



European Union: Defense Procurement Directive

Summary

EU Directive 2009/81/EC governs the procurement procedures for defense and non-military security supply, services and works contracts. The Directive aims to harmonize acquisition procedures throughout the EU: first by increasing competition and encouraging cross-border bidding among European bidders, so as to prevent systematic sole-source procurement or non-competitive procurement from national suppliers; second, by increasing transparency through the obligation to advertise defense contracts in the EU Official Journal. Various contract performance conditions make indirect offsets in defense contracts incompatible with EU Community law.

The Directive contains no “EU preference” clause, and leaves up to Member States the decision to invite non-EU bidders in competitions. Defense contracts covered by the Directive may become subject to investigation from EC authorities in cases of suspicion of violation of EU law, and may come under the jurisdiction of the European Court of Justice.

The Directive was reviewed in 2016 and the text was left unchanged. However, implementation gaps were identified and the Commission is now focusing its efforts on better enforcement. The majority of defense expenditure is still spent through national procurement without an open tender, while the share of collaborative equipment procurement remains around 22%. These two factors combined had led to an unnecessary duplication of capabilities, organizations and expenditures in Europe.

The Commission also published a long awaited guidance note on government to government procurement clarifying some of the relevant provisions of the Directive. The guidance note is available for download from this website: <http://ec.europa.eu/DocsRoom/documents/20358>

Goal of the Directive

Directive 2009/81/EC¹ is intended to open a substantial amount of defense procurement to EU-wide competition. In the past, most defense procurement was exempt from the rules of the common market because Member States invoked national security interests to procure from their preferred, usually national, suppliers. The European Commission has established that Member States abuse the national security exemption under the Article 346 of the EU Treaty (formerly Article 296) to protect their local industry, which contributes to inefficiency, duplication and fragmentation of the EU defense industrial base. Key features of the Directive are: the obligation to advertise contracts; to have a minimum of three bidders; contract awards on the basis of best value; specific provisions on Security of Supply (SOS) and Security of Information (SOI).

¹ Title of the EU Directive: “Coordination of Procedures for the Award of Certain Works, Supply and Service Contracts Awarded by Contracting Authorities in the Fields of Defense and Security”

It is important for U.S. firms to fully understand the implications of this EU Directive with regard to the rights and obligations of procurement authorities in the EU. Companies should also be cognizant of the effects of the EU Directive on their negotiations to ensure the compatibility of their bids with EU law. U.S. procurement professionals and their advisers will need to be properly briefed on their compliance obligations under the EU Directive when they sell equipment or services to European armed forces.

Coverage

The scope of the Directive is based on the List of Arms, Munitions and War Material adopted by Council decision in 1958 to which the provisions of Article 346 of the EU Treaty apply. The List is to be interpreted in a broad way in the light of evolving technologies leading to new equipment. This list includes among others: aircraft, warships, missiles, tanks, chemical agents, explosives, ammunition, electronics and fire control equipment. The 1958 list is very generic and differs from the official "EU Common Military List" (EUML) that is used for export control purposes. The 1958 List was re-published in 2008².

Thresholds

The Directive applies to supply and service contracts worth at least €414,000 and to works contracts above €5,186,000.

Besides the usual restricted procedure, the Directive allows for the use of the "competitive dialogue" in specific circumstances and the negotiated procedure.

- The "negotiated procedure with publication" is the standard contracting procedure for the conduct of negotiations on covered contracts. Under this procedure, the contracting authorities consult the companies of their choice and negotiate with them the terms of the contract. The minimum number of companies invited to bid may not be less than three.

- The "negotiated procedure without publication" is only allowed in specific cases, including: 1) certain R&D services/supply contracts; 2) in cases of urgency, crisis or armed conflict; 3) for products manufactured only for research or experiment; 4) for additional deliveries by an original supplier; 5) for government-to-government contracts; and 6) for reasons connected with the protection of exclusive rights.

Exclusions

The Directive **does not apply** to certain contracts: those pursuant to international rules (such as NATO procurement agencies), arrangements relating to the stationing of troops (including both EU troops in an EU Member State (MS) or EU troops stationed outside the EU territory, but also third-country troops in an EU MS).

Also excluded are:

- **Very sensitive contracts:** intelligence services, counter-intelligence activities, border protection or anti-organized crime, encryption, covert activities by police and security forces;

² Link to the List republished in 2008: <http://register.consilium.europa.eu/pdf/en/08/st14/st14538-re04.en08.pdf>.

