



Defence procurement: the emergence of a single market

On 14 January 2009, the European Parliament approved a directive on defence procurement seeking to create a single market for defence and security equipment and services across national borders in Europe. This briefing outlines the new directive's implications for affected businesses.

On 14 January 2009, the European Parliament approved a directive on defence procurement (the Defence Directive) seeking to create a single market for defence and security equipment and services across national borders in Europe. It was originally proposed by the European Commission in December 2007 and the challenge has been to put in place a legal framework that will encourage intra-Community trade in this sector but that the member states can apply without compromising their national security interests.

By way of background, defence and security contracts currently fall within the scope of the general procurement directive 2004/18/EC1 (the 2004 directive). However, there are a number of EC Treaty exemptions, which allow member states to bypass the 2004 directive when it is necessary to protect national security interests. It was always intended that the use of these exemptions would occur in only strictly defined circumstances. Even so, there is a concern that member states routinely invoke exemptions such as article 296 of the EC Treaty (public defence contracts) or article 14 (public security contracts) and that the 2004 directive is rarely applied in the defence context, so that defence and security procurement procedures differ significantly from one member state to another. The aim of the new Defence Directive is to correct this.

To put the Defence Directive into its economic context, this market is estimated to be worth over €90bn, although 90 per cent of the production of EU defence equipment is concentrated in six member states: France, the UK, Germany, Italy, Spain and Sweden. Of those six

member states, the UK is said to have the largest defence industry in Europe.

Once the Defence Directive has come into effect, member states will have two years to implement it into national law.

The Directive's scope

The Defence Directive covers public contracts concluded between EU operators. It will not apply to contracts governed by specific procedural rules under an international agreement or arrangement concluded between one or more member states and one or more third countries.

An example of this is where member states have agreed to conduct co-operative programmes to develop new defence equipment together. Some of these co-operative arrangements are managed by international organisations such as the Organisation Conjointe de Coopération en matière d'Armement (OCCAR) and Nato, which then award contracts on behalf of member states. The Defence Directive does not apply to such contracts.

The definition of 'military equipment'

Broadly, this will be interpreted by reference to the list of arms, munitions and/or war material agreed by member states in 1958 (the Common Military List of the EU). However, the list should be 'interpreted in a broad way in the light of the evolving character of technology'. It also includes products that, although initially designed

for civilian use, were later adapted to military purposes as arms, munitions or war material.

Procurement procedures

Member states will be able to use the negotiated procedure with prior publication of a contract notice without the need for specific justification, which should provide the requisite flexibility for sensitive defence and security contracts. The restricted procedure and competitive dialogue may also be used. There is also the possibility of the negotiated procedure without publication of a contract notice either in circumstances of urgency or if the contract may be awarded only to a particular tenderer to protect exclusive rights.

Security safeguards

These include:

- the continuing protection offered by article 296(1)(a) of the EC Treaty, under which member states can exempt contracts if the application of the Defence Directive would oblige them to disclose information that they consider contrary to their essential security interests. These include procurements by the intelligence services and other particularly sensitive purchases that require an extremely high level of confidentiality; and
- to ensure security of information, contracting authorities/entities may require commitments from both prime and sub-contractors to protect classified information and sufficient information on their capacity to do so. In the absence of a Community regime on security of information, it will be for the contracting authorities/entities or the member states to define these requirements in line with national laws and to determine whether security clearances issued in accordance with the national law of another member state are sufficient.

Challenges to award procedures

In line with all other public procurements, contract awards under the Defence Directive must be subject to an effective and timely system of review when dissatisfied bidders seek to challenge those awards. However, review bodies may take into account the protection of

defence and security interests in decisions on penalties for infringements of transparency and competition obligations. In particular, the review body may allow a contract to proceed, even though it has been awarded illegally, if it finds that there are overriding reasons to do so in the exceptional circumstances of a particular case. These overriding reasons should be primarily related to the general interests of the defence and security of the member state in question. An example cited in the Defence Directive is where the ineffectiveness of a contract would seriously endanger not only the specific project that is the subject of the contract, but the existence of a wider defence or security programme of which the project is a part.

Research and development

The Defence Directive acknowledges the importance of stimulating research and development (R&D) by emphasising the need for flexibility in the award of contracts for research supplies and services. However, combined research and production contracts cannot be awarded without a competitive stage.

As a result, concern has been expressed about the potential damage that the Defence Directive may inflict on R&D investment. It has been suggested that companies will no longer invest in expensive R&D if there is no guarantee that they will get a return on their investment because production contracts will be open to tender. At the same time governments could cut back investment if the resultant production for their armed forces could be conducted elsewhere.

For further information please contact
Sally Roe
T +44 20 7832 7277
E sally.roe@freshfields.com

Nick Bliss
T +44 20 7832 7170
E nicholas.bliss@freshfields.com

Freshfields Bruckhaus Deringer LLP is a limited liability partnership registered in England and Wales with registered number OC334789. It is regulated by the Solicitors Regulation Authority. For regulatory information please refer to www.freshfields.com/support/legalnotice. Any reference to a partner means a member, or a consultant or employee with equivalent standing and qualifications, of Freshfields Bruckhaus Deringer LLP or any of its affiliated firms or entities.