New rules for intra-EU transfers of defence products

The EU is stepping up its involvement in the regulation of the defence sector with a 'Defence Package' that includes new rules governing the intra-Community transfer of defence technology. Falk Schöning examines the development.

30 June 2012 marks a new stage for European defence markets. As of this date, EU Member States are obliged to apply the new rules on intra-EU transfers of defence technology. Three years ago, Directive 2009/43/EC simplifying terms and conditions of transfers of defence-related products within the Community ('Intra-Community Transfer Directive' – OJ L 146/1 of 10 June 2009) entered into force. Now, the new provisions gain practical importance.

Background

Together with Directive 2009/81/EC on defence and security procurement ('Defence Procurement Directive' – OJ L 216/76 of 20 August 2009), the Intra-Community Transfer Directive forms the so-called 'Defence Package'. Both directives underline the increasingly important role the EU intends to play in the regulation of the defence sector. The Defence Package is designed to put an end to the fragmentation of the European defence market and apply the internal market rules to this *domaine reservé* of Member States, while taking on board the particularities of the sector.

Although there is still significant military spending by EU Member States, there is not yet an EU-wide strategy for a common procurement policy and Member States spend most of their equipment budget domestically. Moreover, complicated legal provisions and administrative proceedings regarding the intra-Community transfer of defence items have proven an obstacle for awards to contractors from other Member States.

The directives aim to facilitate the transfer of defence goods within the EU in order to allow more bidders from other Member States to participate in procurement procedures abroad. In principle, the same criteria for the licensing of intra-Community transfers of defence items will apply in all 27 EU Member States as of 30 June 2012. At the same time, the first public procurement procedures under the new rules will take place – public authorities have been obliged to apply the Defence Procurement Directive since last August.

The Defence Package is designed to put an end to the fragmentation of the European defence market.

Almost all Member States have by now fully implemented the respective national provisions, although the Commission has initiated proceedings against some, including Italy and Romania, for failure to take sufficient national measures regarding the Intra-Community Transfer Directive.

Intra-Community Transfer Directive

The Intra-Community Transfer Directive simplifies the current diversity of 27 different national licensing schemes in the EU for cross-border transfers of military equipment.

The directive deals neither with exports out of the EU to third countries nor does it withdraw the requirement of a prior authorization in principle. However, if an exporter established in one EU Member State obtained such an authorization he is authorized to supply to all the other Member States without restrictions (article 4 (1)).

In order to simplify the authorization process and to burden applicants (and authorities) less with licensing procedures, the Intra-Community Transfer Directive provides for a system of 'general' and 'global licences in place of individual transfer licences. Both types of licence have already been used by several Member States. Now the directive extends these instruments to the defence sector throughout the EU.

General licences

General transfer licences (article 5) are published by Member States and allow domestic companies complying with the conditions set out in the licence to transfer the defence item without individual prior authorization. For cases specified in the directive, Member States are even obliged to publish such general licences. This is the case for intra-Community transfers where the recipient is part of the armed forces; where the transfer is made for the purposes of demonstration, evaluation or exhibition; or where the good is transferred to the originating supplier for the purpose of maintenance and repair.

Importantly, there are also general licences in place if the recipient is an undertaking holding a certificate granted to those able to demonstrate their reliability (article 9 (2)). Such reliability shall be assessed according to the ability of an undertaking to comply with export control law, in particular by ensuring that senior management is committed to implementing an effective internal compliance programme and to providing authorities with all required information on the end use of the transferred product. These criteria are set out in more detail in a Commission recommendation of 11 January 2011 (OJ L 11/62 of 15 January 2011) which also contains a template for the certification process.

The European Commission will also set up a central register of certified defence undertakings which can be accessed on the EU's website. This will allow potential exporters to quickly check whether an intended transfer falls into the scope of a general licence. National agencies, such as the German Federal Office of Economics and Export Control ('BAFA'), also publish

lists of certified recipients with a registered seat of business in that Member State.

Global licences

Global transfer licences (article 6) are not published and applicable to all exporters. They are granted individually to undertakings and require an application. Global licences authorize the intra-Community transfer of a large number of products to one recipient or a certain category of recipients in one single administrative act. Thus, applications for global licences may more often replace individual authorization procedures which were the common standard.

A global licence shall be granted for a period of three years by the authority of the Member State in which the supplier is located or from where the supplier intends to ship the goods. They may be renewed after that period.

Defence Procurement Directive

In the Defence Package, the Intra-Community Transfer Directive is accompanied by another directive on defence procurement. This directive has applied since August 2011. As a general concept, the Defence Procurement Directive adapts the existing civil public procurement law of the EU to the specific needs of defence procurement. However, it enables greater flexibility for the award process where there are also several links between both directives, e.g. in the field of security of supply where the Europe-wide recognition of export licences is relevant. As a result of the new directive, Member States are expected to conduct more public procurement procedures instead of directly awarding contracts to a bidder.

In practice, the U.S. ITAR regulations will continue to play an important role for EU undertakings.

