

PUBLIC CONTRACT LAW AS A BARRIER TO AND INSTRUMENT FOR TRANSATLANTIC DEFENCE TRADE LIBERALIZATION

Luke R. A. Butler
LLB (Hons), LLM (European Law), Pg.Dip.
Barrister of the Middle Temple
Lecturer in Commercial Law and Trusts Law
University of Bristol, United Kingdom

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ABSTRACT

The European Union recently adopted a Defence Procurement Directive. Designed to regulate an internal market for defence material, the development is highly controversial. For many years, the U.S. has received privileged access to the national defence markets of the Member States. A lack of competition has resulted in stagnated markets with decreased increased possibilities of dependence on the U.S. In respect to the Directive, U.S. commentators have identified the possibility for its provisions to discriminate against U.S. contractors. This forces a fundamental assessment of the role of legal institutions which regulate transatlantic defence trade. This thesis aims to subject the EU and U.S. defence procurement regimes to critical description and analysis.

Extract from the first message sent via Transatlantic telegraph cable

August 16, 1858

Her Majesty Queen Victoria of Great Britain and Ireland:

“Glory to God in the highest; on earth peace, good-will towards men!”

President James Buchanan of the United States of America:

“It is a triumph more glorious, because far more useful to mankind, than was ever won by conqueror on the field of battle.

May the Atlantic telegraph, under the blessing of Heaven, prove to be a bond of perpetual peace and friendship between the kindred nations, and an instrument destined by Divine Providence to diffuse religion, civilization, liberty and law throughout the world.”

“In this view, will not all nations of Christendom spontaneously unite in the declaration that it shall be forever neutral, and that its communications shall be held sacred in passing to their places of destination, even in the midst of hostilities?”

Extract from J A Spencer, *History of the United States: from the earliest period to the Administration of President Johnson*, Volume III (New York 1886) 54

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ACRONYMS AND ABBREVIATIONS

AECA – Arms Export Control Act
AFARS – Army FAR Supplement
AFFARS – Air Force FAR Supplement
AG – Advocate General
AP – Allied Publication
ASD-Stan – Aerospace Defence Standards
ASPA – Armed Services Procurement Act 1948
BAA – Buy American Act
BIS – U.S. Bureau of Industry and Security
CAA – Civilian Agency Acquisition Council
CEN – European Committee for Standardisation
CENELEC – European Committee for Electrotechnical Standardisation
CFI – Court of First Instance
CFSP – Common Foreign and Security Policy
CICA – Competition in Contracting Act 1984
CJEU – Court of Justice of the European Union
CPIC – Contract Policy and International Contracting Directorate
CSIS – Center for Strategic & International Studies
D&F – Determination and Findings
DAR – Defense Acquisition Regulation Council
DCAA – Defense Contract Audit Agency
DCSA – Defense Security Cooperation Agency
DDTC – Directorate of Defense Trade Controls
DFARS – Defense Federal Acquisition Regulation Supplement
DLA – Defense Logistics Agency
DLAD – Defense Logistics Acquisition Directive
DPA – Defense Production Act
DPAC – Defense Production Act Committee
DPAP – Defense Procurement and Acquisition Policy
DoD – U.S. Department of Defense
DSPCR – Defence and Security Public Contracts Regulations
DTCT – U.S.-UK Defence Trade Cooperation Treaty
EADS – European Aeronautical, Defence and Space Company
EBB – EDA Electronic Bulletin Board
ECJ – European Court of Justice
ECSC – European Coal and Steel Community
EDA – European Defence Agency
EDC – European Defence Community
EDEM – European Defence Equipment Market
EDSIS – European Defence Standardization System
EDSTAR – European Defence Standards Reference System
EDTIB – European Defence Technological and Industrial Base
EEC – European Economic Community Treaty
EFRS – Engineer Federal Acquisition Regulation Supplement
EHDP – European Handbook on Defence Procurement
ESA – European Space Agency

ESDP – European Security and Defence Policy
ETSI – European Telecommunications Standards Institute
EU SOFAR – European Union Status of Forces Agreement
FAR – Federal Acquisition Regulation
FedBizOpps – Federal Business Opportunities
FPASA – Federal Property and Administrative Services Act
FPDS – NG – Federal Procurement Data System – Next Generation
FMS – Foreign Military Sales
ICC – International Chamber of Commerce
IDIQ – Indefinite Delivery – Indefinite Quantity
IET – Institution of Engineering Technology
IEEE – Institute of Electrical and Electronics Engineers
ITAR – International Traffic in Arms Regulations
GATT – General Agreement on Tariffs and Trade
GAO – Government Accountability Office
GPE – Governmentwide Point of Entry
J&A – Justification and Approval
JSF – Joint Strike Fighter
LOA – Letter of Offer and Acceptance
LoI-FA – Letter of Intent Framework Agreement
MIL-SPEC – U.S. Military Specification
MIL-STD – U.S. Military Standard
MLA – Manufacturing License Agreement
MOU – Memorandum/a of Understanding
MP – Multinational Publication
NAFTA – North American Free Trade Agreement
NAMSO – NATO Maintenance and Supply Organisation
NASA – National Aeronautics and Space Administration
NATO – North Atlantic Treaty Organisation
NATO AWACS – NATO Airborne Warning & Control System
NATO SOFAR – NATO Status of Forces Agreement
NIAG – NATO Industrial Advisory Group
NISP – National Industrial Security Program
NISPOM – National Industrial Security Program Operating Manual
NMCARS – Navy Marine Corps Acquisition Regulation Supplement
NOFORN – Not Releasable to Foreign Nationals
NSA – NATO Standardization Agency
OCCAR – Organisation for Joint Armaments Cooperation
OFPP – Office of Federal Procurement Policy
OFPPA – Office of Federal Procurement Policy Act
OJEU – Official Journal of the European Union
OMB – Office of Management and Budget
PGI – Procedures, Guidance and Information
RDP – Reciprocal Defence Procurement Memorandum of Understanding
RDT&E – Research, Development, Testing and Engineering
RFP – Request For Proposal
SBA – Small Business Administration
SME – Small and Medium-sized Enterprise
SOFARS – Special Operations Federal Acquisition Regulation Supplement

SSA – Special Security Agreement
STANAG – NATO Standardization Agreement
TAA – Technical Assistance Agreement
TEC – Treaty of the European Communities
TEC – Transatlantic Economic Council
TEU – Treaty on European Union
TFEU – Treaty on the Functioning of the European Union
TODO – Task (services) and Delivery (supplies) Order
TRANSFARS – Transportation Command
TTIP – Transatlantic Trade and Investment Partnership
USML – U.S. Military List
WEAG – Western European Armaments Group
WEAO – Western European Armaments Organisation
WEU – Western European Union
WTO GPA – World Trade Organisation Government Procurement Agreement

Introduction and Research Questions

1. Introduction

In order to execute their public functions, States must source goods, services and works from the market. A key public function for most States is the protection of defence and security interests. In protection of these interests, it is necessary for Ministries of Defence and other agencies to purchase defence material in order to develop and maintain the relevant capabilities in support. It is implicit in the protection of those interests that close political control is retained over the market. Defence markets are often characterised as monopsonistic. Whilst State control has decreased in recent years through privatization, the State continues to be the primary customer in a market comprised of a limited number of producers.¹ The State has historically been an important financier through ownership and subsidisation of domestic industries. The State has also dictated the terms of competition by controlling its defence expenditures and limiting the award of contracts to national contractors. Consequently, defence markets are generally non-transparent and economically inefficient.²

¹ M Lundmark, *Transatlantic Defence Industry Integration: Discourse and Action in the Organizational Field of the Defence Market* (Intellecta Infolog 2011) 41

² For an economic perspective on the effect of fragmented national markets within Europe, see H Küchle, 'The cost of non-Europe in the area of security and defence', Study for the European Parliament Subcommittee on Security and Defence, Brussels, June 2006; K Hartley, 'Defence Industrial Policy in a Military Alliance' (2006) 43(4) *Journal of Peace Research* and B Schmitt, 'The European Union and armaments. Getting a bigger bang for the Euro', *Chaillot Paper* no. 63, EU Institute for Security Studies, Paris, August 2003

These issues are compounded in an age of globally reducing defence budgets. Reductions accentuate the variable defence spending that already exists between States. In turn, this could affect the extent to which States are prepared to cooperate in matters of defence.³ According to European Defence Agency (“EDA”) data, in 2010, the United States of America (“U.S.”) spent the equivalent of €520 billion (\$689 billion) on defence.⁴ By contrast, the 26 participating EDA Member States (“pMS”) had a total expenditure of €194 billion on defence, representing a ratio of 2.7:1.⁵ Between 2006 and 2008, the aggregated defence expenditure of the 26 EDA pMS has been approximately half that of the U.S.⁶ Similarly, between 2005 and 2010 there was a 14% decrease in European Research and Development (“R&D”) budgets down to €9 billion.⁷ By contrast, the U.S. spends seven times more on defence R&D than all European Union (“EU”) Member States combined.⁸

Historically, as the world’s largest defence market, the U.S. has been able to sustain its own defence industrial base without substantial recourse to foreign sources. In contrast, the EU is comprised of 28 fragmented and functionally distinct national defence markets which increasingly lack the capabilities to sustain competitive industries. Further, in addition to competition from the U.S., the EU could face

³ D Blair, ‘America, Our Great Protector, Is Looking The Other Way: the free-riding nations of Europe are making a big mistake by slashing their defence budgets’, *The Telegraph* (London, 23 April 2013) <<http://www.telegraph.co.uk/news/uknews/defence/10013197/America-our-great-protector-is-looking-the-other-way.html>> accessed 20 September 2013

⁴ European Defence Agency, Europe and United States Defence Expenditure in 2010, Brussels, 12 January 2012 <http://www.eda.europa.eu/docs/documents/EU-US_Defence_Data_2010.pdf?sfvrsn=0> accessed 20 September 2013

⁵ *ibid.* All EU Member States except Denmark participate in the EDA

⁶ In 2009 and 2010, this difference increased. While the EU aggregated defence expenditure decreased from €201 billion in 2008 to €194 billion in 2010, US expenditure increased from €416 billion (\$612 billion) to €520 billion in the same period <http://www.eda.europa.eu/info-hub/news/12-01-25/EU_and_US_government_Defence_spending> accessed 20 September 2013

⁷ Commission, ‘Towards a more competitive and efficient defence and security sector’ (Communication) COM (2013) 279 final, 3

⁸ *ibid.*

increasing competition from emerging economies.⁹

Today, questions are being asked not only by the EU but also the U.S. regarding the extent to which an exclusively national outlook is sustainable in a world where emerging economies seek to develop their defence markets, defence budgets decrease year on year, accountability in public spend demands cost effectiveness and value for money and non-conventional warfare necessitates coalition forces that require interoperable and high-tech equipment.

It is therefore unsurprising that attention increasingly focuses on the extent to which a robust transatlantic defence market can address these challenges.

