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PUBLIC PROCUREMENT IN THE DEFENCE SECTOR: THE EXEMPTIONS OF DIRECTIVE 2009/81/EC

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Abstract. 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 covers contracts awarded in the fields of defence and security for:[1]

(a) *the supply of* ***military equipment****, including any parts, components and/or subassemblies thereof* – it includes not only equipment specifically designed, but also specifically adapted for military purposes.[2] For example a civilian product that in new versions includes distinguishable military technical features.

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[1] See article 2 of Directive 2009/81/EC.

[2] See article 1(6) of Directive 2009/81/EC: "*'Military equipment' means equipment specifically designed or adapted for military purposes and intended for use as an arm, munitions or war material*".

(b) *the supply of **sensitive equipment**, including any parts, components and/or subassemblies thereof* – the Directive also covers equipment, works and services that: [3]

- Have a security purpose - procured for a **military or non-military security** use.
- Involve access to classified information - the classification results from the application of legislation, regulation or administrative provisions and is based on the interest of national (military or non-military) security.[4] This means that the contracting authority/entity cannot declare certain information as classified or protected if there are no regulations in place.

(c) *works, supplies and services directly related to the equipment referred to in points (a) and (b) for any and all elements of its life cycle – as long as there is a close connection between the works, services or supplies purchased and the military and the sensitive equipment, the purchase of tools and machines needed to produce or maintain it, additional equipment and repair services, the construction of test facilities to test it (as a non-exhaustive list of examples) during the whole life cycle of the military and the sensitive equipment, is covered by Directive 2009/81/EC.*

(d) *works and services for specifically military purposes or sensitive works and sensitive services – this paragraph refers to services*

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[3] See article 1(7) of Directive 2009/81/EC: "'*Sensitive equipment*', '*sensitive works*' and '*sensitive services*' means equipment, works and services for security purposes, involving, requiring and/or containing classified information". Article 1(8) adds that: "'*Classified information*' means any information or material, regardless of the form, nature or mode of transmission thereof, to which a certain level of security classification or protection has been attributed, and which, in the interests of national security and in accordance with the laws, regulations or administrative provisions in force in the Member State concerned, requires protection against any misappropriation, destruction, removal, disclosure, loss or access by any unauthorised individual, or any other type of compromise".

[4] Information protected due to privacy issues, economic interest, etc… is not included.

and works which have a specific military purpose (assigned by the contracting authority/entity at the beginning of the award procedure), but are not directly related to military equipment. An example is the transport of troops.

Contracts awarded by contracting authorities and entities not covered by Directive 2009/81/EC will in principle be subject to the 2014 Public Procurement Directives.[5] I.e. nominally the Directive covers all contracts regarding military equipment, works and services, as well as contracts of sensitive purchases which have a security purpose and involve classified information.[6]

In certain exceptional cases explained in Section 3 Excluded contracts of Directive 2009/81/EC, the application of this Directive is exempted (e.g. contracts awarded pursuant to international rules, as defined in article 12).

Before even considering the application of these exclusions, Member States, Contracting Authorities, Governments need to take into account some aspects:

- These exemptions cannot be used with the goal of avoiding the application of Directive 2009/81/EC (or any other Public Procurement Directive for that matter), as this would greatly hinder transparency and concurrency.[7]
- Under the case law of the CJEU, exemptions to EU public procurement rules must be interpreted strictly. In this case, the

[5] *Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC; Directive 2014/25/EU of the European Parliament and of the Council of 26 February 2014 on procurement by entities operating in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC* and the "novel" *Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014 on the award of concession contracts.*

[6] See *Directive 2009/81/EC on the award of contracts in the fields of defence and security. Guidance Note. Field of application. Directorate General Internal Market and Services.*

[7] See article 11 of Directive 2009/81/EC.

exemptions are exclusively limited to the cases included in article 12 and 13 of Directive 2009/81/EC. And their interpretation must be narrow. Moreover, a Contracting Authority/Entity wishing to rely on an exemption has the burden of the proof that, indeed, the procurement at hand falls within the limits of the provisions.[8]

- Once a Contracting Authority/Entity has correctly established that the procurement is excluded, it is recommendable to publish a voluntary ex ante notice.[9]

This paper will focus on the specific exclusions regulated in article 13, in particular in:

1. Contracts excluded due to the essential security interest of a Member State, based on the exemption provided by article 346 of the TFEU.[10]
2. Contracts awarded in the framework of a cooperative programme based on research and development, conducted jointly by at least two Member States for the development of a new product and, where applicable, the later phases of all or part of the life-cycle of this product.
3. Contracts awarded by a government to another government relating to: (i) the supply of military equipment or sensitive equipment, (ii) works and services directly linked to such equipment, or (iii) works and services specifically for military purposes, or sensitive works and sensitive services.
4. Research and development services other than those where the benefits accrue exclusively to the contracting authority/entity for

[8] Bear in mind that: "*EU law now provides, through Directive 2009/81/EC, a legal instrument that has been specifically created to meet the specific needs and requirements of defence and security procurement". Directive 2009/81/EC on the award of contracts in the fields of defence and security. Guidance Note. Field of application. Directorate General Internal Market and Services.* Page 2.

