal market for defence products. [2]

The fact that defence procurements are exempted from public procurements is well known on a general level. The professional review and analysis of the detailed rules however are hard to be found. The aim of the authors is to give a deeper view into the legal framework of the European Union concerning defence procurements and examine whether the EU legislation is fit for its purpose: striking the fair balance between national security interests and free and fair competition throughout the internal market.

2. General legal background: TFEU

The core background of the topic is Article 346 (former number 296) of the Treaty on Functioning of the European Union (hereinafter referred to as 'Article 296'). This Article serves as basis for the application of national rules within the area of defence procurements. Article 296 sets out that the provisions of the Treaties shall not preclude the application of the following rules: [3]

- no Member State shall be obliged to supply information for disclosure if it considers that the disclosure is contrary to the essential interests of its security,
- any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; provided that such measures shall not adversely affect the conditions of competition in the internal market regarding products which are not intended for especially military purposes.

3. The interpretative communication adopted by the European Commission

The above cited rules are quite vague, thus the European Commission adopted an interpretative communication in 2006 on the application of Article 296 to clarify the legal framework (hereinafter referred to as the 'Interpretative Communication'), based on a consultation which resulted in the following conclusions: [4]

- there is uncertainty regarding the interpretation of Article 296, thus there are differences between the Member States regarding its application,
- the Public Procurement Directive is not suitable for many defence contracts, even if the conditions set out in Article 296 are met.

The Interpretative Communication lays down that a defence contract may rely on the exemption rule (that is Article 296) only if (i) the information that would be subject to disclosure is contrary to the essential interest of a Member State's security, (ii) the subject of the contract is explicitly stated in Paragraph 2 of Article 296 and (iii) the conditions laid down in the case law of the Court of Justice of the European Union (hereinafter referred to as the 'Court') are fulfilled. The Interpretative Communication highlights that only security interest can justify an exemption, other interests such as industrial and economic interest cannot. Furthermore, such security interest shall be essential, which also further reduces the possible application of Article 296, which even itself reduces its own scope when setting out that its application shall not adversely affect the competition in the internal market with regard to the products, which are not intended for expressly military purposes.

The importance of the Interpretative Communication derives from the fact that the European Commission has the competence to review whether the application of Article 296 was justified or not. The concerned Member State has to cooperate in good faith with the Commission during such investigation and if the Commission considers that a Member State uses Article 296 improperly, the Commission may bring the case before

the Court. In the course of such proceedings the burden of proof lies with the concerned Member State. Of course, absolute confidentiality is guaranteed during and following the procedure of the Commission and / or the Court.

4. Strategy for a more competitive European defence industry

The clarification of the legal background is not all what the European Commission has done. In order to make more competitive the European defence industry, it adopted a strategy on 5 December 2007: the Strategy for more competitive European defence industry (hereinafter referred to as the 'Strategy'). [5] The Commission identified three areas in which a better coordination would be necessary between the Member States. First of all, the Member States have to adapt their development and procurement programs. Second, the researches shall be coordinated at Union level. Third, the small and medium-sized enterprises positions shall be strengthened. The Commission proposed in the Strategy for the Member States to adopt two directives: one directive to facilitate intra-EU transfer of defence products by reducing administration, for example simplifying national licensing procedures, while the other directive would aim to enhance the openness and competitiveness of defence procurements.

5. Directive 2009/81/EC

Against the above background, the European Parliament and the Council adopted Directive 2009/81/EC on 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 (hereinafter referred to as the 'Directive'). [6] The Directive regulates the defence procedure in five Titles consisting of seventy-five Articles.

The Directive declares in its preamble that none of its provisions should prevent the imposition or application of any measures, which is necessary for a Member State to defend its interests approved by the Treaties. In order to provide a tool for this, Article 16 sets forth that the contracts regulated by the Directive may be exempted from the measures of the Directive, provided that such exemption is necessary for the protection of the essential security interests of a Member State. The Member States have the right to assess whether the measures of the Directive are proper to protect their essential security interests or not.