- Cooperative programs under NATO, OCCAR, or the European Defense Agency (EDA)³;
 - **International agreements** or arrangements between Member States and third countries: the exclusion covers “international treaties and memorandums of understanding concluded at the level of ministries concerned”, provided that “the arrangement contains specific procedural rules governing the award of the contract in question.” (See EC Guidance Note on Exclusions for further details⁴).
- In 2013, the EC began reviewing of the use of the exclusions provided for under the EU Directive in articles 12 (contracts awarded pursuant to international rules) and article 13 (specific exclusions). Article 13 foresees the exclusion of government-to-government contracts, among others.
- **Cooperative programs**⁵ between MODs based on R&D, but only to the extent that the aim is to develop “new” equipment. The exclusion does not cover off-the-shelf equipment “even if technical adaptations are made to customize the equipment.”

Important EC Guidance Notes on the Directive’s Hot Topics

In November 2010, the EC published important “guidelines” on seven hot topics related to the Directive: the Directive’s field of application; exclusions; research and development; Security of Supply; Security of Information; rules on subcontracting and offsets. The Notes, although not legally binding on EU Member States, present the European Commission’s views on how certain controversial or key aspects should be considered under EU law

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

No European Preference but Reciprocity

The EU Directive does not change the current situation regarding the participation of American firms in defense contracts with European ministries of defense, whether or not they are covered by the EU Directive. No “Buy-European” preferences are included in the EU Directive, and it will be up to each Member State to decide whether to include American suppliers in competitions, and it may depend on their international obligations deriving from Reciprocal Defense Procurement Memorandums of Understanding (“RDPMOUs”⁶) signed with the U.S. government. The U.S. government has signed RDPMOUs with 16 EU Member States. Under these agreements, the restrictions under the Buy-American Act are lifted for the benefit of companies from the beneficiary country, allowing them to participate in U.S. federal defense contracts. The MoU guarantees treatment no less favorable than that accorded to domestic enterprises. The beneficiary European country is to reciprocate by providing the same treatment to U.S. industrial enterprises. However, some EU Member States have introduced “Buy European” language in their national transposition of the EU Directive.

³ See Recital 28 of EU Directive 2009/81 or Guidance Notes on Exclusion

⁴ http://ec.europa.eu/internal_market/publicprocurement/docs/defence/guide-exclusions_en.pdf

⁵ The fairly vague definition of “cooperative programs” in the EU Directive is causing unease among defense contractors and competing suppliers in light of the Franco-British Treaty on defense and security cooperation.

⁶ The US signed Reciprocal Defense Procurement Memorandums of Understanding with: the U.K., Germany, France, Sweden, Italy, Spain, Portugal, Belgium, The Netherlands, Luxembourg, Greece, Poland, the Czech Republic and Denmark (and other non-EU countries such as Norway, Switzerland, Turkey, Australia, Canada, Egypt and Israel).. The agreements signed with Austria and Finland have a Purchase-by-Purchase exception. For more on the U.S. MoUs: http://www.acq.osd.mil/dpap/cpic/ic/reciprocal_procurement_memoranda_of_understanding.html

Most European Member States having a strong defense industrial base have signed a MoU with the U.S. government. However, about half of the 28 EU Member States do not enjoy a similar reciprocal arrangement. It will be their sovereign decision whether or not to allow U.S. suppliers in their contests - as is the case today.

U.S. firms are reminded that EU directives and regulations address the market access rights of companies established on EU territory only. Therefore, access rights or eligibility of foreign companies who bid on the EU market can only be addressed at two levels: either bilaterally, through RDPMoUs such as those signed by the U.S. government; or multilaterally, through the WTO Government Procurement Agreement (GPA), which guarantees participating members (such as the U.S. and the EU) the general principles of transparency, competition and equal treatment. However, contracts relating to arms, munitions and war material are specifically excluded from the scope of the GPA, although non sensitive security contracts are in principle covered. Therefore, the EU Directive is purposely neutral with regard to the decision by Member States to open up their competition beyond the borders of the EU.

Security of Information

The Directive includes specific provisions on security of information, which guarantee that procurement negotiations are conducted with appropriate treatment of classified information by all parties, including subcontractors. Currently, there is no EU-wide harmonization of national security clearance systems. Therefore, EU Member States are free to recognize the security clearances which they consider equivalent to those issued in accordance with their national law.

