

Equipping the market

Catriona Hatton and **Elisabethann Wright**, Hogan & Hartson, report on how 22 EU Member States are committing to open competition in EU defence procurement...

On 1st July 2006, the European Defence Agency (EDA) officially launched the new European Defence Equipment Market (EDEM), designed to bring open competition to EU defence procurement.¹

Undergirding the new market and critical to its success are the following voluntary initiatives: Code of Conduct on Defence Procurement ('Code of Conduct')²; and Code of Best Practice in the Supply Chain ('Code of Best Practice')³.

Responding to a 19th May 2006 deadline, 22 of the EU's 25 Member States have now formally subscribed to these programmes.⁴ Hungary and Spain exercised their option not to subscribe, and Denmark previously opted out of the European Council's collective defence policy and does not participate in the EDA. The centrepiece of the Code of Conduct, the Electronic Bulletin Board (EBB), became operational on 30th June 2006, with Sweden, Germany, France, Finland, the United Kingdom and the Netherlands already posting calls for tender.⁵

EDEM is designed to open Europe's €30bn defence equipment market to substantial cross-border competition. The result could be increased opportunities for any company, whether or not owned in Europe, that has 'a technological and/or industrial base' in a subscribing EDA Member State.

The Code of Conduct, adopted by the Steering Board of the EDA on 21st November 2005, and now formally ratified by the subscribing Member States, is a non-binding guideline intended to foster open markets in the EU defence equipment sector. The defence equipment sector has traditionally been exempted from open market principles by Article 296 of the EC Treaty. Founded on a national security rationale, Article 296 permits Member countries to reserve defence contracts for domestic manufacturers where 'specifically military purposes' are implicated. The meaning of this term is often hotly debated by the EU institutions, the Member States, and contractors. The EC plans to issue an interpretive communication later this year, clarifying and narrowing the kinds of procurements that fall within the scope of Article 296. The Code of Conduct and Code of Best Practice are parallel developments, opening up another front in Europe's attempt to bring integration and cross-border efficiencies to its defence market.

The Code of Conduct and Code of Best Practice will apply to procurements where 'specifically military purposes' are squarely implicated. The Codes are thus designed to establish a voluntary norm of open market procurement in the military hardware sector. General EU defence procurement rules will not be impacted by the new voluntary regime, and most defence procurement within the EU will still be bound by the normal public procurement directives.

Code of Conduct

By adopting the Code of Conduct, the 22 participating countries have agreed to open their Article 296 defence procurements to bids from all suppliers 'having a technological and/or industrial base' within the territory of any subscribing Member State. These defence contracts should be open to non-EU, and EU companies alike, on a cross-border level playing field, provided that they have the requisite commercial presence within the territory of a subscribing Member State.

The centralised EBB, accessible via the internet, is intended as the key operational feature of the Code. Through it, subscribing Member States will advertise procurement opportunities. All procurement opportunities of €1m or more, falling within the scope of Article 296, will be subject to the Code, although certain categories will be exempted (eg. nuclear systems; chemical, bacteriological and radiological goods and services; and cryptographic equipment).

The Code of Conduct could provide significant new opportunities for defence equipment manufacturers in Europe positioned to compete effectively in an open market. A substantial redistribution of market share in Europe's €30bn defence equipment sector is therefore possible.

At this stage, it is not clear that contracts won through the EDA are required to be performed through the contractor's base of operations in Europe, or whether the work may be allocated to divisions or subcontractors outside the territory of the subscribing Member States. Under EU procurement provisions, the place of performance of the contract is normally a matter of negotiation between the competent authority and the successful tenderer. The competent authority could, in principle, impose an obligation on the successful contractor to perform the contract within EU territory. In regard to subcontracting, the new Code of Best Practice does impose a duty upon prime contractors to select from among bidders that themselves have a 'technological and/or industrial basis' in a subscribing Member State.