[9] See article 60(4) in relation to article 64 of Directive 2009/81/EC.

[10] Previously article 296 of the TEC.

its use in the conduct of its own affairs, on condition that the service provided is wholly remunerated by the contracting authority/entity.

The paper does not analyse the exemptions due to:

1. Specific procedural rules pursuant to an international agreement or arrangement concluded between one or more Member States and one or more third countries.
2. Specific procedural rules pursuant to a concluded international agreement or arrangement relating to the stationing of troops and concerning the undertakings of a Member State or a third country.[11]
3. Specific procedural rules of an international organisation purchasing for its purposes, or to contracts which must be awarded by a Member State in accordance with those rules.

These three previous exemptions are regulated in article 12 of Directive 2009/81/EC. This article was a transposition of article 15 of Directive 2004/18/EC – currently article 9 of Directive 2014/24/EU – and even thought it does not explicitly refer to defence, the application is mainly limited to this field, since the international arrangements, agreements and organisations mentioned usually belong to the defence domain. The fact that the article includes the term arrangements and not only agreements implies not only international treaties concluded at national parliaments´ level but also memoranda of understanding concluded at ministry level are covered, as long as the signatories are states and governments. The exemption does not apply with other legal persons, even public undertakings fully owned and/or controlled by the state.

[11] This provision is a relic from the Cold War. Since article 12(a) of Directive 2009/81/EC already covers all international agreements and arrangements between Member States and third countries, this (b) paragraph is useful when moving troops *between* Member States.

The contract must follow a specific award procedure regulated under international rules for the exclusion to apply. The term "*specific procedural rules*" is to be interpreted restrictively, meaning "*a set of distinct rules that specifically concern the award of contracts and provide a minimum of details setting out the principles and the different steps to be followed in awarding contracts*".[12]

Paper does not analyse either:

4. Contracts awarded in a third country, including for civil purchases, carried out when forces are deployed outside the territory of the Union where operational needs require them to be concluded with economic operators located in the area of operations.

Contrary to point 2 above, this exemption plays a role in crisis-management situations outside the EU borders and it is only allowed if "*operational requirements*" demand it, to "*award contracts* ***to economic operators located in the area of operations***". Moreover, only the deployed personnel of the contracting authorities can award these contracts for the exclusion to apply.

The exemption also includes certain civilian purchases needed in order to conduct the operations.[13]

5. Service contracts for the acquisition or rental, under whatever financial arrangements, of land, existing buildings or other immovable property, or concerning rights in respect thereof.
6. Arbitration and conciliation services.
7. Financial services, with the exception of insurance services.
8. Employment contracts.

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[12] See *Directive 2009/81/EC on the award of contracts in the fields of defence and security. Defence- and security-specific exclusions. Guidance Note for the Services Directorate General Internal Market and Services. Guidance Note Defence- and security-specific exclusions*. Page 2.

[13] See article 1(28) of Directive 2009/81/EC. Mostly purchases needed for logistical purposes.

Section 1 of this article will explain when and how to justify the exclusion of contracts due to the essential security interests of a Member State based on article 346 of the TFEU. Section 2 will clarify the exemption provided to contracts awarded in the framework of a cooperative programme based on research and development conducted jointly by at least two Member States. Section 3 will deal with all the intricacies of the Government to Government (G2G) contract award. Section 4 will analyse the exclusion of research and development services when the benefits do not exclusively accrue to the Contracting Authority and the service provided is not wholly remunerated by that Contracting Authority.

Lastly, in Section 5 some conclusions will be presented.

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1. Contracts excluded due to the essential security interest of a Member State. Article 13 (a) of Directive 2009/81/EC states that the Directive shall not apply to:

"contracts for which the application of the rules of this Directive would oblige a Member State to supply information the disclosure of which it considers contrary to the essential interests of its security."