Security of Supply (SOS)

The EC Directive implicitly recognizes that SOS provisions are linked to certain strategic and political connotations since they may be used to ensure that national security interests are preserved in strategic sectors which require dependence on national suppliers only. Therefore, SOS provisions are very general, and require "certification or documentation" demonstrating that security of supply requirements can be met by a bidder based on the location and organization of his supply chain, his capacity to meet additional needs and maintenance, the capacity of his national authorities to support the fulfillment of additional needs and the indication of security or export control restrictions attached to the supplies. The provisions on security of supply are non-exhaustive and purposely vague, therefore allowing governments to take procurement decisions based on broader strategic security of supply concerns.

EU Advantage: The provisions on SOS may be interpreted in a way so as to give European bidders a comparative advantage in certain procurements if they hold an Intra-EU Transfers License (see separate market research report on the Intra-EU Transfers Directive). This pan-European Transfers License allows moving non-sensitive defense equipment (spare parts and components) between EU Member States multiple times without time delay and without the need of a renewed license for each transfer. In contrast, in order to comply with U.S. law, U.S. bidders are required to obtain an export license for each intra-EU transfer of military equipment covered under ITAR, when a certain percentage of U.S. content is reached (according to the "De Minimis" rule). However, license exceptions have been approved for a number of military items formerly covered under ITAR but which today are part of the Commerce Control List (CCL) since the U.S. Export Control reform was approved in 2013⁷. The Intra-EU Transfer Licenses are of

⁷STA or "Strategic Export Authorization": according to BIS – the U.S. Bureau of Industry and Security-, the STA streamlines exports to and among 36 countries (of which 25 EU Member States) by removing license requirements for items currently on the CCL. In the case of items transferred from the USML, the items must be for ultimate end use by the governments of those 36 countries.

particular benefit for large European industrial entities with production lines established in various Member States and need to regularly transfer equipment between them.

Indirect and Non-Military Offsets Are Incompatible with EU Law

In its Guidance Notes on Offsets, the European Commission states that offsets and other industrial compensation schemes are discriminatory and therefore incompatible with EU law: "Since they violate basic rules and principles of primary EU law, the Directive cannot allow, tolerate or regulate them [offsets]. ...Any legislation and/or policy which makes offsets requirements mandatory for all or certain defence and/or security procurement contracts constitute an infringement of the Treaty."

However, the Directive does not include an explicit article that bans offset practices. Instead, references to performance conditions and award criteria allowed in contracts as well as extensive clauses on sub-contracting present alternative, innovative solutions to prevent contracting authorities from *imposing* a local supplier on foreign suppliers or from requiring other percentage-linked local investments. The Directive states that "in any case, no performance conditions may pertain to requirements other than those relating to the performance of the contract itself." This clause as well as Articles 20 and 47 will make indirect offsets (i.e. those not linked to the object of the contract) illegal, as well as all other non-military offsets⁸.

Innovative Provisions on Subcontracting: Competition via the Supply Chain

The EC believes that its provisions on subcontracting offers an alternative solution through increased bidding opportunities provided to sub-tier suppliers established in countries other than that of the procuring MOD. The provisions on subcontracting present three options with different choices for the calculation of the portion of the contract that is destined for subcontracting and the competitive procedures in order to choose subcontractors. Bidders *cannot be required* to discriminate against certain subcontractors on grounds of nationality. It is up to the bidder to specify which part of his offer he intends to subcontract. Also, a Recital obliges the contracting authority to indicate all contract performance conditions within the contract documents, so as to avoid separate offset contracts. According to the European Commission, those provisions on subcontracting are drafted in such a way that contracting authorities will find it quite hard to legally require offsets in the way authorities have been used to in past years.

Research and Development

The "negotiated procedure *without* publication" is to be used for R&D contracts up to the technical demonstration stage. Contracts for the actual production phase that derive from the research will have to be re-tendered competitively. This process cuts any automatic contractual link between the developer of the research and the commercialization of the product of research. The EC specifically introduced these provisions in the Directive in order to encourage EU MODs to consider cheaper, off-the-shelf options already put on the market in other EU Member states in the hope of triggering a real cost-effective policy.

Defense standards

Annex II of the Directive includes "international standards organizations" in the list of definitions pertaining to defense standards that are not restricted to a local or regional source. In the provisions of the Directive, standards may be determined in terms of performance or functional

⁸ See our separate report on "The EU Policy on Offsets in Defense Contracts", April 2011, available upon request on our website).

requirements. The provisions on technical specifications were substantially improved during the negotiations in order to allow "technical requirements to be met by the Member State under international standardization agreements in order to guarantee the interoperability required by these agreements." The order of preference for standards is defined as: first national, second European and finally international rank, will have to be considered in light of interoperability requirements and international standardization agreements. The Directive also states that "technical specifications cannot have the effect of creating unjustified obstacles to the opening up of procurement to competition."