2. An Evolving Transatlantic Defence Market

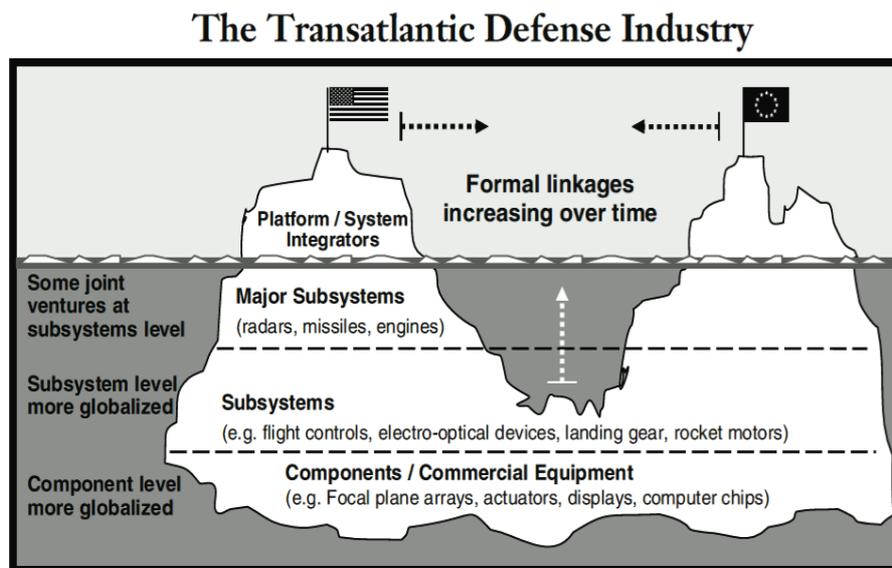
Commentators have questioned whether a transatlantic defence market is “forever elusive”.¹⁰ This question neatly captures the incongruence between the political emphasis on shared U.S. and European defence objectives whilst national markets continue to remain largely fragmented and closed to transatlantic competition. Debates continue to ask: how do the U.S. and EU overcome concerns to protect jobs, industries, ensure security of supply and guard against risks of illegal re-

⁹ FWC Sector Competitiveness Studies (Commissioned study for the Commission) *Study on the Impact of Emerging Defence Markets and Competitors on the Competitiveness of the European Defence Sector* 12 February 2010, Final Report <http://ec.europa.eu/enterprise/sectors/defence/files/study_defence_final_report_en.pdf> 20 September 2013

¹⁰ C M O'Donnell, 'A transatlantic defence market, forever elusive?' Policy Brief, Centre for European Reform, July 2010 <http://www.cer.org.uk/sites/default/files/publications/attachments/pdf/2011/pb_transatlantic_defence_july10-704.pdf> accessed 20 September 2013

exportation of defence material? A more fundamental question is: should the U.S. and EU even commit to more coordinated cooperation on matters of defence trade? Possible answers admit as many questions.

Notwithstanding, policy makers and academics continue to recognize the existence of a “market” which could be subjected to more competitive discipline through coordination.¹¹ Figure 1 is an extract from a major U.S. study entitled “Fortresses and Icebergs” which, for explanatory purposes, is sufficient to illustrate the core dimensions of the transatlantic defence market.¹²



Source: U.S. Department of Defense, Office of Deputy Under Secretary of Defense for Industrial Policy.

Figure 1: The Transatlantic Defence Industry

¹¹ The references in the literature are too numerous to recite in this footnote but many of which will be cited throughout this thesis. One of the most often cited is B Schmitt (ed) *Between cooperation and competition: the transatlantic defence market* (Institute for Security Studies, Western European Union, Paris January 2001). An extensive review of transatlantic defence trade ‘discourse’ is provided in M Lundmark, *Transatlantic Defence Industry Integration: Discourse and Action in the Organizational Field of the Defence Market* (n 1)

¹² J P Bialos, C E Fisher S L Koehl, *Fortresses and Icebergs: The Evolution of the Transatlantic Defence Market and the Implications for U.S. National Security Policy*, Volume I, Study Findings and Recommendations (Washington D.C.: Centre for Transatlantic Relations 2009) Executive Summary, 7. See also its companion text J P Bialos, C E Fisher S L Koehl, *Fortresses and Icebergs: The Evolution of the Transatlantic Defence Market and the Implications for U.S. National Security Policy*, Volume II, Study Findings and Recommendations’ (Washington D.C.: Centre for Transatlantic Relations 2009)

“Fortresses” represent the demand side of the market, in particular, insular tendencies towards closed national defence markets protected from foreign competition through government laws, policies and practices based on considerations of sovereignty, jobs, and security of supply, among others.¹³ Conversely, “icebergs” represent the supply side of the market.¹⁴ At one tier, prime level defence firms are substantially isolated from each other, with little cross ownership or integration; however, globalization has resulted in greater sub-tier integration, in particular at the lower component levels where commercial technology and industries are involved.¹⁵

Historically, European nations purchased their defence requirements on a predominantly national basis. To the extent that recourse to foreign competition was necessary, preference would likely be accorded to the U.S. above other European nations.¹⁶ However, the Study identifies the evolution (albeit extremely gradual) in European behaviour, specifically a decline in sole source procurement from national and U.S. sources, towards increased cooperative and competitive purchasing within the EU.¹⁷ Conversely, the same Study identifies a movement away from an historical U.S. approach to competitive but primarily nationally oriented procurement towards increasing openness to foreign competition at the prime contract level.¹⁸

¹³ *Fortresses and Icebergs* (Vol I) 7, Figure 1

¹⁴ *ibid* 8

¹⁵ *ibid*

¹⁶ *ibid* 13

¹⁷ *ibid*

¹⁸ *ibid* 16-18

As will be examined in detail in this thesis, as part of its so-called “Defence Package”,¹⁹ the EU recently adopted a defence and security procurement Directive (“Defence Procurement Directive”)²⁰ and a Directive on intra-Community transfers of defence material (“ICT Directive”).²¹ The U.S. identifies the Defence Package as determinative that the U.S. can no longer only operate on a bilateral level with individual EU Member States nor confine its interactions with Europe to those pursued through the North Atlantic Treaty Organisation (“NATO”); rather, the U.S. must deal with the EU’s growing role not only as a global defence actor but also as a defence trade regulator.²² Whilst U.S. observers identify these initiatives as a constructive development for Europe with the potential to positively impact the competitiveness of the transatlantic defence market, these initiatives have also been described as a “mixed blessing” for the U.S that could risk the development of a “Fortress Europe”.²³

Consequently, as will be discussed in this thesis, official and commissioned studies have increasingly focused on so-called “barriers” to transatlantic defence trade. Transatlantic defence procurement has also been specifically identified as an area which could benefit from the complementarity of competition policy and trade liberalisation.²⁴

¹⁹ The Commission launched the EU’s so-called Defence Package on 5 December 2007. See Commission, ‘A Strategy for a Stronger and More Competitive European Defence Industry’ (Communication) COM (2007) 764 final

²⁰ 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 [2009] OJ L 216/76

²¹ Directive 2009/43/EC of the European Parliament and of the Council of 6 May 2009 simplifying terms and conditions of transfers of defence-related products within the Community [2009] OJ L 146/1

²² See J Gansler, Special Forward to the *Fortresses and Icebergs* Study (Vol 1) (n 12) viii

²³ *Fortresses and Icebergs* (Vol I) (n 12) 31-32

²⁴ R D Anderson and W E Kovacic, ‘Competition Policy and International Trade Liberalisation: Essential Complements to Ensure Good Performance in Public Procurement Markets’ (2009) 18 PPLR 67, 94-99

3. Procurement as a Proportion of Defence Expenditure

In order to put the significance of procurement in its economic context, Figures 2 provides an indication of the relative importance attributed to procurement as part of overall defence expenditure.

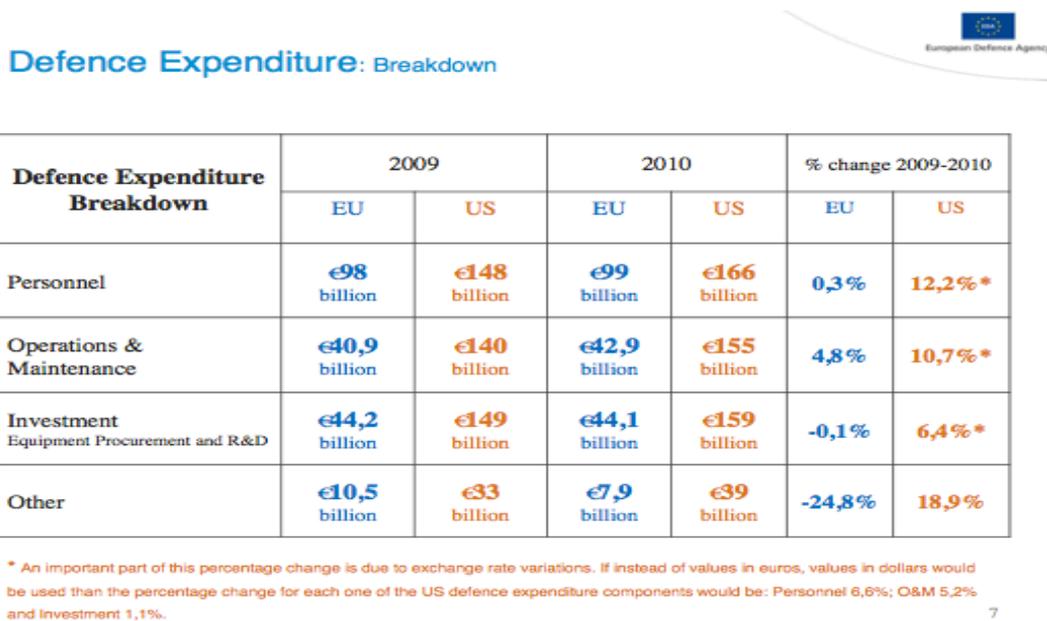


Figure 2: Defence Expenditure Breakdown²⁵

Further, Figure 3 provides a breakdown of investment expenditure. As indicated, the differences in procurement and R&D expenditure are stark.

²⁵ EDA, Europe and United States Defence Expenditure 2010 (n 4) 7

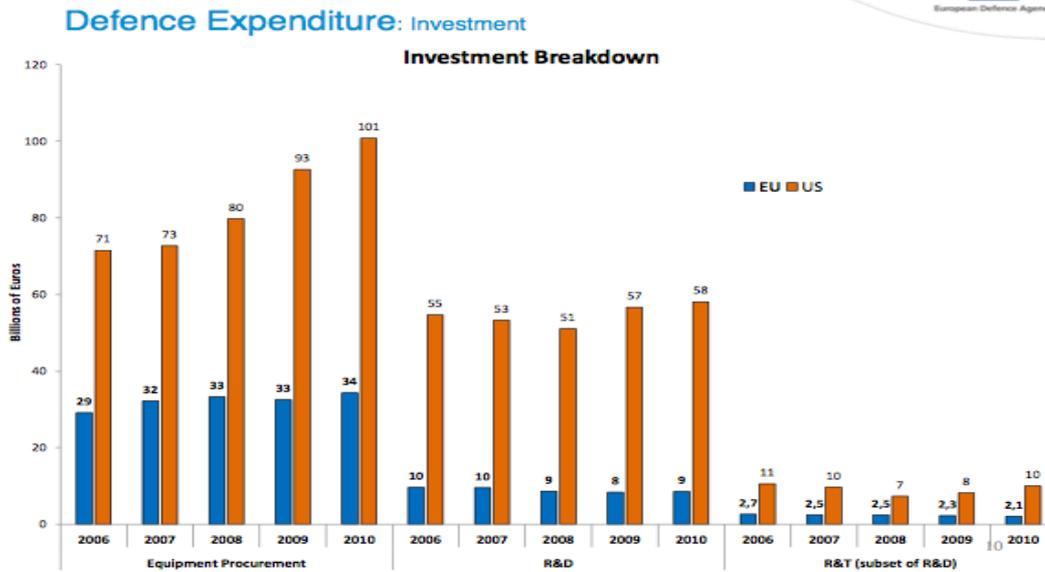


Figure 3: Defence Investment Breakdown²⁶

Having outlined the relative significance of defence procurement as part of overall U.S. and EU expenditures, it is necessary to consider the notion that public procurement law can act as a barrier to, and instrument for, transatlantic defence trade liberalisation. This, in turn, necessitates consideration of the correspondence between procurement law and its effects in practice.

4. Correspondence Between Procurement Law and its Impact

In recent years, academic focus has increasingly been placed on comparative approaches to, and uses of, regulatory controls in the U.S. and EU and their effects as “barriers” to transatlantic trade.²⁷ These insights become even more pertinent in

²⁶ *ibid* 10

²⁷ See, for example, D Vogel, *Barriers or Benefits, Regulation in Transatlantic Trade* (Brookings Inst. Pr. 1997), although the principal focus has concerned health, safety, and environmental standards. More recently, see R J Ahearn, ‘Transatlantic Regulatory Cooperation: Background and Analysis’, Congressional Research Service Report for Congress, August 24 2009 <<http://www.fas.org/sqp/crs/row/RL34717.pdf>> accessed 20 September 2013

light of the recent proposal for a Transatlantic Trade and Investment Partnership (“TTIP”), which, by its terms, intends to cover public procurement.²⁸

More generally, legal commentators have identified that public procurement law, especially the legal regimes that govern public contract formation, often erects “a dense, twisted web of rules, which may impede (and frequently intimidates) potential foreign entrants”.²⁹ In the U.S., it has been identified that statutory restrictions that deny eligibility to foreign firms seeking to supply goods and services to federal agencies constitute a “straightforward illustration of regulatory barriers”.³⁰ It has been observed that given the global value of defence procurement, the operation or effectuation of procurement laws can result in a significant increase of international trade flows.³¹ To this extent, whilst procurement legislation may act as a barrier, it may also inversely act as an instrument to achieve trade liberalization.

