



The 7th International Scientific Conference
**“DEFENSE RESOURCES MANAGEMENT
IN THE 21st CENTURY”**
Bra ov, November 15th 2012



**DEFENSE ACQUISITION MANAGEMENT WITHIN EU
DIRECTIVES FRAMEWORK**

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Abstract:

This paper summarizes briefly the European Unions regulations on acquisition, trying to outline the main aspects applying to defense area. It begins with the principles stipulated in the Treaty on the Functioning of the European Union – TFEU than, it introduces the regulatory framework in the field of procurement adopted by European Parliament and the European Council in order to achieve a European defense equipment market. It focuses on Directive 2009/81/EC that sets new rules for the acquisitions of armaments, ammunitions and war material and as well for the procurement of sensitive supplies, works and services for security purposes. The paper makes reference to exemptions based on article 346 TFEU as well as to offset and introduce the initiative of the European Defense Agency (EDA), the Code of Conduct on Offsets, that is a voluntary, non-legally binding, non-legally enforceable regime applicable to defense procurement contracts. The bottom line conclusion is that defense resources management sooner or later ends-up with the need of an acquisitions or modernizations program and at that point, there is always required to organize and run an acquisition procedure that must not only follow national legislative framework but also take into account the EU Directives and TFEU.

Key words: Defense, acquisition, European Union, Directives, procurement, offset.

1. Introduction

In order to better understand defense acquisition regulations one should take a first look at the origin of public procurement regulations within European Union. At the beginning was the Treaty of Rome 1957, now known as the Treaty on the Functioning of the European Union – TFEU, which even though does not include any explicit provisions relating to public procurement, establish however a number of fundamental principles, some of them being relevant in terms of public procurement, as follows:

- free movement of goods;
- prohibition against discrimination on grounds of nationality;
- freedom to provide services;
- freedom of establishment.

In addition to these principles stipulated in the Treaty, we have a set of so called general principles, emerged from the case law of the European Court of Justice (ECJ), which are often used to fill in gaps in the legislation and to provide solutions. The most important of them to the procurement area are the following:

- transparency;

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- equality of treatment;
- mutual recognition;
- proportionality.

Even if the Directives do not apply, these general principles still apply to the procurement and award of contracts by contracting entities.

2. EU Directives on procurement

To strengthen the Treaty principles in the field of public procurement and to provide the necessary guidance to member states, the European Parliament and the European Council have adopted two procurement Directives:

1. DIRECTIVE 2004/17/EC OF coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors;
2. DIRECTIVE 2004/18/EC on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts.

These two procurement Directives have been adjusted with another two Directives, which apply to complaints and review. These are so called “remedies” Directive 89/665/EC and the Directive 92/13/EC. Both of them have been significantly updated by another Directive 2007/66/EC, which was due to be implemented by the member states by 20 December 2009.

One should keep in mind that the Directives apply only to contracts of a value that exceed or meet certain thresholds. These thresholds have been set based on the assumed cross-border commerce and have taken into consideration the cost of applying a tender procedure which is supposed to be proportionate to the estimated value of the contract.

In addition there is a new Directive, which applies to the procurement of military supplies and related works and services - Directive 2009/81/EC. According to this directive, the gradual establishment of a European defense equipment market is essential for strengthening the European Defense Technological and Industrial Base and developing the military capabilities required to implement the European Security and Defense Policy.

It is important to note that before having the Defense and Security Directive, procurement of sensitive equipment and services was in principle covered by the other procurement directives. This means that procurement of non-sensitive and non-military equipment, works and services remained covered by the general public procurement Directive 2004/18/EC and that contracting authorities should be aware of the field of application of the Defense and Security Directive.

3. Defense and Security Directive 2009/81/EC

Defense acquisition constitutes a noticeable segment of public procurement in the EU. The aggregate defense expenditure of the 27 EU member states is approximately EUR 200 billion. This figure includes approximately EUR 90 billion for procurement in general (namely acquisitions, operation and maintenance) and roughly EUR 50 billion for the acquisition of new defense equipment in particular.