The European Handbook for Defense Procurement (EHDP) was developed in a CEN workshop, supported by the European Commission, and led to the creation of a database. At the end of 2011, it was decided that the European Defense Agency (EDA) would be responsible for future updating of the Handbook – with CEN and CENELEC (the European Standards organizations) staying involved in the process. The new website, managed by the European Defense Agency, provides a link to the European Defense Standards Reference System (EDSTAR) which contains references to "Best practice" standards and "standard-like" specifications. The "Best practice" standards are those which have been selected by consensus by industry and governmental organizations to be the best applicable for defense purposes.

For more information see <http://www.eda.europa.eu/EDSTAR/home.aspx>

Review Procedures

Provisions on remedies provide that aggrieved bidders may request to stop an award procedure: a standstill period of 10 calendar days is introduced between the announcement of contract award and the contract signature to that effect. Sound reasons must be given. Under the Corrective Mechanism clause, the EC may enter into discussion with a contracting authority *prior to a contract being concluded* if it considers that a serious infringement of Community law has been committed. Each Member State will be responsible for setting its own review procedures with national courts. Review procedures, however, have to take into account the protection of defense and security interests in the assessment of the infringement. Overriding reasons relating to national security interests⁹ may be considered before cancelling a contract award under exceptional circumstances.

Obligation to Advertise Contracts in the EU Official Journal

In this regard, the provisions on the ineffectiveness of contracts are important, as they outline that a contract will be considered ineffective if a review body finds that a contract notice has not been published in the EU Official Journal in accordance with the Directive. The non-publication of certain defense contracts may be used by the European Commission to control the cases where Article 346 TFEU may be invoked, thereby ultimately entrusting the European Court with the role of ultimate assessor of what may constitute the "essential national security interests" of a Member State.

Defense contracts will be advertised in the EU Tenders Electronic Daily (the "TED" database) of the EU Official Journal: <http://ted.europa.eu/>.

European Court of Justice Jurisdiction

The contracts covered by EU Directive 2009/81 fall under the jurisdiction of the European Court

⁹ "The review body may not consider a contract ineffective, even though it was awarded illegally [e.g. contrary to the provision on ineffectiveness] if the body finds that overriding reasons relating to a general interest, first and foremost in connection with defense and or security interests, require that the effects of the contract should be maintained."

- "A contract may not be considered ineffective if the consequences of this ineffectiveness would seriously endanger the very existence of a wider defense or security program that is essential for Member States' security interests."

of Justice. The EC has the power to initiate an infringement procedure against a Member State based on its own suspicion that the Directive has been violated. Acting as guardian of the EU Treaty, the EC will also be in a position to investigate whether the justifications put forward for the use of Article 346 TFEU (formerly Article 296) meet the criteria outlined in its 2006 "Interpretative Communication on the Application of Article 296 in the Field of Defense Procurement." Contracting authorities who have recourse to the Article 346 TFEU exemption may be confronted with the possibility of legal pursuit either by the European Commission at the European Court of Justice, or by a bidder who feels discriminated against. Member States can be condemned by the European Court of Justice for violation of the Directive or the EU Treaty, and asked to remedy the situation. A repeated violation may lead to financial or disciplinary sanctions. Judgments of the European Court of Justice supersede all national court decisions.

In addition to a procedure in national courts, a company headquartered in the United States, which bids on a contract covered under the Directive, may file an official complaint to the European Commission if it finds itself the subject of discrimination during the procurement process, even if it does not have an office established in the EU. U.S. firms encountering procurement problems are encouraged to contact the U.S. Commercial Service at the U.S. Mission to the EU in Brussels for additional guidance on how to proceed.

Website references

EC Directorate-General for Internal Market and Services covers public procurement: EU Directive 2009/81/EC, the Interpretative Communication on the Use of Article 296 (=346 TFEU) of the EU Treaty" and the EC Guidance Notes:

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

The European Defense Action Plan

http://europa.eu/rapid/press-release_IP-16-4088_en.htm

The EDA Procurement Gateway portal

<http://www.eda.europa.eu/procurement-gateway>

The Reciprocal Defense Procurement Memorandums of Understanding signed by the Department of Defense:

http://www.acq.osd.mil/dpap/cpic/ic/reciprocal_procurement_memoranda_of_understanding.html

For More Information:

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