However, there is, in fact, little known legal or empirical research examining precisely how legal institutions³² may “impact” (howsoever defined)³³ on procurement in

²⁸ For details on the Transatlantic Trade and Investment Partnership, see: <<http://ec.europa.eu/trade/policy/in-focus/ttip/>> accessed 20 September 2013. With specific regard to public procurement, see EU-US Transatlantic Trade and Investment Partnership, ‘Public Procurement’, Initial EU position paper <http://trade.ec.europa.eu/doclib/docs/2013/july/tradoc_151623.pdf> accessed 20 September 2013. However, defence procurement is not covered by the terms of current negotiations or the envisaged agreement

²⁹ C R Yukins and S L Schooner, ‘Incrementalism: Eroding the Impediments to A Global Procurement Market’ (2006-2007) 38 *Geo J Int’l L* 529, 530. As will be discussed in Part II, the U.S. Defence Procurement and Acquisition Policy Office itself states that access to the U.S. defence market is complicated by a number of laws which prevent or impair the ability of non-U.S. entities to perform defence work as well as those which prevent or discourage DoD use of non-US products. See <<http://www.acq.osd.mil/dpap/cpic/ic/about.html>> accessed 20 September 2013. The main laws identified in this regard will be examined in this thesis

³⁰ W E Kovacic, ‘Regulatory Controls as Barriers to Entry in Government Procurement’ (1992) 25:1 *Policy Sciences*, 29, 34

³¹ D B Miller, ‘Is it Time to Reform Reciprocal Defense Procurement Agreements?’ (2009) 39(1) *Pub Cont LJ*, 93, 95-6

³² In light of the different forms of legislation which are found in a discussion of national, regional and international procurement systems, this thesis uses the descriptor “legal institutions” to refer collectively to the forms which legislation may take e.g. treaties, statute, regulation, directive, decision etc. However, the thesis will distinguish these forms where their particular characteristics have a bearing on the nature and function of the legislation. As will become apparent, differences in approach to legislating on defence procurement issues e.g. from directory provisions to comprehensive regulatory codes are an important consideration in any analysis

practice.³⁴ As this thesis will observe, it is important to differentiate (so far as is possible) between any legitimate function of legislation and its discretionary (mis)application and consequent effect(s). Further, it is important not to over or understate the ability of legislation to affect the behaviour of the relevant actors.³⁵

The upshot of the above is that there is often a central underlying assumption that legislation will have a “positive” or “self-evident” effect on the behaviour of relevant actors and the market in which those actors operate.³⁶

To a certain extent, it must be accepted that the legislator cannot necessarily know the precise effects of the legislation it adopts in advance or at all, an issue which is exacerbated by the secrecy and reluctance on the part of relevant stakeholders in the defence sector to impart information. Nevertheless, legislators should think at a deeper level of enquiry about how legislation in the field is configured with a view to mitigating the potential for its (in)discriminate use.

These basic observations underscore much of the thinking that has motivated and qualified the objectives of a thesis, which, in the first instance, is concerned to focus

³³ The thesis highlights use of the word “impact” in light of the fact that official publications often identify the purported impact of legislation on procurement without precisely identifying how such effects are qualified and quantified

³⁴ For a useful discussion which purports to be the first to examine the impact of international agreements in the field of public procurement on foreign discrimination, see S J Rickard and D Y Kono, ‘Do Preferential Trade Agreements Discourage Procurement Discrimination?’ (Princeton: 2010) <http://ncgg.princeton.edu/IPES/2010/papers/S830_paper1.pdf> accessed 20 September 2013

³⁵ It is stark that major studies often qualify Governments and industries as relevant stakeholders in such debates without recognizing the interests of the legal community/communities that will be required to advise those very stakeholders on the legislation which is intended to result. It is even more stark when supranational legislation is then adopted without a comprehensive understanding of the national legal position of individual States

³⁶ Kovacic, ‘Regulatory Controls as Barriers to Entry in Government Procurement’ (n30) 30. As Kovacic also observes at 34, as result of this assumption, little consideration is given *inter alia* to the costs of regulatory compliance which must be factored in as an increment to the price of, for example, airplane, missile and tank contracts, as well as to its effects on the ability or willingness of firms to compete

on the role that *existing* legal institutions do, and could, play as barriers to, and instruments for, transatlantic defence trade liberalisation. This is a necessary precursor to any consideration of the kinds of transatlantic defence trade treaties which have either been adopted or proposed.

5. Purposes, Aims and Objectives

Much of the transatlantic defence trade literature comprises economic and policy analyses which support findings about the extent of transatlantic trade flow, barriers to transatlantic trade, degrees of political and industrial integration and cooperation and proposals for a more competitive transatlantic defence market (and usually in that order). However, analyses of legal institutions are largely descriptive, providing only a background context for the above.

The thesis of the present work is that whilst policy-makers continue to identify legal institutions as barriers to trade and advocate their use to liberalise transatlantic defence trade, there is, in fact, little understanding of the role which legal institutions have played, and could play, in this regard. It has been observed that the issue of ensuring “more effective regulatory approaches” to transatlantic defence competition has long been recognized although not substantially acted on.³⁷ Yet, it is difficult to discern what an “effective regulatory approach” is absent a fundamental understanding of how existent approaches may be said to be ineffective. It is submitted that it is necessary to engage the foundational task of subjecting EU and

³⁷ Speech by K V Miert, ‘The Transatlantic and Global Implications of European Competition Policy’ (European Commissioner for Transportation) delivered on February 16 1998, North Atlantic Assembly Meeting, Palais Egmont, Brussels, 1, 11-12

U.S. laws to critical description and analysis with a view to better understanding their role in the conduct of transatlantic defence trade relations. By providing a legal cartography of the core components of each system using procurement law as an example, the groundwork will be put in place for developing comparative legal research. It is hoped that a transatlantic dialogue will inform the task of policy-makers and legislators in assessing the extent to which existing and proposed legal institutions could occupy a discrete role in liberalising transatlantic defence procurement.³⁸

5.1. A Cartography of EU and US Defence Procurement Law

The intuition for the thesis derives from observations about the limited legal scholarship on transatlantic defence procurement issues.

Firstly, there is substantially no detailed contemporary legal scholarship examining the legal position of foreign contractors in terms of their access to, and treatment in the conduct of, public defence contracts.³⁹ This is likely due to the fact that, as indicated above, in both the U.S. and the EU, defence procurement has largely been conducted on a national basis. Therefore, the external interface of procurement legislation has not been a priority. As this thesis will demonstrate, the Defence Directives have brought issues of access and treatment to the fore. However, whilst U.S. legal commentary has focused on the Directives' implications for U.S. interests,

³⁸ The thesis intends to engage dialogue at the level of U.S. and EU Member State Governments, international organisations (e.g. the EU and its institutions, EDA, NATO etc) and civil society more generally. It is also strategically aimed at advisory groups such as the Transatlantic Legislators' Dialogue set up to guide the Transatlantic Economic Council (among others)

³⁹ Part II of the thesis will identify certain examples dating back to the 1970's and 1980's. However, these are largely descriptive

this has not been accompanied by more penetrating analysis of how the U.S., EU Member State and EU legal regimes operate with regard to foreign contractors.

Secondly, legal scholarship is largely written from a discernable “perspective” which centres on an overt national bias.⁴⁰ This creates a risk that legal commentary simply becomes a vehicle to advocate protectionist regulatory responses. It is necessary to address these issues in the interests of a more openly reflectively and rigorous comparative legal scholarship.

The lack of a methodological pre-commitment to systematic comparative legal analysis means that no real attempt is made to question the premises, definitions and configuration of procurement legislation by reference not only to national and European objectives but also by reference to transatlantic objectives (howsoever defined). It is hoped that this thesis will provide a normative reference point to further explore, through comparison and contrast, fundamental conceptual issues facing the design and operation of procurement legislation, as well as incidents of (inter-)relation between U.S. and EU laws from which it may be possible to extrapolate priority areas which could be amenable to some level of transatlantic coordination.

In light of the above, this thesis is not intended to propose and analyse a full set of regulatory reforms or promote grand designs for a “Transatlantic Defence Procurement Treaty”. Rather, the thesis emphasises the necessity, in the first

⁴⁰ This is particularly, although not exclusively, prevalent in certain of the U.S. legal literature. The thesis is cautious to observe that this is due, primarily, to the fact that only U.S. legal literature has focused on issues of foreign access and treatment. The preoccupation of the EU legal literature has, to date, been on the internal operation of the Defence Directives with regard to EU economic operators as opposed to third countries. As will be indicated in Part I, this reflects more generally a discernable “internalisation” of the EU legal debate which focuses on the prioritisation of EU internal market objectives absent any real consideration of the external interface of EU defence procurement legislation with third countries

instance, of exploring the idiosyncratic national and regional legal perspectives on defence procurement issues in order to inform the bases for reform proposals. These risk being overlooked in premature proposals for supra-legal structures.⁴¹ However, whilst prioritising the importance of fundamental research of this kind, it is also necessary to provide an indication of the extent to which there is increasing evidence of a process of *legalization* of transatlantic defence trade relations. Through the identification of short-term, medium-term and long-term research priorities, this thesis will seek to tie fundamental research to more long-term possibilities for substantial reform.

5.2. Specific and General Objectives

The specific aims and objectives of the thesis are:

- a. To consolidate the existing body of legal literature on issues pertaining to defence procurement under EU and U.S. law.
- b. To provide a first formative legal analysis of EU law applicable to defence procurement with specific regard to its external relation to States which do not constitute EU Member States (so-called “third countries”), in particular, the U.S.⁴²
- c. To provide a first formative legal analysis of U.S. law applicable to defence procurement in light of developments in EU law.
- d. To identify current initiatives aimed at regulating transatlantic defence

⁴¹ In any event, the thesis' more modest objectives also respect that any assessment of the viability, feasibility and credibility of the proposed use of legal institutions to regulate transatlantic defence procurement or trade more generally, would have to take account of the broader political and economic context of any such proposals

⁴² This thesis should be seen as a continuation of the developing body of legal research in the field of EU defence procurement law which is referenced throughout this work

trade with a view to discerning the nascent state of legalization of transatlantic defence procurement and trade relations.

The general aims and objectives are to stimulate legal and empirical research in a number of areas (which are not exhaustive). A full list of research questions arising from this thesis are appended in the Annex. Key issues include:

- a. The use of exclusions and exceptions limiting access of foreign competitors to defence contracts (e.g. on grounds of national/essential security; industrial mobilization; security of supply etc);
- b. Access to, and treatment of, foreign competitors in procedures for the award of public defence contracts;
- c. Access to, and treatment of, foreign competitors in judicial and administrative proceedings on matters pertaining to defence procurement;
- d. The interaction between the national laws of the Member States and EU law with regard to third countries in the field of defence procurement;
- e. EU external relations law and policy in the field of defence procurement (e.g. issues of national and EU competence; terms of access etc);
- f. U.S. law and policy in the field of defence procurement with specific regard to U.S-EU relations (as distinct from U.S. relations with individual EU Member States);
- g. The interaction of procurement law with other legislation relevant to the regulation of defence trade (e.g. anti-trust law, State aid, merger control, investment, licensing etc).

At the international level, these issues include:

- a. The possibilities for discrete regulatory mechanisms to govern transatlantic defence procurement and trade more generally;
- b. The possibilities for inclusion of defence procurement matters within the scope of existing international procurement regimes.