Despite the substantial resources allocated to defense procurement by EU member states, defense procurement contracts have for a number of years been subject to different national procurement regimes, with different procurement rules and procedures. These differences across national lines discouraged and in some cases even prevented cross-border competition. As a result, there has so far never been a genuine pan-European

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defense procurement market but rather 27 national markets fenced off with regulatory barriers to entry aimed at protecting national defense industries.

In order to achieve a European defense equipment market it is required to establish an appropriate legislative framework in the field of procurement. This involves the coordination of contracts awarding procedures to meet the obligations arising from the Treaty and the security requirements of Member States.

The Directive 2009/81/EC sets the rules for the acquisition of arms, munitions and war material (as well as related works and services) for defense purposes, but also for the procurement of sensitive supplies, works and services for security purposes. For the purposes of this Directive, military equipment is understood in particular as the product types included in the list of arms, munitions and war material adopted by the Council in its Decision 255/58 of 15 April 1958.

As with other procurement directives, in order for the Defense and Security Directive to apply, the value of the contracts must be above certain thresholds. The applicable thresholds are currently as follows:

- EUR 412 000 for supply and service contracts;
- EUR 5 150 000 for works contracts.

The purpose of Directive 2009/81/EC is to introduce at European level:

- transparent and fair rules that allows companies to access other defense markets within EU;
- increase flexibility for contracting authorities to negotiate contracts;
- the option for contracting authorities to require suppliers to ensure:
 - the protection of classified information;
 - security of supply.

It covers specific security and defense acquisition of:

- Military equipment, i.e. arms, munitions and war material included in the 1958 list (which defines the scope of Article 346 of the Treaty) plus related works and services,
- Sensitive security equipment works and services which involve access to classified information.

One of the most significant innovations of the Defense and Security Directive is that contracting authorities in the field of defense are free to choose the negotiated procedure with prior notice (together with the restricted procedure) as a standard procurement procedure. This provides greater flexibility to contracting authorities and more freedom to discuss available solutions with economic operators. It should be remembered that the European Legislator has chosen a similar approach for the Utilities Directive (open bid was the main recommended acquisition procedure). In addition, contracting authorities can use the competitive dialogue and the negotiated procedure without prior notice on specific grounds.

Another innovation of the Defense and Security Directive is represented by the specific provisions related to the security of information. Because of the sensitive subject matter of defense and security acquisition contracts, the handling of classified information is extremely important. The Directive 2009/81/EC includes provisions that try to tackle this issue. For instance, contracting authorities may require from economic operators the following:

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- A commitment that tenderer shall appropriately safeguard the confidentiality of all classified information in their possession or coming to their notice, in accordance with the relevant member state's provisions on security clearance;
- A commitment that tenderer shall obtain the commitment outlined above from all its feature sub-contractors during the execution of the contract;
- Information about the sub-contractors that allows the contracting authority to determine if they possess the capabilities to safeguard the confidentiality of the classified information.

The Directive 2009/81/EC has been transposed into Romanian legislative framework by the Governmental Emergency Ordinance no. 114/ 21.12.2011 which entered into force by the 1st October 2012.

4. The Directive 2009/81/EC's exemptions

As any other instrument of secondary EU law, Directive 2009/81/EC does not change but must abide by the Treaty (primary EU law). As a consequence, it should be applied as it is, subject to the exceptions established by the Treaty on the Functioning of the European Union. Such exemptions are established in articles 36, 51, 52 62 and 346 of Treaty on the Functioning of the European Union.

The most relevant exception for the area of defense is provided by article 346 TFEU where is stipulated that for the protection of essential security interests and for the avoidance of information disclosure, a Member State may award contracts without applying the Directive.

The definition of member state's essential security interests remains the sole responsibility of Member States. However, according to ECJ case-law, article 346 TFEU does not allow Member States to deviate from the provisions of the Treaty by simply making a reference to such interests. Derogations under Article 346 TFEU are limited to exceptional cases and European Court of Justice emphasized that the measures taken must not extend the limits of such cases.

