

Thousands of companies have benefited from attending BiP's tendering events – Now you have direct access to that tendering expertise.

The PASS Mark Health Check considers your company's current organisational structures, strategies, processes, practices and related strengths and weaknesses in relation to public sector procurement. It delivers a detailed PASS Mark Health Check Outcome Highlight Report (OHR) that outlines your areas of strength as well as those requiring further attention, and provides an outline Project Initiation Document (PID) designed to deliver your company a more effective and efficient tendering process that will help you achieve even greater tendering success.

After the PASS Mark Health Check is completed and your OHR is delivered, you are free to choose whether to progress with the recommendations it contains and implement the next stage with the support of the PASS team, or to implement the proposals yourself without making further use of PASS. The choice is entirely yours.

The PASS Mark Health Check reviews your:

- resources for identifying tendering opportunities
- knowledge of public sector tendering legislation
- tendering process controls
- practices for responding to "Expressions of Interest"
- weaknesses in any of your current mandatory policies (health and safety/environment/equal opportunities, etc)
- presentation of tender response documentation
- knowledge of your clients' processes and practices, including their evaluation techniques
- understanding of when and how to address government initiatives



The PASS Mark Health Check is a process-based evaluation technique that helps identify how your company can develop more effective processes when tendering for public sector contracts.

For further information on the PASS service, contact our Customer Services Team on +44 (0)141 332 8247, email [pass@bipsolutions.com](mailto:pass@bipsolutions.com) or visit [www.bipsolutions.com/pass/](http://www.bipsolutions.com/pass/)

## EU GREEN PAPER: DEFENCE PROCUREMENT



**T**he European Commission has launched a Green Paper as one of the measures announced in its Communication 'Towards a European Union defence equipment policy', adopted on 11 March 2003. Through these measures, the Commission intends to contribute to the gradual creation of a European defence equipment market (EDEM) which is more transparent and open between Member States and which, whilst respecting the sector's specific nature, would increase economic efficiency.

Moving towards a truly European market is crucial for strengthening the competitiveness of European industry, improving the allocation of defence resources and supporting the development of the Union's military capabilities under the European Security and Defence Policy (ESDP).

The establishment of the European Defence Agency, with its responsibilities in the field of defence capabilities, research, acquisition and armaments, makes the development of such a market even more important.

Creating an EDEM would require a set of complementary initiatives, including the establishment of an appropriate regulatory framework for the procurement of defence equipment. The opening-up of defence markets, which are currently fragmented along national lines, would increase the commercial opportunities for European companies in the sector, including SMEs, and contribute to their growth and increase their competitiveness.

The purpose of the Green Paper is to develop the debate on these issues, bearing in mind the principle of subsidiarity. For this purpose the Commission set up two working parties, consisting of representatives of the Member States and European industry, to contribute to the preparatory stages of the Paper.

In the first part, the Paper identifies the reasons for specific action by giving a summary of the current state of defence procurement markets, their numerous special characteristics and the existing regulatory framework. In the second part, on the basis of this analysis, it considers possible lines of action.

Defence expenditure constitutes a large part of Member States' public spending, to the order of €160 billion for the 25 Member States, one-fifth of which is used for the procurement of military equipment (acquisition plus research and development).

Defence procurement is currently characterised by the fragmentation of markets along purely national lines, by the specific features which distinguish it from other types of public procurement and by a complex legal framework.

### DEFENCE MARKETS

Although Member States' combined military expenditure is considerable, it remains split into national markets. This fragmentation poses a major problem for all Member States with defence industries. Following budgetary reductions and the restructuring of the armed forces, the size of national markets – including those of the large states – is no longer sufficient to allow for production volumes that can offset the high R&D costs of arms systems. This situation, along with the fragmentation of R&D spending in Europe, increases the cost to the taxpayer and damages both the competitiveness of the European defence industry and its ability to meet the requirements of the ESDP. Given the growing dual-use potential of technologies (military and civilian), the global competitiveness of European industry is also affected.