6. Research Questions

The thesis will utilise the following research questions as a guiding structure.

6.1 The External Dimension of Defence Procurement Regulation

1. What is the scope of application of EU and U.S. law with regard to defence procurement?
2. How does EU and U.S. law regulate access and treatment of foreign contractors in the field of defence procurement?
3. To what extent are the EU and U.S. procurement systems legally configured or calibrated to deal with issues concerning access, and treatment, of foreign contractors bidding for public defence contracts, with particular reference to the transatlantic defence trade context?

6.2. Discerning the Impact of Legal Institutions in Practice

4. On the basis of available data, how, and to what extent, does EU and U.S. defence procurement law apply to and/or impact on foreign contractors in practice?

5. How is any “effect” or “impact” qualified and quantified?

6.3. Incidents of Relation Between Defence Procurement Regimes

6. In what respects does EU law and U.S. law compare and contrast in the field of defence procurement?
7. How could these points of comparison and contrast affect choices about how to regulate transatlantic defence trade?

6.4. Role of Legal Institutions in Transatlantic Liberalisation

8. What is the extent of current transatlantic initiatives aimed at the regulation of transatlantic defence trade and, more specifically, transatlantic defence procurement?

7. Methodology and Limitations

Before commencing the research, the following considerations were taken into account.

7.1. Desk-Based Analysis

This thesis is primarily a text- and desk-based analysis of defence procurement law. In light of the limited research on the practices of procurement officials in the defence sector, the inability to fully qualify and quantify the effects of legal institutions in practice constitutes a significant limitation of the thesis. Consequently, any and all statements have, as far as possible, been appropriately qualified.

7.2. Procurement of “Hard” Defence Material

In the U.S., the descriptors “public contract law” and “federal acquisition law” encompass both formation of government contracts and contract administration. Contract formation includes (but is not confined to) the rules which regulate the public award of defence contracts from the selection of procedure to award and review. The EU procurement Directives generally cover aspects of contract formation to the exclusion of contract administration. Therefore, this thesis focuses primarily on the common aspect of regulated contract formation and which may be termed “procurement”.

It follows from the specific focus on defence that the thesis does not cover sensitive security procurement.⁴³ Further, the law on “civil” procurement is only examined to the extent that it is relevant to an analysis of the defence procurement rules.

This thesis also does not specifically differentiate the type of contract or material that might be covered by the term “defence procurement”. Its overriding focus is on goods as opposed to works or services. This focus therefore also excludes the regulation of dual-use material.⁴⁴

The limits of the thesis also preclude a more extensive analysis of the interaction of

⁴³ This thesis accepts that the distinction between “defence” and “security” is not clear-cut. For an interesting examination of the extent to which there is a “blurring” of the distinction within the EU, see EU Commissioned study, ‘Industrial Implications in Europe of the Blurring of Dividing Lines between Security and Defence’, Final Report Contract no. SI2. 516182, 15 June 2010. With specific regard to public procurement, see 117-124 <http://ec.europa.eu/enterprise/sectors/defence/files/new_defsec_final_report_en.pdf> accessed 20 September 2013

⁴⁴ An examination of the law in this area would necessitate a thesis in its own right

procurement law and regulation with other trade law regimes.⁴⁵ However, this thesis is conscious to ensure that procurement law is not viewed in isolation from other areas of trade regulation.⁴⁶

Importantly, given the focus on procurement law, this thesis does not examine the significant issue of corruption.

7.3. Exclusion of NATO and EU Member States

Finally, it is recalled that the U.S. emphasises the need to focus on its relations with the EU independently of NATO and the EU Member States. The thesis does not examine NATO procurement. This would necessitate a thesis in its own right.

Further, the thesis is cautious to observe that EU defence procurement law will ultimately be interpreted, applied and adjudicated, in the first instance, in accordance with national law. This interaction inevitably magnifies the complexity of the legal issues faced not least because of the discrete relations each Member State will have with the U.S. However, as this thesis will demonstrate, there is, in fact, little available research on the operation of the national laws and policies of Member States with regard to the conduct of defence trade, especially concerning access and treatment of foreign contractors. It is therefore not possible to engage substantial analysis of the national legal and policy positions. Notwithstanding, whilst a primary focus of the

⁴⁵ On the relation of public procurement law to other EU trade law regimes see e.g. B Heuninckx, 'Defence Procurement: The Most Effective Way to Grant Illegal State Aid and Get Away with It...Or is It?' (2009) 46 CML Rev, 191; A S Graells, *Public Procurement and the EU Competition Rules* (Oxford Hart 2011); A S Graells, 'Public Procurement and State Aid: Reopening the Debate?' (2012) 6 PPLR 205

⁴⁶ As will be demonstrated, the thesis examines the relevance of certain other fields of trade regulation such as export control and licensing laws, the regulation of technical standards and competition law

thesis is on assessing the overall configuration of EU defence procurement law, it is hoped that the research will encourage further analysis of the extent to which the Defence Procurement Directive affects the dynamics of the interactions between Member States and third countries.

8. Constituent Parts

The Thesis comprises Three Parts.

8.1. A View from the European Union

Part I is entitled “A View From the European Union” and comprises six Chapters. Chapter 2 examines the conditioning effect of the EU essential security interests derogation on the development of an EU armaments market and the possible relevance of this derogation to third countries. Chapter 3 examines the Defence Procurement Directive’s provisions on excluded contracts and their relevance to transatlantic defence trade. Chapter 4 examines the legal position of third countries seeking access to the EU procurement market. Chapters 5 and 6 undertake a critical analysis of the Defence Procurement Directive’s provisions on security of supply and technical specifications, which U.S. commentators have identified as demonstrating a latent potential to “discriminate”. Chapter 7 examines the intergovernmental dimension of EU defence procurement law.

8.2. A View from the United States of America

Part II is entitled “A View from the United States of America” and comprises four Chapters. Chapter 8 provides an overview of the institutional and legal framework of U.S. federal procurement law. Chapters 9 and 10 examine U.S. law on full and open competition and non-competitive awards, respectively. Chapter 11 examines U.S. foreign acquisition law with particular emphasis on Reciprocal Defence Procurement Memoranda of Understanding (“RDPs”) given their attributed significance to transatlantic defence trade.

8.3. Cables and Bridges Across the Atlantic

Part III is entitled “Cables and Bridges Across the Atlantic”. This Part comprises a single Chapter 12 which summarises the thesis’ findings, identifies the current state of existing and proposed legal initiatives in the field and proposes areas for further research.

PART I

A VIEW FROM THE EUROPEAN UNION

Limiting the Essential Security Derogation: Priming the EU Defence Procurement Market

1. Introduction

In 1950, a European Defence Community (“EDC”) Treaty was proposed.⁴⁷ Designed to integrate the defence efforts of the European Coal and Steel Community (“ECSC”),⁴⁸ the EDC would have comprised *inter alia* a European army, supranational institutions with legislative competences, an independent administration and a Court of Justice.⁴⁹ However, in 1954, the project was terminated after the French Assemblée Nationale entered a motion préalable against further deliberation.⁵⁰ This precipitated a shift away from integration predicated on defence

⁴⁷ For a useful historical overview of events leading to the proposal, see M Trybus, *European Union Law and Defence Integration* (Modern Studies in European Law, Hart Oxford 2005) 9-22

⁴⁸ The European Coal and Steel Community Treaty was signed by France, Germany, Italy, the Netherlands, Belgium and Luxembourg in 1951. See Treaty establishing the European Coal and Steel Community, 18 April 1951 (not published). The U.S. citation can be found at 261 U.N.T.S. 140. The Treaty entered into force on 24 July 1952 and expired on 23 July 2002. For a discussion of the influence of defence considerations on the ECSC’s development, see Trybus, *European Union Law and Defence Integration* (n 47) 19-21

⁴⁹ See *La Traité Instituant la Communauté Européenne de Défense – La Documentation Française* (undated: circa 1952) published by the Ministère des Affaires Etrangères. There appear to be two English translations of the Treaty. One was presented to the United Kingdom Parliament in April 1954 as The European Defence Community Treaty Paris, 27 May 1952 (together with related documents), Cmd 9127 (HMSO, London 1954). The Office of the United States Special Representative in Europe published a separate and unofficial translation of the EDC Treaty on 26 January 1953 based on the United States Senate publication 94118 (82nd Congress 2nd session), a NATO version published on 12 July 1952 and on translation of one of the agreements by the Allied High Commission’s Secretariat. See Trybus, *European Union Law and Defence Integration* (n 47) 22, fn 61. For contemporary commentary, see J L Kunz, Editorial Comment: ‘Treaty Establishing the European Defense Community’ (1953) 47(2) AJIL 275; C G Fenwick, ‘Treaty Establishing the European Defense Community’ (1952) 46 AJIL 698; J Trempont, ‘La Communauté Européenne de Défense’ (1952) 1(4) ICLQ 519; H W Briggs, ‘The Proposed European Political Community’ (1954) 48(1) AJIL 110; G Bebr, ‘The European Defence Community and the Western European Union: An Agonizing Dilemma’ (1955) 7(2) Stan L Rev 169. For a detailed discussion of the EDC Treaty provisions, see Trybus, *European Union Law and Defence Integration* (n 47) 22-42

⁵⁰ For this and other reasons for failure, see Trybus, *European Union Law and Defence Integration* (n 47) 43 and fn143

towards an economic common market imperative which culminated in the 1957 European Economic Community Treaty (“EEC”).⁵¹

Consequently, European defence integration has been incremental and slow to progress.⁵² The 1992 Treaty on European Union (“TEU”) introduced a Common Foreign and Security policy (“CFSP”).⁵³ A European Security and Defence Policy (“ESDP”) was added under the Treaty of Nice in 2001.⁵⁴ The current Consolidated Version of the TEU pursues a CFSP committed to the framing of a common defence policy, which “might” lead to a common defence.⁵⁵ The TEU also provides for a Common Security and Defence Policy (“CSDP”).⁵⁶ However, the Treaties confirm their “progressive” status.⁵⁷ Thus, supranational centralization of the kind envisaged by the EDC continues to lack political consensus.⁵⁸

⁵¹ Treaty Establishing the European Economic Community, 25 March 1957 (unpublished). The U.S. citation can be found at 298 U.N.T.S. 3. The EEC Treaty into force on 1 January 1958

⁵² For a discussion of the extent of predominantly intergovernmental initiatives after the EDC’s failure, see Trybus, *European Union Law and Defence Integration* (n 47) 44-47 and 51-57

⁵³ Treaty on European Union (Treaty of Maastricht) [1992] OJ C 191

⁵⁴ Treaty of Nice Amending the Treaty on European Union, The Treaties Establishing the European Communities and Certain Related Acts [2001] OJ C80/01. For a discussion of the CFSP and ESDP, see Trybus, ‘*European Union Law and Defence Integration*’ (n 47) 57-118. See also P Koutrakos, *Trade, Foreign Policy & Defence in EU Constitutional Law: The Legal Regulation of Sanctions, Exports of Dual-Use Goods and Armaments* (Hart Oxford 2001) Ch. 2; P Koutrakos, *EU International Relations Law* (Hart Oxford 2006) Chs.11 and 13; F Naert, ‘ESDP in Practice: Increasingly Varied and Ambitious EU Security and Defence Operations’ in M Trybus and N White (ed), *European Security Law* (OUP 2007); A Georgopoulos, ‘The European Armaments Policy: A *conditio sine qua non* for the European Security and Defence Policy?’ In M Trybus and N White (ed) *European Security Law*

⁵⁵ Article 24(1) TEU (ex Article 11 TEU). For a discussion of a Common Defence, see M Trybus, ‘The Vision of the European Defence Community and a Common Defence for the European Union’ in M Trybus and N White (ed), *European Security Law* (n 54)

⁵⁶ Article 42(1) TEU (ex Article 17 TEU). For a discussion of the legal dimension of the CSDP, see M Trybus, ‘On the Common Security and Defence Policy of the EU Constitutional Treaty’ in M Trybus and N White (ed) *European Security Law* (n 54); M Webber, ‘The Common Security and Defence Policy in a Multilateral World’ in P Koutrakos (ed), *European Foreign Policy: Legal and Political Perspectives* (Edward Elgar 2011); P Koutrakos, ‘The Role of Law in Common Security and Defence Policy: Functions, Limitations and Perceptions’ in P Koutrakos (ed), *European Foreign Policy: Legal and Political Perspectives*

⁵⁷ Article 24(1) and Article 24(2) TEU

⁵⁸ For the most recent addition to the literature on European defence cooperation, see T Dyson and T Konstadinides, *European Defence Cooperation in EU Law and IR Theory* (Palgrave Macmillan 2013)

Historically, therefore, whilst EU internal market law has generally applied to the defence sector like any other, the limitations of the EU's defence and security competences combined with its failure to render explicit the link between those competences and the internal market has meant that Member States have generally excluded such trade from compliance with EU law, thereby limiting EU-wide competition. As this Chapter will discuss, this has been achieved, primarily, through recourse to Article 346 of the Treaty on the Functioning of the European Union ("TFEU") (ex Article 296 Treaty of the European Communities ("TEC")), which enables derogation from the EU Treaties on the basis of the need to protect "essential security interests". It is at this point that the issue of balance, or separation, between economic and security interests is most acute, reflecting fundamental uncertainties about who exercises what competences in a field that implicates both "defence" and "trade" interests.