In addition, the Directive enumerates several cases when its provisions are not applicable, such as (i) in cases where special rules apply which derive from international agreements or arrangements between Member States and third countries, (ii) where rules relating to the stationing of troops apply, (iii) in case of agreements awarded by international organisations for their purposes or agreements which must be awarded by a Member State under the rules that are specific to such organisations, (iv) regarding procurements conducted by intelligence services and procurements for all type of security services, (v) with regard to sensitive purchases which require a remarkably high level of confidentiality, such as procurements for border protection, combating terrorism or organised crime and covert activities, (vi) when Member States conduct cooperative programmes to develop new defence equipment, (vii) for armed or security forces which conduct operations beyond the borders of the European Union concerning purchases where the contracted parties are located in the area of the operation, including civilian purchases directly connected to the conduct of the operation, (vii) in case of purchases of works and services between governments, (viii) regarding the acquisition or rental of immovable property or rights related to such property, (ix) for arbitration and conciliation services, (x) for financial services and (xi) co-financing of research and

development programmes. The Directive (based on the EU's fundamental values) also declares additional exemptions to facilitate the sheltered workshops and sheltered employment programs, as the integration or reintegration of people with disabilities in labour market is a key object of the European Union's Social Policy. The core values of the European Union appear as a basic idea in case of several measures, for example, the Directive sets out that a potential subcontractor should not be discriminated on grounds of nationality; performance conditions of the contract shall not be discriminatory; in case of verification of economic operators with respect to security information the verification should be carried out in accordance with the principles of non-discrimination, equal treatment and proportionality; and contracts should be awarded on the basis of objective criteria observing the principles of transparency, non-discrimination, equal treatment and proportionality. The Directive refers to principles related to internal market which are set forth in the Treaties, and also refers to general fundamental principles as well, which have been introduced into the Union law by the Court. [7]

The Directive contains provisions ensuring the compliance with transparency and competition obligations, e.g. it enables to challenge the award procedure – of course necessitating such 'review procedures' to take into account the protection of defence and security interests. Title IV of the Directive specifically sets out the scope and availability of such review procedures, and also the requirements, the applicable deadlines and the possible sanctions related to them.

The Directive can be seen as a relatively flexible instrument: it allows the conclusion of framework agreements as well, provided that they are concluded for a maximum period of seven years. The use of electronic purchasing techniques is also allowed, however only those subjects that can be expressed in figures or percentages may be the object of electronic auctions, and the principles of equal treatment, non-discrimination and transparency shall be respected. Finally, a flexibly approach is further strengthened by the fact that (for obvious reasons) the contracting authority is entitled to exclude an economic operator at any point of the procurement process if it has information that the concerned economic operator could cause a risk to the essential security interests of that Member State.

6. Transposition of the Directive

The transposition of the Directive is an obligation for the Member States, with an applicable deadline of 21 August 2011. Given that directives are flexible instruments, the Member States can ensure in the course of the transposition to have their national characteristics articulated – of course, provided that objectives of the directive are achieved. Thus, it is equally important that the Member States adopt measure that are capable of transposing the Directive completely and correctly, just as it is important to properly apply them. The European Commission observes the transposition and the proper application, and prepares a report on these matters to the European Parliament and the Council. According to the report of the European Commission on transposition of the Directive [8], only three Member States notified the European Commission until 21 August 2011 about the complete transposition and four Member States within did the same within further one month. The European Commission thus opened infringement procedures against as many as 23 Member States. The result of these procedures was in almost every case that the Member State concerned fulfilled its obligation - there were only four Member States not notifying the Commission by July 2012 about the transposition or partially disposition of the Directive. The European Commission established that those Member States who transposed the Directive as