Paragraph (b) adds to this list:

"contracts for the purposes of intelligence activities"

These exemptions are based on article 346(1) of the TFEU:

"(a) no Member State shall be obliged to supply information the disclosure of which it considers contrary to the essential interests of its security;

(b) 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; *such measures shall not adversely affect the conditions of competition in the internal market regarding products which are not intended for specifically military purposes."*

The mention which article 346(1)(b) does to "specifically military purposes" confirms that only the procurement of equipment which is designed, developed and produced for specifically military purposes can be exempted. Therefore, only procurement procedures referred to the military capabilities of highest importance of the Member State concerned are included under this exemption.[14] The scope of article 346(1)(b) is limited by the concept of "essential security interests", which is broad enough to take into account the evolving character of technology and procurement policies.[15]

Indirect non-military elements, even if they are related to a defence procurement contract but which do not serve a specific security interests, are not covered by the exemption of article 346(1)(b). Nevertheless, dual-use equipment for both military and non-military security purposes is covered under article 346(1)(a) of the TFEU, if applying EU rules would force a Member State to disclose information that would harm its essential security interests

To summarise, the exemption regulated in both article 13 (a) and (b) of Directive 2009/81/EC is based on the idea that in the field of defence and security, there are contracts so sensitive and requiring such a degree of confidentiality, that the application of the Directive

[14] Procurement for non-military security purposes is excluded from the field of application of article 346(1)(b) of TFEU. Article 15(3) of Directive 2014/24/EU, article 10(6a) of Directive 2014/23/EU and article 24(3) of Directive 2014/25/EU respectively, exclude these procurements if the Member State has determined that the essential interests concerned cannot be guaranteed by less intrusive measures.

[15] See Interpretative Communication on the application of Article 296 of the Treaty in the field of defence procurement. Brussels, 7.12.2006. COM(2006) 779 final. Page 5.

would make it impossible to guarantee such high standards.[16] A non-exhaustive example list would be procurement referred to counter-intelligence activities, to border protection, to combating terrorism and/or organised crime, etc.[17]

Member States can resort to these exemptions for the award of defence contracts, as long as the conditions laid down in the Treaty as interpreted by the Court of Justice are fulfilled. Nevertheless, it is important to consider different aspects:

- The measures taken by the Member States cannot adversely affect the conditions of competition in the internal market regarding products not intended for military purposes.
- Member States are the ones responsible to define and protect their security interests.
- According to the case law of the CJEU, any derogation from the rules intended to ensure the effectiveness of the rights conferred by the Treaty must be interpreted strictly. Therefore, these conditions have to be interpreted in a narrow way.
- Moreover, when the Commission investigates a defence procurement case, the Member State concerned will have the burden of proof that the application of the Directive would hamper its essential interest. Abstract explanations referring to the geographical and political situation are not sufficient.

[16] Please note that article 13 (b) refers to intelligence activities, *not to intelligence services or agencies*. The reason behind this is that not all purchases made by intelligence services are so sensitive that the EU Procurement rules cannot be applied.

[17] See recital 27 of Directive 2009/81/EC.

When deciding *on a case-by-case basis* if the procurement they wish to conduct is exempted from the Directive´s rules, Member States must ask themselves three questions:[18]

1) Which is the essential security interest concerned?
2) What is the link between the specific procurement decision and the security interest concerned?
3) Why is the non-application of the Directive necessary to protect the essential security interest concerned?

"It follows that the contract award procedures provided for in Directive 2009/81/EC should be considered as the standard procedures for defence and sensitive security procurement, and that recourse to Article 346 TFEU should be limited to clearly exceptional cases".[19]

2. Contracts awarded in the framework of a cooperative programme based on research and development, conducted jointly by at least two Member States for the development of a new product and, where applicable, the later phases of all or part of the life-cycle of this product. This exclusion intends to foster cooperative programmes to strengthen Europe's military capabilities and to establish a European Defence Technological and Industrial Base (EDTIB). Indeed recital 28 of the Defence Directive highlight the importance of these programmes that *"help to develop new technologies and bear the high research and development costs of complex weapon systems"*.

[18] See Interpretative Communication on the application of Article 296 of the Treaty in the field of defence procurement. Brussels, 7.12.2006. COM(2006) 779 final. Page 8.

[19] *Directive 2009/81/EC on the award of contracts in the fields of defence and security. Guidance Note. Field of application. Directorate General Internal Market and Services.* Page 2.

Only new products that include an R&D phase can be excluded under this exception.[20] If a Commercial-Off-The-Shelf (COTS) product needs technical adaptations is not under the scope of this exception.

Nevertheless, the exclusion includes later phases of all or part of the life-cycle of this product. Meaning that, as long as there is an R&D phase, the purchase of the developed products can be - unless the Contracting Entity decides to purchase in a separated procedure - exempted of the application of the Directive. Moreover, a Member State can join the programme after the end of the R&D and benefit from the purchase of the end products, as long as it officially becomes a full member of the agreement and notifies the Commission about it.