Consequently, if any of the European Union member state has the intention of awarding a contract already covered by Directive 2009/81/EC, Directive 2004/17/EC or Directive 2004/18/EC, without following the procedure stipulated in those directives, it must ensure that the procedural measures chosen (e.g. the direct award of the contract to a certain manufacturer) is absolutely necessary to protect its essential security interest. Therefore, before using article 346 TFEU, an assessment must be performed in order to identify security interests at stake and to evaluate the need of such specific procedural measures that avoids the application of directives.

5. Offsets

Offsets represent specific practices used by contracting authorities in the field of defense procurement, targeting to safeguard the domestic industries, and are basically some kind of "investment return ". Somehow, this represents a payment given by a foreign defense contractor for the acquisition of defense equipment or related services.

Until nowadays European member states have imposed offset clauses to external suppliers. There is no unified rules and regulations applied by all the states, on the contrary, there is a considerable variation from state to state (e.g. the offset requirements ranges from 0% up to 200%).

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Sometimes, offset activities are directly related to the nature of the contract and thus they have a military nature (e.g. participation of local/domestic industry to the production of some parts of equipment that are procured). In other cases, offset activities are indirect but still pertaining to military area (e.g. domestic supplier are involved in the production of other military products, not-related to the main contract) or indirect and nonmilitary (supplier commitment to buy civilian goods from that country).

In Romania there is the Government Emergency Ordinance no. 189/2002 that establishes the principles, general framework as well as offset procedure in addition to the acquisition contracts for defense and public security area. According to this ordinance the offset requirements are mandatory for every defense or security contract that involves the import or intra-communitarian acquisition bigger then EUR 3 mil.

These offset requirements are considered restrictive measures that are contrary to the principles established by the Treaty because do not allow the free movement of goods and services and there is no equal treatment for all (foreign and domestic) economic operators. As they breach the basic rules and principles of primary EU law, offset activities are not allowed, tolerated or regulated by Directive 2009/81/EC.

Being restrictive practices that infringe EU primary law, offset practices could be justified only based on one of the Treaty derogations, particularly by Article 346 TFEU. Even so, such practices should not affect the competition' conditions regarding products that are not intended for military purposes.

In the offset area it was the European Defense Agency (EDA) that has taken the initiative by proposing a Code of Conduct on Offsets, having the same objective as Directive 2009/18/EC which is to facilitate companies' access to defense markets in other EU countries. This code is applicable to acquisition contracts based on article 346 TFEU – so not being covered by Directive 2009/18/EC and has a voluntary, non-legally binding, non-legally enforceable regime. It has been adopted on 1st of July 2009 by 26 countries (25 EDA participating States (all except Romania) plus Norway)

According to this code contracting authorities are free to select any acquisition procedure as long as they comply with transparency, equal treatment and non-discrimination principles.

The contracts under this regime must fulfill certain publicity requirements (e.g. stipulate offset requirements in contract notice) and when awarding criteria is the most economically advantageous offer, offset will be allocated a less significant weight. Offset shall not exceed the value of the contract.

6. Conclusion

Defense resources management sooner or later ends-up with the need of an acquisitions or modernizations program and at that point, there is always required to organize and run an acquisition procedure that must respect not only national legislative framework but also the European Directives that have been transposed more or less into national regulations.

Instead of regulating all of the public acquisition contracts, EU community has chosen to deal only with those contracts of a value that exceed or meet certain thresholds and that could affect the intra-community trade. The main reason beyond such an approach was the desire to establish a European Defense Market and to strengthen the European Defense Technological and Industrial Base.

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The Defense and Security Directive 2009/81/EC sets the rules for the acquisition of arms, munitions, war material and sensitive supplies for defense and security purposes. It makes it easier for EU members to follow common rules and drastically reduce the possible exemptions (more difficult to justify). Procurement of non-sensitive and non-military equipment, works and services remained covered by the general public procurement Directive 2004/18/EC.

The Code of Conduct on Offsets proposed by European Defense Agency has the same objective as Directive 2009/18/EC which is to facilitate companies' access to defense markets in other EU countries but is applicable to acquisition contracts based on article 346 TFEU (not covered by Directive 2009/18/EC) and has a voluntary, non-legally binding, non-legally enforceable regime.

References:

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