Notwithstanding, the EU's purported strengths as a vehicle of economic integration have driven defence integration forward. The most significant legal innovations are not to be found in grand designs for an EDC but rather in the Defence Procurement and ICT Directives aimed at developing an internal market for the trade of defence material.

Whilst the following Chapters examine the relevance of the Defence Directives to a transatlantic defence procurement analysis, this Chapter first examines the extent to which variable interpretations of Article 346 TFEU have conditioned the development of an EU internal market, in particular, with regard to its purported effects on the

ability of economic operators to openly compete for the public award of defence contracts on a non-discriminatory basis.

For a host of reasons, this analysis is relevant to a transatlantic perspective. Firstly, Article 346 TFEU has, in part, precipitated the adoption of the Defence Procurement Directive. The fact that the Directive is defined by reference but also remains subject to Article 346 TFEU raises questions about the continued effect of this derogation.⁵⁹ Secondly, in its White Paper recommendations for improving EU-NATO cooperation, the NATO Industrial Advisory Group (“NIAG”) has specifically identified the need to define “legally acceptable interpretations of an ‘essential security interest’” under Article 346 TFEU.⁶⁰ Thirdly, and perhaps most importantly, the analysis provides a fundamental insight into the role and effect that broadly defined legal institutions can have in conditioning both regulatory approaches to defence procurement and Member State and contracting authority practices.

2. Security Exceptions and Derogations in the TFEU

The TFEU contains provisions to ensure rights to free movement of goods,⁶¹ persons,⁶² services,⁶³ capital,⁶⁴ and establishment⁶⁵ but also exceptions which

⁵⁹ Article 1(6) Defence Procurement Directive incorporates the specific wording of Article 346 TFEU by defining military equipment covered by the Directive as equipment that is: “[...] specifically designed or adapted for military purposes, intended for use as an arm, munitions or war material [...]” As will be indicated in Section 2.1 below, this replicates the wording of Article 346 TFEU. However, Article 2 Defence Procurement Directive expressly provides that: “[s]ubject to Articles 30, 45, 46, 55 and 296 of the Treaty, this Directive shall apply to contracts awarded in the fields of defence and security [...]”

⁶⁰ For example, see NATO NIAG High Level Advice Study No 154, Developments in Europe to Reform Export Control and Defense Procurement Processes and Implications and Opportunities Resulting, Particularly with Regard to Multinational Programs Supporting NATO Capabilities and Interoperability’, 17 (2011) <<http://www.aofs.org/wp-content/uploads/2011/06/110920-Developments-in-Europe.pdf>> accessed 20 September 2013

⁶¹ Articles 34 (ex Article 28 TEC) and 35 (ex Article 29 TEC) TFEU

⁶² Article 45 TFEU (ex Article 39 TEC)

authorise restrictions on these rights. In *Marguerite Johnston v. Chief Constable of the Royal Ulster Constabulary*,⁶⁶ the European Court of Justice (“ECJ”), now Court of Justice of the European Union (“CJEU”)) held that the only articles in which the Treaty provides for derogations applicable in situations involving public safety are Articles 36 (ex 30 TEC), 45(3) (ex 39 TEC), 51 (ex 45 TEC), 346 (ex 296 TEC) and 347 (ex 297 TEC) TFEU.⁶⁷ Article 65(1)(b) (ex 58(1)(b) TEC) TFEU was only inserted into the Treaty after *Johnston* and must be added to this list. Whilst concerned with public safety, the ECJ (and now CJEU) has applied *Johnston* analogously to measures taken on public security grounds. Importantly, the ECJ confirmed that these exceptions deal with clearly defined cases, do not lend themselves to a wide interpretation and from which it cannot be inferred that a general proviso is inherent in the Treaty covering all measures taken under a specified ground.⁶⁸ Therefore, whilst Member States are said to retain responsibility to determine public security requirements, such recourse nevertheless remains subject to judicial review when challenged.⁶⁹

⁶³ Article 56 TFEU (ex Article 49 TEC)

⁶⁴ Article 63 TFEU (ex Article 56 TEC)

⁶⁵ Article 49 TFEU (ex Article 43 TEC)

⁶⁶ Case C-224/94 *Marguerite Johnston v. Chief Constable of the Royal Ulster Constabulary* [1986] ECR 1651. For a useful discussion of this case, see Trybus, *European Union Law and Defence Integration* (n 47) 266-269 and references cited at 266, fn 23. See also the earlier cases of Case C-13/68 *SpA Salgoil v Italian Ministry of Foreign Trade* [1968] ECR 453, 463; Case C-7/68 *Commission v Italy* [1968] ECR 633, 644

⁶⁷ Case C-224/94 *Johnston*, para 26

⁶⁸ *ibid.* This finding was subsequently confirmed in Case C-273/97 *Angela Maria Sirdar v. The Army Board, ex parte Secretary of State for Defence* [1999] ECR I-7043, para 16; Case C-285/98 *Tanja Kreil v. Germany* [2000] ECR I-69, para 16; Case C-186/01 *Alexander Dory v. Germany* [2003] ECR I-2479, para 31 as well as the cases discussed in the main text of this Chapter relating to Article 346 TFEU

⁶⁹ For early cases in this regard, see Case 35/76 *Simmenthal* [1976] ECR 1871, para 14; Case 153/78 *Commission v. Germany* [1979] ECR 2555, para 5; Case 36/75 *Rutili v. Minister for the Interior* [1975] E.C.R. 1219, paras 26-27; Case C-54/99 *Association Eglise de Scientologie de Paris and Scientology International Reserves Trust v. The Prime Minister* [2000] E.C.R. I-01335, para 17

2.1. Relevance of Article 346 TFEU to Defence Procurement

Both the Public Sector Directive, which regulates the award of civil contracts (including by contracting authorities in the field of defence),⁷⁰ and the Defence Procurement Directive, expressly provide that their provisions remain subject to Article 346 TFEU.⁷¹ Article 346 TFEU provides as follows:

1. The provisions of the Treaties shall not preclude the application of the following rules:

(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.

2. The Council may, acting unanimously on a proposal from the Commission, make changes to the list, which it drew up on 15 April

⁷⁰ Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts [2004] OJ L 134/114

⁷¹ Article 10 Public Sector Directive; Article 2 Defence Procurement Directive

1958,⁷² of the products to which the provisions of paragraph 1(b) apply.

Commentators appear to qualitatively distinguish between the free movement public security exception and Article 346 TFEU, the latter constituting one of two⁷³ “national security” exceptions.⁷⁴ The predecessor to Article 346 TFEU dates back to the original Article 223 EEC. Importantly, its wording has remained unchanged throughout each successive treaty revision. On the one hand, the fact that the present economic, political and legal context differs from the time of the provision’s initial adoption should be kept firmly in mind when evaluating interpretations of Article 346 TFEU. On the other hand, it has been argued that present political and economic circumstances should not detract from its nature as a “constitutional” article, which delineates Member State and EU competences in the politically sensitive field of defence trade.⁷⁵ Article XXIII(1) WTO Government Procurement Agreement (“WTO GPA”) contains a similar exclusion as follows:

nothing in this Agreement shall be construed to prevent any Party from taking any action or not disclosing any information which it considers necessary for

⁷² Council Decision defining the list of products (arms, munitions, and war material) to which the provisions of Article 223(1)(b) apply. See Minutes of 15 April 1958, 368/58 (unpublished)

⁷³ Article 347 TFEU constitutes the other exception in this regard. Article 347 TFEU (ex 297 TEC) provides that: “Member States shall consult each other with a view to taking together the steps needed to prevent the functioning of the internal market being affected by measures which a Member State may be called upon to take in the event of serious internal disturbances affecting the maintenance of law and order, in the event of war, serious international tension constituting a threat of war, or in order to carry out obligations it has accepted for the purpose of maintaining peace and international security.” For a discussion of Article 347 TFEU, see C Stefanou and H Xanthaki, *A Legal and Political Interpretation of Articles 224 and 225 of the Treaty of Rome, The Former Yugoslav Republic of Macedonia Cases* (Ashgate 1997); P Koutrakos, ‘Is Article 297 EC ‘a reserve of sovereignty?’ (2000) 37 CMLRev 1339; Trybus, *European Union Law and Defence Integration* (n 47) Ch 6; P Koutrakos, ‘The Notion of Necessity in the Law of the European Union’ in I F Dekker (ed), *Netherlands Yearbook of International Law: Necessity Across International Law* (TMC Asser Press 2010) 204-207

⁷⁴ See M Trybus, ‘The EC Treaty as an Instrument of European Defence Integration: Judicial Scrutiny of Defence and Security Exceptions’ (2002) 39 CML Rev 1347, 1349 fn9. However, not all commentators accept this distinction. See for instance, A Arda, ‘Member States’ Right to Derogate from the European Treaties: A Commentary on Article 297 TEC’, in: H Smit, P Herzog, C Campbell and G Zagel (eds), *Smit & Herzog on the Law of the European Union* (2nd edition 2006) Chapter 398, 1, 7

⁷⁵ See A Georgopoulos, ‘European Defence Procurement Integration: Proposals for Action within the European Union’ (Ph.D Thesis submitted to the University of Nottingham, January 2004) 110-111

the protection of its essential security interests relating to the procurement of arms, ammunition or war materials, or to procurement indispensable for national security or for national defence purposes.⁷⁶

The scope of Article XXIII(1) remains unclear.⁷⁷ A notable difference in wording, however, is the additional reference to procurement “indispensable” for “national security” or “national defence purposes”.⁷⁸

2.2. “Secrecy” and “Armaments” Derogations

Article 346 TFEU in fact comprises two derogations. Article 346(1)(a) TFEU has been categorised as a “secrecy” exception.⁷⁹ By contrast, Article 346(1)(b) TFEU has been categorised as an “armaments” exception,⁸⁰ and is the primary focus of this Chapter.⁸¹ An important component is Article 346(2) TFEU which refers to a 1958 list stipulating the products to which Article 346(1)(b) TFEU is said to apply.⁸² It has been

⁷⁶ See Uruguay Round of Multilateral Trade Negotiations (1986-1994) – Annex 4 – Agreement on Government Procurement (WTO) (GPA 1994) [1994] OJ L336/273. The GPA applies only to those supplies and equipment listed in Annex 1 and Part 3 in Appendix 1 to the GPA. This list covers only non-warlike material

⁷⁷ It has been suggested that the interpretation of Article XXIII(1) “might be different” from that of Article 346 TFEU. See S Arrowsmith, *Government Procurement in the WTO* (Kluwer 2003) 148-150

⁷⁸ For a discussion of the range of similar terms used in security exceptions, see S Schill and R Briese “‘If the State Considers’: Self-Judging Clauses in International Dispute Settlement” in A. von Bogdandy and R. Wolfrum, (eds), *Max Planck Yearbook of United Nations Law*, Vol 13, (2009) 61