The framework must be conducted by at least two Member States, but participation is not *per se* limited to EU Members States. The Members States have to immediately inform the Commission on:

1) *the share of research and development expenditure relative to the overall cost of the programme* - to ascertaining that the programme is indeed an R&D program.

2) *the cost-sharing agreement as well as the intended share of purchases per Member State* - to assure that the Member States´

[20] Recital 13 of Directive 2009/81/EC explains what is to be understood as R&D:

"For the purposes of this Directive, ***research and development should cover fundamental research, applied research and experimental development****. Fundamental research consists in experimental or theoretical work undertaken mainly with a view to acquiring new knowledge regarding the underlying foundation of phenomena and observable facts, without any particular application or use in view. Applied research also consists of original work undertaken with a view to acquiring new knowledge. However, it is directed primarily towards a particular practical end or objective. Experimental development consists in work based on existing knowledge obtained from research and/or practical experience with a view to initiating the manufacture of new materials, products or devices, establishing new processes, systems and services or considerably improving those that already exist. Experimental development may include the realisation of technological demonstrators, i.e. devices demonstrating the performance of a new concept or a new technology in a relevant or representative environment. Research and development does not include the making and qualification of pre-production prototypes, tools and industrial engineering, industrial design or manufacture".*

See also article 1(27) of the aforementioned Directive.

participation is not just symbolic, and that it is proportional. When evaluating this, the Commission will take into account the differences between Member States' defence budgets and will check if the programme is based on a "genuinely cooperative concept".[21] This latter point is important because the participation must be *intense*, i.e. the States jointly implementing the cooperative programme cannot limit their action to just purchase the developed solution, but they have to actively engage in the management of and the decision-making and share proportionally the technical and financial risks and benefits.

3. Contracts awarded by a government to another government relating to: (i) the supply of military equipment or sensitive equipment, (ii) works and services directly linked to such equipment, or (iii) works and services specifically for military purposes, or sensitive works and sensitive services. Government to Government (G2G) procurement is the acquisition of services, supplies and works in the field of defence and security by one government to another government, who has previously purchased the equipment for the purpose of reselling it or had it in its own stocks. This is a way for Member States having a surplus to dispose of this equipment and for the other Member States to acquire military and/or sensitive equipment at affordable prices.[22]

[21] See *Directive 2009/81/EC on the award of contracts in the fields of defence and security. Defence- and security-specific exclusions. Guidance Note for the Services Directorate General Internal Market and Services. Guidance Note Defence- and security-specific exclusions*. Page 8.

[22] *Commission Notice. Guidance on the award of government-to-government contracts in the fields of defence and security (Article 13.f of Directive 2009/81/EC).* C(2016) 7727 final. Brussels, 30.11.2016.

Only contracts awarded by, or on behalf of a State, a regional or local government are under this exclusion. On the contrary, contracts concluded by other contracting authorities/entities are not included.

The advantages of this approach are several:

- Face the challenges of budget constraints.
- Restructure the armed forces in an economic and efficient way.
- Increase cooperation among Member States.
- Increase interoperability of the equipment used in the armed forces of different Member States.

However, G2G can have an important (negative) impact on the market, as it can exclude procurements, in which economic operator could participate, from the internal market. Consequently, Governments making use of this exemption must analyse all procurement options and justify that the chosen procurement strategy is the only - or the best option - prior to the contract award.

Governments – which have the option to limit the analysis to the internal market - must in particular assess whether:

1) Competition is absent or impracticable – a good example of this type of contract is the training of soldiers of one Member State by another Member State. It also would be the case of a market with a single operator due to technical reasons or exclusive rights. Whenever a Government identifies that there is no competition on the analysed market, they should make their decision known by either publishing a free text in the Official Journal of the European Union (OJEU) or a Voluntary Ex Ante Transparency (VEAT) notice.[23] It is also recommendable to publish the award of the G2G contract on their institutional website or different platforms.

[23] See https://simap.ted.europa.eu/documents/10184/99173/EN_F15.pdf for a template example.

2) There is potential competition in the market analysed – Contracting Authorities should examine the market further via pre-procurement advertising of their requirements. This can be done in the OJEU and in national journals, in the contracting authorities' own website or procurement portal, sending information to potential suppliers…

   In these notices, the Government intending to purchase from another Government needs to indicate the requirements and the available budget, as well as mention that they might award the contract to another Government, depending on the outcome of the market analysis.