Some progress has been made in the last ten years, particularly as a result of the increase in European armaments cooperation and an initial opening-up of national markets to European competition. These initiatives have had modest success, but have not resulted in the creation of a European defence market. As regards cooperative programmes, the still-frequent use of the principle of fair return on investment ('juste retour') generally limits any opening-up to the participating countries and implies a distribution of work based on purely national industrial policy criteria. As for national procurement, the share of contracts awarded by competitive procedure is still low. Irrespective of the procedures used, national suppliers are still generally awarded most of the contracts.

## DEFENCE MARKET FEATURES

Defence markets have particular characteristics because of the very nature of military products and related services. These characteristics are not only economic and technological; they are also related to the security and defence policies of each Member State. Defence industries are therefore of a strategic nature and have special relations with the state.

Following privatisations and efforts to optimise procurement policies in recent years, the role of the state has been reduced, but it still remains dominant. As sole clients, states determine demand for products on the basis of military needs linked to their strategic objectives and thus define the size of the market. They participate (to varying degrees depending on the country) in the financing of R&D, thus influencing the technological know-how and long-term competitiveness of industry. As regulators, they control the arms trade by means of the licences which exporters must have, including for the delivery of equipment within the European Union, and the granting of authorisations to tender for contracts. State control also extends to industrial restructuring, although to a more limited degree, and even to the level of shareholding.

The nature of defence requires sources of supply to be guaranteed for the entire duration of an arms programme from the time the equipment is designed until it is withdrawn from service, at times of peace and at times of war. States may, therefore, see fit to set up special supply guarantees. The maintenance of a purely national industrial capacity for defence may seem a reliable way of being able to respond to strategic interests and emergency situations (military operations).

The nature of defence may also require states to have equipment that guarantees the technological superiority of their military forces. This superiority depends, in particular, on the confidentiality of programmes and their technical specifications. The obligation to protect this confidential information means companies must have special national security clearances.



## COMPLEXITY OF ARMS ACQUISITION PROGRAMMES

Arms development programmes are complex. Since production volumes are limited and the risk of commercial failure high, state support is required. Equipment often consists of new systems which incorporate both military and civilian technologies. It also has a long life cycle: the time between the expression of an operational need and the end of a system's life may be as long as 50 years. The quality-to-price ratio and risk management must be guaranteed throughout this period. States must, therefore, have access to adequate industrial and technological capacity throughout the life cycle of a system and maintain lasting, reliable relations with suppliers.

In addition to this, 'off-the-shelf' arms purchases are often subject to offset arrangements. This allows the purchasing country to require a return on investment that may exceed 100% of the value of the contract. Such offsets may be direct, in the form of orders for local companies or transfers of know-how and technology related to the original contract. Offsets may also be indirect and concern industrial sectors other than the one covered by the contract in question, even non-military ones.

## LIMITS TO THE EXISTING LEGAL FRAMEWORK

The special nature of the defence sector has been recognised ever since the establishment of the Community through an exemption system laid down in Article 296 EC of the Treaty.

According to paragraph 1 of that Article:

- (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 common market regarding products which are not intended for specifically military purposes.

Given its wide scope, this article may also apply to public procurement.

As recently clarified in Article 10 of Directive 2004/18/EC, Community rules on public procurement apply to contracts awarded by the awarding authority in the field of defence, subject to Article 296 EC of the Treaty. Consequently, Community rules also apply in principle to the defence sector, but Member States may derogate from them under the circumstances and subject to the conditions set out in the Treaty. In any event, the possibility of a derogation provided for under Article 296 EC cannot apply either to civilian goods or to those not intended for specific military purposes, even if they are purchased by national defence ministries.

For defence procurement, most national legislation provides for exemptions to the application of public procurement rules, with differing degrees of transparency.

Some Member States have undertaken, under an intergovernmental political agreement of the Western European Armaments Group (WEAG), to harmonise the content and publication of their national gazettes and to follow more open tendering rules.

The Member States recently created a European Defence Agency under the authority of the Council within the single institutional framework of the European Union, which will among other things have the remit to contribute, in consultation with the Commission, to the setting-up of a competitive European defence market.

## DEFINING ACTION AT EU LEVEL

The Commission now proposes pursuing the debate on the case or Community action in the field of defence procurement. So far the Commission has identified two possible instruments: one limited to clarifying the existing legal framework and the other aimed at establishing specific rules in the field of defence, taking into account the sector's characteristics.