⁷⁹ Trybus, *European Union Law and Defence Integration* (n 47) 163-4. To date, Article 346(1)(a) TFEU has not been the subject of a specific ruling by the EU courts

⁸⁰ On the respective scope of application of Article 346(1)(a) and (b) TFEU both before and in light of the Defence Procurement Directive, see Trybus, *European Union Law and Defence Integration* (n 47) 164-5 citing at fn 96 Article XXI(a) GATT and H L Schloemann and S L Ohloff, “Constitutionalisation” and Dispute Settlement in the WTO: National Security as an Issue of Competence’ (1999) 93 AJIL, 424; see also B Heuninckx, ‘Lurking at the boundaries: applicability of EU law to defence and security procurement’ (2010) 3 PPLR, 91, 113

⁸¹ However, caution must be exercised as this description suggests that Article 346(1)(b) TFEU is the exclusive legal basis for excluding “armaments”. It has been argued that Article 346(1)(a) TFEU also theoretically covers “armaments”. See E Aalto, ‘Interpretations of Article 296’ in D Keohane, C Mölling and S de Vaucorbeil (ed) *Towards a European Defence Market*, Chaillot Paper No 113, Institute for Security Studies, European Union, November 2008, 30-31

⁸² See Council Decision defining the list of products (arms, munitions, and war material) to which the provisions of Article 223(1)(b) apply (n 72). The list has not been amended since 1958. See Commission Answer to a Written Question 573/85 [1985] OJ C-269; Case C-367/89 *Criminal Proceedings against Aimé Richardt and Les*

argued that Article 346(2) is “integral” to Article 346(1)(b) TFEU in the regard that the 1958 list is said to replace the words “arms, munitions, and war material”.⁸³ The ECJ has recently confirmed that it is for the national court to determine whether a product may be classified in one or other of the categories featured in the list.⁸⁴

In addition, Article 346(1)(b) TFEU is subject to the condition that such measures must not adversely affect the conditions of competition in the common market regarding products not intended for specifically military purposes. An unresolved issue that falls beyond the scope of this thesis, concerns whether Article 346 TFEU may also apply to dual-use goods.⁸⁵

Accessoires Scientifiques SNC [1991] ECR I-4621, Opinion of AG Jacobs, para 30; P Gilsdorf, ‘Les réserves de sécurité du Traite CEE, a la lumière du Traite sur L’Union Européenne’ (1994) *Revue du marche commune et l’Union européenne* 17, 20. Further, the list was never officially published. Member States have expressed different attitudes regarding its confidentiality. The list has been reproduced in academic publications, and has therefore been in the public domain. See H Wulf (ed), *Arms Industry Limited* (OUP 1993) 214. For a list of publications citing the list, see Trybus, *European Union Law and Defence Integration* (n 47) 143, fn 15 and references therein and M Trybus, ‘The list of hard defence products Under Article 296 EC Treaty’ (2003) 2 PPLR, 15. In a written question dated 4 May 2001, a Member of the European Parliament asked the Council: “which products appear on the list of 15 April 1958 to which Article 296(1)(b) refers?” See Written Question E-1324/01 by Bart Staes (Verts/ALE) to the Council [2002] OJ C-364 E, 20 December 2001, 85-86. In a reply dated 27 September 2001, the Council provided a version of the list which can be found in Trybus, *European Union Law and Defence Integration* (n 47) 143-145. For a comparison of this list with those previously in the public domain, see Trybus, *European Union Law and Defence Integration* (n 47) 145-149. This version of the list is the one most referenced in the academic literature and continues to be the subject of academic debate. It should also be observed that the 1958 list was translated into all languages of the EU in November 2008 and has been publicly available since this date. For a cogent argument calling for official publication of the list, see K Eikenberg, ‘Article 296 (ex 223) EC and external trade in strategic goods’ (2000) *EL Rev*, 117, 128

⁸³ Trybus, *European Union Law and Defence Integration* (n 47) 142

⁸⁴ Case C-615/10 *Insinoritoimisto InsTiimi Oy v. Puolustusvoimat* (Judgment of the Court, Fourth Chamber June 7 2012), para 37

⁸⁵ There is a longstanding debate on the issues of whether or not Article 346(1)(b) is exclusively limited to the goods identified in the 1958 list, and whether Article 346(1)(b) TFEU also covers “dual-use” items which can be used for civil and military purposes. For a useful discussion, see K Eikenberg, ‘Article 296 (ex 223) EC and external trade in strategic goods’ (n 82) 125-128; Trybus *European Union Law and Defence Integration* (n 47) 149; B Heuninckx, ‘Towards a Coherent European Defence Procurement Regime? European Defence Agency and European Commission Initiatives’ (2008) 11 PPLR, 1, 4; P Oliver, *Free Movement of Goods in the European Union* (5th ed Hart Oxford 2010), 389 and citations at fn104

Finally, it should be emphasised that only Member States can invoke Article 346 TFEU.⁸⁶ A company is not itself entitled to invoke the provision in proceedings brought against it for an infringement of EU law.⁸⁷

2.3. Distinguishing Exceptions and Derogations: Judicial Review

By contrast to the public security exception, which only excepts a measure from compliance with internal market rules, Article 346 TFEU is a Treaty “derogation” *stricto sensu* excepting a measure from compliance with the EU Treaties. Further, Article 346 TFEU is subject to a distinct procedure under Article 348 TFEU (ex 298 TEC). This procedure permits Member States and the Commission to examine how measures taken under Article 346 TFEU can be adjusted to the rules of the Treaties but also a possibility to refer a matter to the ECJ if it considers that a Member State is improperly using Article 346 TFEU.⁸⁸ This procedure has only ever been used once and only in the context of Article 347 TFEU.⁸⁹

It is generally considered that the main feature that distinguishes the public security and national security exceptions is the form and level of scrutiny applied. With regard

⁸⁶ See *GEC-Siemens/Plessey* (Case IV/33.018) Commission Notice relating to a proceeding under Articles 85 and 86 of the EEC-Treaty [1990] OJ C-239/2

⁸⁷ In support of this view, see J B Wheaton, ‘Defence Procurement and the European Community: The Legal Provisions’ (1992) 6 PPLR 432; Trybus *European Union Law and Defence Integration* (n 47) 233

⁸⁸ Article 348 TFEU provides: “If measures taken in the circumstances referred to in Articles 346 and 347 have the effect of distorting the conditions of competition in the internal market, the Commission shall, together with the State concerned, examine how these measures can be adjusted to the rules laid down in the Treaties. By way of derogation from the procedure laid down in Articles 258 and 259, the Commission or any Member State may bring the matter directly before the Court of Justice if it considers that another Member State is making improper use of the powers provided for in Articles 346 and 347. The Court of Justice shall give its ruling in camera.”

⁸⁹ This case was later struck from the Court report. See Case C-120/94 *Commission v Greece* [1996] E.C.R. I-1513. For a discussion of this case, see Koutrakos, ‘The Notion of Necessity in the Law of the European Union’ (n 73) 205-207

to the public security exception, a strict proportionality test applies.⁹⁰ Conversely, as Section 4 will demonstrate, whilst it is accepted that the Court applies a reduced level of scrutiny to Article 346 TFEU, there is no consensus on the form of scrutiny applied.⁹¹

Collectively, these exceptions constitute an important balancing mechanism between the recognition of Member State security interests and the EU's objectives, in turn, defining the limits of EU law as a supranational instrument of European defence integration.⁹²

2.4. Differentiating Notions of “Security”

Commentators have also differentiated Article 346 TFEU from the free movement exceptions on the basis of the differing notions of “security” to which each exception is said to apply. At its most basic, it has been argued that “public security” is a wide concept covering all aspects of security both internal and external and includes the concept of “national security”.⁹³ According to one view, “public security” refers to the entire field of rules, laid down by sovereign authorities and incapable of being waived, which have been adopted in the interest of the political and social integrity of

⁹⁰ According to this test, the measure must: (1) be suitable to promote the objective of public security; (2) be adequate in the sense that there is no other measure less restrictive from the point of view of free movement that is capable of achieving the same objective and (3) the positive effect of the measure on public security has to be balanced with the negative effect on the internal market. This test was originally formulated by AG van Gerven in Case C-159/90 *SPUC v Grogan* [1991] ECR I-4685. It has been argued that this test has been applied in a number of cases invoking public security grounds. See Trybus, *European Union Law and Defence Integration* (n 47) 134-139

⁹¹ See Section 4.1

⁹² Trybus *European Union Law and Defence Integration* (n 47) 142

⁹³ Trybus, *European Union Law and Defence Integration* (n 47) 131 citing Case C-367/89 *Criminal Proceedings against Aimé Richardt and Les Accessoires Scientifiques SNC* [1991] ECR I-4621, para 22; Case C-70/94 *Fritz Werner Industrie-Ausrüstungen GmbH v Germany* [1995] ECR I-3989, para 25 and Case C-83/94 *Criminal Proceedings against Peter Liefer* [1995] ECR I-3231, para 26

society”.⁹⁴ This would concern any measure enacted to protect a Member State’s “integrity”.⁹⁵ However, it has been observed that the precise ambit of the justification of public security is “somewhat elusive”.⁹⁶ By contrast, Articles 346 and 347 TFEU would concern a narrower concept, which could be called “national security” or “external military security”.⁹⁷ It has been suggested that “national security” could be defined as the entire field of rules which have been adopted to protect the territorial integrity, important strategic interests and political independence of a State.⁹⁸

In assessing the notion of “security”, particular reliance has been placed on Advocate General (“AG”) Slynn’s Opinion in *Campus Oil v. Minister for Industry and Energy*.⁹⁹ This case concerned Irish legislation requiring importers of petroleum products to purchase certain quotas from an Irish refinery, which the ECJ found to be justified under Article 30 TEC on public security grounds.¹⁰⁰ AG Slynn took the view that Article 30 TEC “is clearly not limited to external military security which largely falls to be dealt with under Articles [296 to 298]” in support of the proposition that the public

⁹⁴ Trybus, *European Union Law and Defence Integration* (n 47) 131 citing the definition of J Schwarze, *European Administrative Law* (Sweet & Maxwell 1992) 778 based in turn on Wagbur in H von der Groeben, v Boeckh, Thiesing, Ehlermann, *Kommentar zum EWG Vertrag*, 3rd edn (Nomos, Baden-Baden, 1983) Article 36, margin nos. 18 et seq

⁹⁵ Trybus, *European Union Law and Defence Integration* (n 47) 131

⁹⁶ See L W Gormley, *EU Law of Free Movement of Goods and Customs Union* (OUP 2009) 11.68, 463-465

⁹⁷ Trybus, *European Union Law and Defence Integration* (n 47) 131 citing at fn 44 Case C-72/83 *Campus Oil Limited v. Minister for Industry and Energy* [1984] ECR 2727, Opinion of AG Sir Gordon Slynn, 2764

⁹⁸ Trybus, *European Union Law and Defence Integration* (n 47) 131

⁹⁹ Case C-72/83 *Campus Oil Limited v Minister for Industry and Energy* [1984] ECR 2727. For a discussion of this case, see K Mortelmans, ‘Annotation to Case 72/83 *Campus Oil*’ (1984) CML Rev 696; L W Gormley, *Prohibiting Restrictions on Trade within the EEC* (Elsevier, 1985) 134-139; F Ortino, *Basic Legal Instruments for the Liberalisation of Trade: A Comparative Analysis of EC and WTO Law* (Hart 2004) 188-192; P Koutrakos, ‘The Notion of Necessity in the Law of the European Union’ (n 73) 197-8; C Barnard, ‘Derogations, Justifications and the Four Freedoms: Is State Interest Really Protected?’ in C Barnard, O Odudu (eds) *The Outer Limits of European Union Law* (Hart Oxford 2009), 273. See also Case C-398/98 *Commission v Greece* [2001] ECR I-7915