Code of Best Practice

The Code of Best Practice is a non-binding guideline intended to extend the benefits of competition down the supply chain to subcontractors. The Code augments the Code of Conduct, and is designed to be read and implemented as part of that instrument. However, the Code of Best Practice would impose duties beyond those that apply to the contracting agencies of the Member States. Under the Code, the open-bid practices that subscribing Member States have agreed to apply in awarding defence contracts will be imposed down the chain of supply. The Code of Best Practice thus aims to encourage a voluntary commitment by prime contractors to select subcontractors on a free and open basis among suppliers 'having a technological and/or industrial' basis in a subscribing Member State. Wherever it is 'efficient and practical', prime contractors, and other buyers in the supply chain, are required to evaluate their own suppliers, to ensure that fair opportunities and the benefits of increased competition are extended to all capable enterprises with the requisite territorial presence in Europe, including those not economically positioned to compete for prime contracts.

The responsibilities that the Code of Best Practice would impose upon prime contractors and other buyers within the chain of supply are quite limited. The Code provides that the process of evaluating and awarding subcontracting opportunities should be transparent. Subcontracting opportunities would be published either through the relevant administrative agency of a subscribing Member State, through the EBB, or through the contractor's own website. Buyers are asked to evaluate bids objectively and notify all bidders of the outcome on the same day. Likewise, buyers would, when requested and without breaching commercial confidentiality, provide losing bidders with a statement explaining the reasons for the decision. As is the case for the Code of Conduct, a monitoring system will be introduced to assess the operation of the Code of Best Practice. Monitoring will rely on information furnished by the prime contractor.


In general, the Code of Best Practice will be a voluntary undertaking by which buyers agree to subject their requisitions to open competition when it is 'efficient, practical, or technologically appropriate' to do so. The Code of Best Practice thus appears to affirm the discretionary business judgement of management, and the prime contractor remains wholly responsible for the selection of subcontractors. The Code expressly accommodates the possibility of strategically preferred suppliers within a contractor's line of business, and that such relationships should be honoured but 'test[ed] where appropriate'.

For component manufacturers in Europe serving the defence equipment sector, the Code of Best Practice is expected to have a market opening effect. Companies that are looking for cross-border opportunities may be able to benefit significantly. Note, however, that the rate of participation under the Code of Best Practice is difficult to predict. While the administrative agencies of subscribing Member States have


agreed to participate in the Code of Conduct, participation by private parties in the Code of Best Practice will likely depend on the efficiency with which the process unlocks demand and supply, enabling buyers to find sellers who can bring economies to their operations, without additional transactional costs. If the process frees buyers from restricted pools of sellers, then significant new opportunities for component makers could ensue. Presumably prime contractors will also conform to the Code of Best Practice to the extent that adherence positions them more favourably to win additional business through the EDA.

The Code of Conduct in conjunction with the Code of Best Practice constitutes EDEM's voluntary open market platform. While entailing no legal commitment, this voluntary regime signals an overriding commitment by the EU to open competition in defence procurement and is expected to significantly ameliorate the protectionist application of Article 296. The European Commission is contemplating the possibility of a binding Directive, imposing enforceable procurement guidelines, but those developments are procedurally more complex and will take time. While the voluntary regime provides a clear platform for adherence, EDA initiatives have generated domestic political opposition in the United Kingdom and in Poland. Ultimately participation will depend on EDEM's capacity to deliver efficient economic results that are politically acceptable.


- 1 See Press Release, European Defence Agency, Birth of European Defence Equipment Market with Launch of Code of Conduct (30th June 2006), <http://www.eda.europa.eu/news/2006-06-30-0.htm>.
- 2 The Code of Conduct on Defence Procurement of the EU Member States Participating in the European Defence Agency, European Defence Agency, 21st November 2005.
- 3 The Code of Best Practice in the Supply Chain, European Defence Agency, 27th April, 2005.
- 4 The subscribing EU Member States ratified key aspects of EDEM in May, agreeing to the July launch. See Press Release, European Defence Agency, 22 EU Member States to Take Part in New European Defence Equipment Market (22nd May 2006), <http://www.eda.europa.eu/news/2006-05-22-0.htm>.
- 5 See EDA Code of Conduct on Defence Procurement, Electronic Bulletin Board, <http://www.eda.europa.eu/ebbweb>.



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