These instruments would not prejudice any complementary measures taken by the Member States in the appropriate fora. Indeed, they could not provide exhaustive answers to all the specific aspects of defence markets. This is the case in particular for security of supply – a concept bound to change with the growing convergence of national security interests in the context of European foreign, security and defence policy. The gradual development of a common approach in this field could facilitate application of Community instruments. Equally, these instruments would constitute a useful tool for successful cooperation between Member States.

## CLARIFICATION OF THE EU'S EXISTING LEGAL FRAMEWORK

The legal framework could be clarified by a non-legislative instrument, such as an interpretative communication from the Commission. This instrument would aim to explain existing Community legislation in order to facilitate application by the competent authorities and to improve the operators' understanding of it. An interpretative communication could be adopted relatively quickly. By its very nature it could only confirm existing law. The Commission would give a further explanation of the principles defined by the Court on the interpretation of Article 296 EC, in particular their application to public procurement, to make it easier, in practice, to distinguish between contracts covered by the exemption and those which are not. As regards the latter, the normal rules – public procurement Directives – would remain applicable.

The communication would not be legally binding as such, but it would explain the principles and rules which are. Consequently, the Commission would be obliged to abide by this interpretation in the performance of its functions as guardian of the Treaty. The Commission would also have to draw all the operational conclusions resulting from the adoption of such a clarification of existing law.

The EU's legal framework could be supplemented by a new specific legal instrument for defence procurement (goods, services and work), such as a Directive to coordinate the procedures for awarding such contracts. The Directive would establish a special set of rules for contracts falling within the scope *ratione materiae* of Article 296 EC, but for which use of the derogation is not justified (conditions defined by the case law of the Court). It would apply to defence procurement currently falling within the scope of existing Directives but it would contain rules better suited to their specific nature.

It would pursue three main objectives:

- greater legal certainty, since it would improve the classification of:
  - (a) contracts covered by current Directives; (b) contracts covered by the new Directive; and (c) contracts excluded from any Community rules
- more information at Community level on the contracts in question, and therefore greater opening of the markets, which would allow European defence industries to participate equally in calls for tender in all Member States



- the introduction of the necessary flexibility for the award of these contracts by the creation of a body of rules suited to the specific features of such contracts

Such an instrument could also serve as a reference point should a Member State decide not to make use of the Article 296 EC derogation, even when it would have been entitled to do so.

## CONTENT

The field of application could be determined on the basis of a general definition of the category of military equipment covered and/or a list. The list could be that of 1958 or another more accurate, updated list, such as that of the Code of Conduct on Arms Exports.

There would be a provision modelled on Directives in other sectors, stating that the Directive would not prejudice the possibility of invoking Article 296 EC under the conditions defined by the Court. It would also identify cases in which the conditions for application of the exemption were clearly fulfilled (eg nuclear equipment).

The awarding authorities would be the ministries of defence and agencies acting on their behalf and other ministries buying military equipment. Application of the Directive to other bodies, such as the new Defence Agency, would have to be determined by the appropriate fora.

Implementation of the Directive would not prejudice the possibility of exemptions conferred on the Member States under WTO agreements such as the Government Procurement Agreement.

The procedures should ensure observance of the principles of transparency and non-discrimination, bearing in mind the specific characteristics of these contracts. The rule could be general use of the negotiated procedure with prior publication of a contract notice. Use of an unpublished negotiated procedure could be envisaged in certain cases determined on the basis of exemptions laid down in existing Directives and, where appropriate, other cases based on national legislation.

Publication could be through a centralised system at Community level using a harmonised publication bulletin. The subject of the contract could be described in terms of technical performance, in order to prevent potential discrimination between suppliers.

The selection criteria approved should ensure non-discrimination and equal treatment of companies and take account of the specific features of defence contracts, such as confidentiality and security of supply. They should also take into consideration the clearance necessary under defence secrecy rules.

The award of the contract would take place on the basis of defined criteria. This would require a discussion on the gradual elimination of practices such as direct and indirect offsets.

This guidance has been developed from the European Commission's Green Paper on defence procurement.

The full Green Paper can be accessed at:

[http://europa.eu.int/comm/internal\\_market/consultations](http://europa.eu.int/comm/internal_market/consultations)