¹⁰⁰ See Case C-72/83 *Campus Oil* [1984] ECR 2727, para 34. For a critique of the general and unclear wording of aspects of the judgment, see L W Gormley, *Prohibiting Restrictions on Trade within the EEC* (n 99) 136-139

security exception must be construed more restrictively.¹⁰¹ It has been further argued that the fact that the material scope of Article 346 TFEU covers “arms, munitions and war material” focuses on the exercise of the most fundamental aspects of “national sovereignty” and which must therefore be viewed as underpinning the definition of “security”.¹⁰² On this conception, Article 346 TFEU would concern interests of fundamental significance e.g. protecting the territorial integrity of a State from external threat¹⁰³ or aggression or the protection of State institutions from terrorists.¹⁰⁴ Whatever conception of security is adopted, it has been suggested that the interpretation of “security” under Article 346(1)(b) TFEU does not render it *lex specialis* in relation to the free movement security exceptions.¹⁰⁵

However, this discussion (and that which follows) indicates that there has been only limited focus on what conceivably constitutes an “essential” “security” “interest”, such as to provide an indication as to the distinct conceptual bases of “public security” and “essential security” as well as their relation.¹⁰⁶ Rather, the focus has concerned the standard of judicial review applied to Article 346 TFEU. In consequence, the issue of competence has only been addressed tangentially. The general conceptual and legal

¹⁰¹ Case C-72/83 *Campus Oil* [1984] ECR 2727, 2674. See also Trybus, *European Union Law and Defence Integration* (n 47) 136 and Koutrakos, *Trade, Foreign Policy and Defence in EU Constitutional Law: The Legal Regulation of Sanctions, Exports of Dual-use Goods and Armaments* (n 54) 187 and 189

¹⁰² Koutrakos, *Trade, Foreign Policy and Defence* (n 54) 188

¹⁰³ The Court has found that the risk of a serious disturbance to foreign relations or to peaceful coexistence of nations as affecting the security of a Member State. See Case C-70/94 *Fritz Werner* [1995] ECR I-3189, para 27 and Case C-83/94 *Leifer* [1995] ECR I-3231, para 28

¹⁰⁴ Koutrakos, *Trade, Foreign Policy and Defence* (n 54) 188. This categorisation would appear to broadly correspond with that presented by Trybus, in particular in reference to protection of “territorial integrity”

¹⁰⁵ It may be argued that Member States can always plead a security exception within the Treaties (i.e. pursuant to a free movement exception like Article 36 TFEU) before relying on Article 346 TFEU in the alternative. See Koutrakos, *Trade, Foreign Policy and Defence* (n 54) 188

¹⁰⁶ For a discussion of this notion in investment law, see OECD, ‘Security-Related Terms in International Investment Law and in National Security Strategies (May 2009) <<http://www.oecd.org/daf/inv/investment-policy/42701587.pdf>> accessed 20 September 2013; K Yannaca-Small, ‘Essential Security Interests under International Investment Law’ in OECD (ed) *International Investment Perspectives: Freedom of Investment in a Changing World* (OECD 2007) <<http://www.oecd.org/daf/inv/investment-policy/40243411.pdf>> accessed 20 September 2013

nebulosity of “public security” and “national security” as legal terms corresponds with uncertainty on the part of the EU legislator¹⁰⁷ and the ECJ¹⁰⁸ about how to approach, define, interpret and question invocation of such an “open textured”¹⁰⁹ provision. One commentator has even gone as far as to state that it is legally impossible to define “essential security interests”.¹¹⁰

To a certain extent, this is explicable and understandable. Security is a multifaceted concept with defence, political and economic aspects and which does not lend itself to a legal definition.¹¹¹ Further, emphasis is often placed on the notion that a Member State must determine its essential security interests in light of reference in Article 346 TFEU to “[...] as it considers necessary [...]”.¹¹² However, it may be questioned to what extent any review exercised by the ECJ encroaches upon the exercise of this apparent competence.¹¹³ It is submitted that references to the conferment and exercise of “discretion” substantially enable the avoidance of this

¹⁰⁷ For example, Article 14 Public Sector Directive provides that: “[t]his Directive shall not apply to public contracts [...] when the protection of the essential interests of that Member State so requires.” This provision should be contrasted with Article 2 of its predecessor Council Directive 93/36/EC of 14 June 1993 co-ordinating procedures for the award of public supply contracts [1993] OJ L -199/1 (“Supplies Directive”) which referred to the “basic interests of the Member State’s security” (emphasis added). For a discussion of the latter, see Trybus, *European Union Law and Defence Integration* (n 47) 219-221

¹⁰⁸ See for instance, the judgment of the Court in Case C-337/05 *Commission v Italy* [2008] ECR I-2173, para 42 which states: “[i]t should be noted at the outset that measures adopted by the Member States in connection with the legitimate requirements of *national interest* are not excluded in their entirety from the application of Community law solely because they are taken in the interests of *public security* or *national defence* [...]”, citing Case C-186/01 *Dory* [2003] ECR I-2479, para 30

¹⁰⁹ “Open texture” here is used in the sense appropriated by Hart. See H L A Hart, *The Concept of Law* (Clarendon Press 1961). More recently, see B H Bix, ‘Defeasibility and Open Texture in J F Beltrán and G B Ratti (ed) *The Logic of Legal Requirements, Essays on Defeasibility* (OUP 2012)

¹¹⁰ See Aalto, ‘Interpretations of Article 296’ (n 81) 18

¹¹¹ For a discussion in this regard, see Koutrakos, *Trade, Foreign Policy and Defence* (n 54) 165-175

¹¹² For instance, it is unsurprising that emphasis is placed on statements made in Case C-120/94 R *Commission v. Greece (FYROM)* [1996] ECR I-1513, Opinion of Advocate General Jacobs, para.54 where he states: “Each Member State is better placed than the Community institutions or the other Member States when it is a question of weighing up the dangers posed for it by the conduct of a third state. Security is, moreover, a matter of perception rather than hard fact. What one Member State perceives as an immediate threat to its external security may strike another Member State as relatively harmless.”

¹¹³ For a general discussion in this regard see L Azoulay, ‘The ‘Retained Powers’ Formula in the Case Law of the European Court of Justice: EU Law as Total Law?’ 2011 4(2) EJLS, 192. Although, Article 346 TFEU is cited at 194, fn4 as an exception to an observable phenomenon in which the Court disassociates the existence of state powers from the exercise of such powers, thereby legitimizing the application of EU law in any domain that is not *a priori* within the Union’s scope of intervention

issue.¹¹⁴ By not engaging these matters, it is possible to avoid difficult questions about the delimitation of Member State and EU defence and security competences.

These issues are not simply theoretical excursions that are of little relevance to transatlantic defence procurement. It is recalled from the Introduction that NIAG has recently recommended that “legally acceptable interpretations” of an “essential security interest” should be defined.¹¹⁵

3. National Interpretations of Article 346 TFEU

Most Member States have interpreted Article 346(1)(b) TFEU as permitting an automatic exemption of defence material from the application of all internal market regimes.¹¹⁶ It has been suggested that Member States have “abused” Article 346 TFEU.¹¹⁷ A number of reasons for such abuse have been identified. These include: the *prima facie* exclusion of defence issues after the EDC’s failure and which Member States have correspondingly viewed as reflected in the essential security interests derogation; caution on the ECJ’s part to avoid a politically sensitive provision; Commission reluctance to institute proceedings out of a possible concern

¹¹⁴ On the posited “deference versus discretion” dichotomy generally, see Schill and Briese “If the State Considers”: Self-Judging Clauses in International Dispute Settlement’ (n 78) 74-81

¹¹⁵ NIAG High Level Advice Study No 154 (n 60) 17

¹¹⁶ The Member States’ early submissions before the ECJ are instructive. In Case C-224/94 *Johnston* (n 66) the UK argued at 1671 that: “The EEC Treaty itself leaves intact the power of the Member States to take such measures as they consider necessary or *expedient*” (emphasis added)

¹¹⁷ It has even been argued that the Commission has, for a long time, accepted this abuse. See D Eisenhut, ‘The Special Security Exemption of Article 296 EC: Time for a New Notion of “Essential Security Interests”?’ (2008) 33(4) EL Rev 577, 578

to find a clear case in which the ECJ could narrow the provision's interpretation and application in practice; and, finally, the difficulty of detecting and proving abuses.¹¹⁸

However, it was not always clear that the Public Sector Directive applied to defence contracts.¹¹⁹ Further, absent a pre-notification requirement for the invocation of Article 346 TFEU, monitoring what kinds of contracts have been excluded and for what reasons is difficult to verify. In addition, as will be discussed below in Section 5, interpretative guidance on Article 346 TFEU is by no means comprehensive and unequivocal. Finally, whilst it has been suggested that reference in Article 346 TFEU to the fact that Member States "may" take measures confirms the existence of EU competence to regulate defence trade,¹²⁰ as indicated in the Introduction, the EU has only recently rendered explicit the link between EU security and defence policy and internal market regulation.

Notwithstanding, available evidence indicates that Member States have generally excluded material on the basis that all defence goods are said to implicate essential

¹¹⁸ See Trybus, *European Union Law and Defence Integration* (n 47) 150-151

¹¹⁹ One manifestation of this uncertainty concerned the wording of the public sector Directives in their successive revisions and the possible effects of case law developments on their interpretation. Specifically, Article 3 Supplies Directive (n 107) exempted "products" to which Article 223(1)(b) TEC (now Article 346(1)(b) TFEU) applied. By contrast, Article 4(1) Council Directive 92/50/EEC of 18 June 1992 relating to the co-ordination of procedures for the award of public services contracts [1992] OJ L-209/1 excepted "contracts" to which Article 223(1)(b) TEC applied. It had been argued that use of the word "contracts" in substitution of "products" evidenced that the EU legislator had taken into account the ECJ ruling in Case C-414/97 *Commission v. Spain* [1999] ECR I-5585 (delivered between revisions of the Directives and discussed below) confirming that Article 346 TFEU did not except all hard defence "products" but rather only those "contracts" satisfying the conditions of Article 346 TFEU in each individual case. For a discussion of the interpretational uncertainty surrounding the applicability of the public procurement Directives to hard defence material, see S Arrowsmith, *The Law of Public and Utilities Procurement* (Sweet & Maxwell 2nd Rev ed 2005) 347, para 6.97 and 349, para 6.100; Georgopoulos, 'European Defence Procurement Integration: Proposals for Action within the European Union' (n 75) 86-109 and Trybus, *European Union Law and Defence Integration* (n 47) 202-213. Article 10 Public Sector Directive (n 71) omits any reference to "products" or "contracts", merely providing that the Directive applies "subject to Article 296 of the Treaty"

¹²⁰ See Eikenberg, 'Article 296 (ex 223) EC and external trade in strategic goods' (n 82) 119 and reference cited at fn 8

security interests and without defining a relevant security interest.¹²¹ It has been suggested that barriers to European defence market regulation primarily take the form of national objections to the loss of control over a “sovereignty-defining” economic sector and that in Member State representatives’ minds and wording, the concept of “essential interest of State security” is generally extended, without any legal basis, to “sovereignty”.¹²² Some support for this conclusion can also be derived from official statistics.¹²³

The Defence Procurement Directive has now modified the Public Sector Directive to provide that the Public Sector Directive now applies to public contracts awarded in the fields of defence and security, with the exception of contracts to which the Defence Procurement Directive applies, and subject to Article 346 TFEU.¹²⁴ The intention is to make clear that the public award of defence contracts must comply with the Directives unless otherwise excepted. The most contentious issue which now arises concerns to what extent the Defence Procurement Directive will discourage routine recourse to Article 346 TFEU in light of the fact that it is said to be specifically ‘tailored’ to defence procurement contracts.¹²⁵

¹²¹ Trybus, *European Union Law and Defence Integration* (n 47) 150. This interpretation is just one specific instantiation of a view generally held by foreign ministries, that all aspects of defence, including defence trade, are the imperative of State “sovereignty” and must be excluded from the EU Treaties. See for example Case C-285/98 *Sirdar v. Army Board* [1999] ECR I-7403, Opinion of AG La Pergola, para 10; Case C-285/98 *Kreil v Germany* [2000] ECR I-69, para 12

¹²² See Unisys, (Commission Study), ‘Intra-Community Transfers of Defence Products’, Final Report of the Study ‘Assessment of Community initiatives related to intra-community transfers of defence products’, Brussels, February 2005, 65 <http://www.edis.sk/ekes/en_3_final_report.pdf> accessed 20 September 2013

¹²³ In 2007, the Commission published statistics showing that an average of only 13 % of contracts are published in the Official Journal of the European Union (“OJEU”), with some Member States publishing as little as 1 or 2 % of their defence procurement expenditure. See Commission Staff Working Document, ‘Annex to the Proposal for a Directive of the European Parliament and of the Council on the coordination of procedures for the award of certain public works contracts, public supply contracts and public service contracts in the fields of defence and security’ (Impact Assessment) SEC(2007)1589, December 5, 2007, 13-14 <http://ec.europa.eu/internal_market/publicprocurement/docs/defence/impact_assessment_en.pdf> accessed 20 September 2013

¹²⁴ Article 71 Defence Procurement Directive

¹²⁵ See generally, M Trybus, ‘The tailor-made EU Defence and Security Procurement Directive: limitation, flexibility, descriptiveness, and substitution’ (2013) 38(1) EL Rev, 3

4. Interpretation of Article 346 TFEU by the Court of Justice

As indicated, a critical issue that will continue to remain is the precise instances in which Article 346 TFEU may provide a legal basis to justify non-compliance with the Defence Procurement Directive. The following review of certain of the Article 346 TFEU case law provides the general interpretative context. However, the ECJ has not yet been presented with a genuine case requiring detailed examination of its terms.