Scope and procedure

The Defence Procurement Directive covers all public works and service contracts for the supply of arms, munitions and war materials as well as those for the non-military security sector. The threshold for such contracts is EUR 400,000 for works and service contracts and EUR 5 million for construction contracts (according to a recent change by Commission Regulation (EU) No 1251/2011 of 30 November 2011).

Member States generally need to publicly tender contracts (including framework contracts) above this threshold in non-discriminatory proceedings which are open at least to EU/EEA nationals. Although the new provisions do not contain a European preference clause, Member States may nevertheless decide on an individual basis to exclude bidders from third-countries except where an inter-ministerial agreement between the EU Member State and the third-country exists; this is the case for agreements between many EU Member States and the United States.

The Defence Procurement Directive provides for three procedures for contracting authorities to choose from (article 25): the restricted procedure; the negotiated procedure with publication of a contract notice; and the competitive dialogue for very complex projects.

In practice, the negotiated procedure allows a sufficient amount of flexibility for the contracting authority. It includes a pre-qualification period which results in the short-listing of a minimum of three bidders. These bidders are invited to negotiate the contract over several bidding rounds. The winning bid is identified after the application of award criteria which are specified in detail and for which weightings must be given. The contract can only be signed after the lapse of a 'standstill period' allowing competing bidders to challenge the award decision.

Interaction with the Transfer Directive

The new licensing framework under the the Intra-Community Transfer Directive is also of relevance for the procurement procedure. The contracting authorities may lay down special conditions relating to the performance of the contract, amongst others, regarding its requirements of security of supply. The authorities may require that the bid contains a sufficient certification that the tenderer will be able to fulfil its obligations regarding the export, transfer and transit of goods to be procured (article 23). This provision is deemed to enhance the trust of contracting authorities in tenderers from other Member States and in their ability to deliver the product and services to other Member States. Since the Intra-Community Transfer Directive provides for a mutual recognition of transfer licences, tenderers from the EU should generally be able to demonstrate such a certification.

The ability of bidders to export the product to the destination required by the contracting authority is also reflected in the award criteria. If the award of the contract is not based solely on the lowest price, the authority will award the contract to the most economically advantageous tender (article 47). Amongst the various criteria which may apply in order to identify the

Scope and exceptions

Article 1 (2) of the Intra-Community Transfer Directive underlines the fact that the new provisions do not affect the discretion of Member States as regards policy on the export of defence-related products to countries outside the EU. Restrictions of exports to non-EU countries continue to apply.

Therefore, exporters need to consider both the national laws of EU Member States when it comes to exports to third countries as well as the export control legislation of such recipient countries. In practice, the U.S. ITAR regulations will continue to play an important role for EU undertakings.

Additionally, Member States reserve the right to protect the essential interests of their security which are connected with the production of, or trade in, arms according to article 346 of the Treaty on the Functioning of the European Union ('TFEU'), leaving a loophole for Member States to ignore any European legislation which they consider to interfere too strongly with their national security interests.

However, despite these exceptions, the Intra-Community Transfer Directive will facilitate the licensing application process for undertakings. Although the new rules do not entirely cut through the red tape, they make it easier for exporters to apply for licences as Member States have to mutually recognise such licences.

most advantageous tender is also security of supply. Thus, a proven ability of a bidder as regards export and intra-Community transfer licences may even help to win a contract.

Practical impact

Both the Intra-Community Transfer Directive and the Defence Procurement Directive have ambitious goals, but opening up closed European defence markets will not occur overnight. Although the new provisions on intra-Community transfers will apply in all Member States it remains to be seen whether the suppliers will in fact have the opportunity to make use of them. This would require a higher spending of Member States abroad – in times of the European currency crisis and of a decreasing military budget in most EU countries a rather unlikely scenario.

Moreover, the Defence Procurement Directive contains several exemptions from the general obligation to publicly tender contracts. Among others, government-to-government ('G2G') contracts, awards according to international organization rules, e.g. the OCCAR, or research & development projects remain outside the scope of the new Directive. Member States may also continue to invoke article 346 of the Treaty on the Functioning of the European Union ('TFEU'), in order to evade any European obligations.

The ease of the EU licensing requirements according to the Intra-Community Transfer Directive will be welcomed by many businesses throughout Europe.

Moving forward

As contracting authorities are used to awarding contracts directly to preferred suppliers it may take some time – and probably legal action under the review procedure (article 55 et seq.) – before the new provisions are applied as a matter of course. However, the Court of Justice of the European Union only recently narrowed the scope of application of article 346 TFEU in a reference for a preliminary ruling under article 267 TFEU (judgment of 7 June 2012, case C-615/10 – InsTiimi).

Nevertheless, the ease of the EU licensing requirements according to the Intra-Community Transfer Directive will be welcomed by many businesses throughout Europe. Once the same can be said for the effective implementation of the Defence Procurement Directive in practice, the interaction between both directives will be even more important since successful contractors may rely on an efficient Europe-wide recognition of transfer licences.

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