   The information gathered in the discussions with potential suppliers -who will be equally treated – will be used to refine the procurement strategy and, if needed, to negotiate with the "*selling*" government.

All the steps of the assessment must be well documented in order to justify their decisions if needed.

4. Research and development services other than those where the benefits accrue exclusively to the contracting authority/entity for its use in the conduct of its own affairs, on condition that the service provided is wholly remunerated by the contracting authority/entity. R&D *service* contracts are excluded from the scope of the Directive due to the fact that they are a "*key way of strengthening the European Defence Technological and Industrial Base*" and thus, Contracting Authorities are not obliged to follow the award procedures of Directive 2009/81/EC, which allows them to

devise an award procedure that offers sufficient flexibility, while guarantying competition.[24]

Note that, contrary to what was discussed under point 2 (*Contracts awarded in the framework of a cooperative programme based on research and development, conducted jointly by at least two Member States for the development of a new product* as defined in article 13(c) of Directive 2009/81/EC), only research and development contracts are excluded from the scope of Directive in this case.

Indeed, the exclusion defined under article 13(j) is referred to the R&D phase – "*only up to the stage where the maturity of new technologies can be reasonably assessed and de-risked"* - but does not include the latter phases, as opening procurement up to competition is crucial for the competitiveness of Europe's defence industry and a truly European defence and security equipment market.

Nevertheless, Contracting Authorities do not have to organise a separate tender to purchase the developed solution, as long as the signed contract already includes an option to purchase the solutions and was awarded through a restricted procedure, a negotiated procedure or a competitive dialogue.[25] I.e. as long as they award a procedure following the provisions of Directive 2009/81/EC.

The term 'benefits' of the article includes Intellectual Property Rights (IPR) related to the findings and outcomes of the project, which are especially important during an R&D service contract. If the benefits of the R&D *service* contract accrue exclusively to the Contracting Authority, article 28(2)(a) of Directive 2009/81/EC, allows the use of the negotiated procedure without prior publication of a contract notice. In the case of supply contracts, this procedure is also allowed for "*products manufactured purely for the purpose of research and*

[24] Directive 2009/81/EC on the award of contracts in the fields of defence and security. Guidance Note. Research and development. Directorate General Internal Market and Services

[25] See recital 55 of Directive 2009/81/EC.

development, with the exception of quantity production to establish commercial viability or recover research and development costs".[26] Again, commercial deployment is clearly excluded.

5. Conclusions. Directive 2009/81/EC was promulged with the intention of fostering and opening up to competition the European defence equipment market, in order to strengthen the European Defence Technological and Industrial Base and develop the facilities, equipment… needed to implement the European Security and Defence Policy.

Coordination in the award of security and defence contracts is a must to achieve these goals. However, the procurement of supplies, services and works in the defence and security sectors is often of a sensitive nature. For this reason, the choice of procedures offered by the Directive is more limited than in the 2014 Public procurement Directives. Indeed, Contracting Authorities can choose among the restricted procedure, the negotiated procedure with publication of a contract notice, competitive dialogue (if the conditions of article 27 apply - mainly complex contracts in which the Contracting Authorities consider that use of the restricted procedure or the negotiated procedure with publication of a contract notice cannot be used) and the negotiated procedure without publication of a contract notice (if the conditions of article 28 apply). Article 25 of Directive 2009/81/EC regulating the procedures to be applied does not include the open procedure.[27]

The EU legislator notices that in certain exceptional cases, even this limitation in the choice of procedures is not sufficient to protect the

[26] See article 28(2)(b) of Directive 2009/81/EC.

[27] Nor does it include the Innovation Partnership, but this procedure was introduced in the 2014 Public Procurement Directives for the first time and the Defence Directive was published on 2009.

sensitive nature of the purchase of supplies, services and works in the defence and security sector. This is the reason why articles 11, 12 and 13 regulate contracts exempted from the scope of the Directive.

But the exceptions are to be interpreted in a very restrictive way. Therefore, only contracts so confidential or which have very high security of supply requirements that even all the safeguards introduced by Directive 2009/81/EC are not enough to guarantee the essential security interests of the Member State, are exempted. And even then "*the non-application of this Directive must be proportionate to the aims pursued and cause as little disturbance as possible to the free movement of goods and the freedom to provide services*".[28]

The EU Commission has realised the merely describing the exempted contracts was not enough to provide Contracting Authorities with the necessary legal certainty to resort to these exemptions in a justified manner. This is the reason why, since the publication of Directive 2009/81/EC it has issued guidelines on when and how to justify the exclusions regulated in article 12 and 13.

[28] See recital 17 of Directive 2009/81/EC.