of July 2012 have – *prima facie* – done this correctly, and that many Member States transposed the non-compulsory subcontracting provisions as well.
The European Commission summarized the national implementing measures regarding (i) the scope of the Directive, (ii) the exclusions from the application of the Directive, (iii) the provisions relating to subcontracting, and (iv) the review mechanism.
With regard to exclusions from the application of the Directive, the Commission concluded that the Member States transposed the Directive mostly correctly. However, the Commission established that in a number of cases the wording of the national implementing measures changed the material scope of the Directive. E.g. according to Article 13(a) the Directive does not apply to contracts where the application of the Directive would oblige a Member State to supply information the disclosure of which it considers contrary to the essential interests of its security. Now, a Member State, with reference to this Article, excluded all contracts where publication would lead to disclosure of classified information, while another Member State has not transposed this Article at all.
The findings of the Commission regarding the transposition of the review mechanism necessitates particular attention. The applied solutions of the Member States in the course of the disposition of these provisions can be divided into two parts. According to the report of the European Commission, cca. half of the Member States transposed the provisions on review mechanisms within their general rules on remedies, while the other half of the Member States transposed these by means of a specific national implementing measure.
If we take a closer look at the details of the review procedures, there are two important aspects that need to be observed. First, the Directive provides a possibility for the Member States to set up a specific body having as sole jurisdiction the review of contracts concerning defence and security in order to guarantee the confidentiality of classified information – interestingly enough, none of the Member States opted for this solution, and only a few Member States have adopted specific rules requiring security clearance from the members of the review body. Second, according to the wording of the Directive, the review body is not entitled to consider a contract ineffective if the consequences of the ineffectiveness would seriously endanger the essential security interest of a Member State. The Commission concluded that all but two Member Sates have included wording in their local laws making it possible to abstain from declaring a contract ineffective. The findings of the European Commission and the reports on the transpositions are not end in themselves, these findings help the Member States to improve the transposition of the Directives and to standardise the legal frameworks – even in an area which is as sensitive as the defence procurement - within the European Union.

7. Electronic Bulletin Board

The creation of the proper legal background as detailed above has of course great importance. However, the importance of certain practical solutions aiming at the integration of the European defence market shall not be underestimated either. A good example is the Electronic Bulletin Board, launched by the European Defence Agency on 1 July 2006 with the goal of providing opportunity for suppliers across Europe to bid for defence contracts in the European Union. [9] This webpage brings together the buyers and the suppliers, promoting the fair and equal opportunities for all participants. With the advertisement of the subcontract opportunities, the Electronic Bulletin Board fosters a more open, fair and competitive market throughout the supply chain.

8. Summary

In view of the above detailed legal framework, we can conclude that the decision makers do their best to achieve the establishment of a common defence market within the European Union. However, the legislator has a difficult task, given that any derogation from the Treaties affect the fundamental principles and the objectives of the Internal Market, thus the related regulation shall be clear and accurate, with full respect for the principle of necessity. With regard to the exclusions from the application of the Directive, we shall note that these exclusions (given their broad nature and the already mentioned "flexibility") have negative impact on the essentially necessary competition, which competition is useful for the consumers and – in our case this is even more important – fosters the innovation. [10]

Given that the above described method of regulation, that is the very nature of a directive, allows the Member States to choose how they accomplish the objectives set forth at supra-national level, the transposition of the Directive by each and every Member State is certainly a good topic for further research – this is something the authors are looking forward to become engaged in.

Such research would be important as specifically defining the applicable legal rules in case of defence procurement projects by the affected parties may cause difficulties, given that they have to take into account their domestic laws, the Union law, the international law and the even the procurement rules of the organisation or the entity which manages the program. According to some, the legislation regarding defence procurement shall leave less loopholes, facilitating the more certain definition of the applicable legislation. [11]

In conclusion, we can summarise that the ultimate aim of the existing EU legislation is to increase the competition and decrease the fragmentation in the defence market, and further to establish a European Defence Equipment Market and a European Defence Technological Industrial Base. Still, as the national security of the Member States is one of their essential interests, being the exclusive competence of the Member States for decades passed and (probably) for decades to come, we may feel free to assume that barrier-free regulation of the defence procurements, or even a less flexible approach within the frame of the intergovernmental cooperation is not to be expected.

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