4.1. Spanish VAT Exemption

Commission v. Spain was the first formative ruling on Article 346 TFEU.¹²⁶ Spain adopted legislation¹²⁷ exempting intra-Community imports and acquisitions of equipment exclusively for military use from value added tax contrary to an EEC Directive.¹²⁸ Spain submitted that its legislation was necessary to guarantee essential strategic objectives, in particular, the effectiveness of Spanish armed forces both nationally and as part of NATO.¹²⁹ Spain had neither invoked the then Article 223(1)(b) TEC (raising Article 223(1)(b) only at the litigation stage) nor provided evidence to substantiate its claim. Therefore, the Commission initiated enforcement proceedings under the former Article 226 TEC.¹³⁰

¹²⁶ Case C-414/97 *Commission v. Spain* [1999] ECR I-5585

¹²⁷ Law No 6/87 of May 14, 1987 concerning budgetary appropriations for investments and operating costs of the armed forces (BOE of May 19, 1987)

¹²⁸ Council Directive 77/388/EC of May 17, 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, [1977] OJ L145/1

¹²⁹ Case C-414/97 *Commission v. Spain* para 17

¹³⁰ Trybus, *European Union Law and Defence Integration* (n 47) 156 observes that Spain had not based its argument on Article 223(1)(b) TEC in the pre-judicial stage, which could explain why the case had not proceeded under the then Article 298(2) TEC. This suggests that if Spain had, in fact, raised Article 296 TEC in argument in the pre-litigation procedure, it would have been likely that Article 298(2) TEC proceedings would have been

Confirming *Johnston*, the Court reiterated that because of their limited character, Treaty exemptions do not lend themselves to a wide interpretation.¹³¹ Further, that it is for the Member State to provide evidence that the exception does not go beyond the limits of such cases.¹³² Given that the principal objective was to determine and allocate financial resources for its armed forces, Spain had not demonstrated that the exemptions provided for were “necessary” for the protection of its essential security interests.¹³³

The most fundamental aspect of *Commission v. Spain* is its confirmation that Article 346(1)(b) TFEU only applies when there is a security reason for disapplying the EU Treaties. Exclusive reliance on the classification of the material as “defence-related” is insufficient.¹³⁴ It also confirmed the ECJ’s jurisdiction to address Article 346 TFEU arguments outside the Article 348 TFEU procedure.

However, the most controversial aspect concerns the form and standard of review applied, an issue that was not explicit in the judgment as Spain did not provide any

brought. However, as Trybus also observes (citing at fn 66 W Hummer in Eberhardt Grabitz and Meinrad Hilf, (eds), *Kommentar zum EWGV* (CH Beck Verlag, Munich, 1997) loose-leaf, Article 225, para 8, use of the word “may” means that Article 298(2) TEC does not actually prioritise, as a matter of law, this particular procedure when Article 296(1)(b) TEC is concerned. Trybus, at 152, suggests that the action was also possibly motivated by the fact that the Spanish legislation affected the Community’s revenue. This view appears to be substantiated by the recent enforcement cases which concerned similar circumstances and also proceeded under Article 226 TEC. These cases are discussed in Section 4.4

¹³¹ Case C-414/97 *Commission v. Spain*, para 21 citing Case C-224/94 *Johnston* (n 66)

¹³² *Commission v. Spain*, para 22. On the issue of who bears the burden of proof, see Trybus, *European Union Law and Defence Integration* (n 47) 157-158 and Georgopoulos ‘European Defence Procurement Integration: Proposals for Action within the European Union’ (n 75) 131

¹³³ The Judgment at para 22 reads in relevant part: “[...] In the present case, the Kingdom of Spain has not demonstrated that the exemptions provided for by the Spanish Law are *necessary* for the protection of the essential interests of its security. It is clear from the preamble to that Law that its principal objective is to determine and allocate the financial resources for the reinforcement and modernization of the Spanish armed forces by laying the economic and financial basis for its overall strategic plan. It follows that the VAT exemptions are not *necessary* in order to achieve the objective of protecting the essential interests of the security of the Kingdom of Spain.” (emphasis added)

¹³⁴ See S Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 347, point 6.97

evidence to substantiate its claim.¹³⁵ It has been argued that use of the word “necessary” amounted to the application of a proportionality test.¹³⁶ On this view, the Court applies the test with differing degrees of intensity, leaving variable margins of discretion to Member States depending on the security exemption in question.¹³⁷ It is recalled that a strict test is applied to the free movement exceptions, leaving a relatively narrow margin of discretion.¹³⁸ By contrast, it has been argued that the tax exemptions were manifestly unnecessary and so the judgment does not confirm the application of a very strict scrutiny.¹³⁹ Instead, Member States had a wide margin of political discretion.¹⁴⁰

Conversely, certain commentators have argued that a proportionality test cannot be derived from the judgment.¹⁴¹ Whilst use of the word “necessary” is ordinarily such an indication¹⁴² in this case, the Court instead applied a test of “manifest unsuitability”.¹⁴³

¹³⁵ *ibid* 241, point 4.60

¹³⁶ It has been suggested that AG Saggio also used the word in the same sense. The Court makes reference to para 12 of AG Saggio’s Opinion at para 23. See Trybus, *European Union Law and Defence Integration* (n 47) 153

¹³⁷ For a cogent assessment of certain of the main arguments for and against the adoption of a proportionality test by the Court in *Commission v. Spain*, see Trybus, *European Union Law and Defence Integration* (n 47) 154-157

¹³⁸ See Section 2.3 above

¹³⁹ Trybus *European Union Law and Defence Integration* (n 47) 153-4

¹⁴⁰ According to this interpretation, the Court will only consider a measure disproportionate when: (1) it is clearly unsuitable to promote national security which is put forward in bad faith; (2) the Member State has arbitrarily chosen a measure which is more detrimental to the internal market than necessary; or (3) the balance between the two interests is manifestly not present. See Trybus, *European Union Law and Defence Integration* (n 47) 153. See also D Eisenhut, ‘The Special Security Exemption of Article 296 TEC’ (n 117) 577-585 who states that the Court has “made it clear that the proportionality test should apply when examining national measures on the basis of Article 296 EC.” The conferment of a “wide discretion” was later confirmed by the CFI in Case T-26/01 *Fiocchi Munizioni SpA v Commission* [2003] E.C.R. I-11859 para 58 where it was stated: “Article 296(1)(b) EC confers on the Member States a particularly wide discretion in assessing the needs receiving such protection.” Case T-26/01 *Fiocchi* is discussed in more detail in Section 4.2 below

¹⁴¹ For a detailed discussion of the arguments against the application of a proportionality test, see Georgopoulos, ‘European Defence Procurement Integration: Proposals for Action within the European Union’ (n 75) 123-133

¹⁴² A strict proportionality test would require three levels of scrutiny. Applied to Article 346(1)(b) TFEU, this would require that the measure must be: (1) suitable for addressing the essential security interest and must not be relied upon in bad faith (on which the Member State bears the burden of proof); (2) necessary in the sense that there is not any other less restrictive measure with regard to the internal market which could address the aim (on which the Member State also bears the burden of proof) and (3) the security interest should be balanced with the interest of the internal market. See Georgopoulos, ‘European Defence Procurement Integration: Proposals for Action within the European Union’ (n 75) 124

The Court first examined whether the Spanish law referred to the protection of essential interests of security but does not proceed to an evaluation of these interests, rather confining assessment to the evidence adduced by the Member State.¹⁴⁴ Further, the Court identified that, even if it was accepted that the law genuinely addressed essential security interests, the imposition of tax would not undermine this objective given that the largest percentage of the income would in fact go to the State.¹⁴⁵ Accordingly, the exemption was unsuitable beyond any reasonable doubt.¹⁴⁶ In addition, the Court used a negative syllogism in its conclusion that Article 296(1)(b) TEC was not able to justify the Spanish law.¹⁴⁷ In particular, it provided that Spain had not established that the “abolition of the exemption from VAT” constitutes a measure which could undermine the protection of essential security interests, thus reinforcing the negative character of the Court’s scrutiny.¹⁴⁸

More recently, it has been argued that the ECJ simply applies a test based on the substantive wording of Article 346 TFEU.¹⁴⁹

¹⁴³ See Georgopoulos, ‘European Defence Procurement Integration: Proposals for Action within the European Union’ (n 75) 129 and A Georgopoulos, ‘Defence Procurement and EU Law’ (2005) 30(4) *European Law Review*, 559-572, 569 et seq. On this view, the Court did not apply step (2) or (3) of the proportionality test identified above at (n 142). Interestingly, Arrowsmith *The Law of Public and Utilities Procurement* (n 119) 242, point 4.61 has referred to Trybus’ interpretation as a “version” of the “manifest unsuitability” test, although Georgopoulos has attempted to qualitatively distinguish his version from the test proposed by Trybus

¹⁴⁴ See Georgopoulos, ‘European Defence Procurement Integration: Proposals for Action within the European Union’ (n 75) 129

¹⁴⁵ *ibid.* Here the Court placed specific reliance at para 23 on the reasoning of AG Saggio in his Opinion at para 12

¹⁴⁶ Georgopoulos, ‘European Defence Procurement Integration: Proposals for Action within the European Union’ (n 75)

¹⁴⁷ *ibid.*

¹⁴⁸ *ibid.*

¹⁴⁹ See N Pourbaix, ‘The Future scope of Application of Article 346 TFEU’ (2011) 1 *PPLR* 1. According to Pourbaix, this test comprises a four-stage examination. The first stage considers whether there are security interests which the Member State is seeking to protect. The Member State will enjoy a wide “discretion” in deciding what interests are to be protected and the ECJ will not interfere in these choices. The second question follows the wording of Article 346 TFEU itself, which states that these security interests must be essential. According to this view, existing case law is said to support the proposition that Member States will have a wide discretion in deciding what is essential to their security. The third step is to determine whether there is a link between the protection of these essential security interests and the procurement in question. The final step is

Thus, the issue of the form and standard of review has not been conclusively resolved. This issue is compounded by the fact that there are anomalous cases in which the ECJ has limited its scrutiny to verifying whether security interests are invoked without questioning the security requirements in issue or the suitability and necessity of the exclusion.¹⁵⁰ As the remainder of this Section will demonstrate, it is at least clear that *Commission v. Spain* did not fundamentally alter Member State practices.

4.2. Munitions Intended for Export

In 2003, the Court of First Instance (“CFI”) (now General Court of the EU) gave its ruling in *Fiocchi Munizioni SpA v. Commission*.¹⁵¹ In this case, Spain granted subsidies to a Spanish arms manufacturer. Fiocchi, an Italian arms manufacturer, requested a determination by the Commission of the subsidies’ compatibility with Articles 87,¹⁵² 88¹⁵³ and 296 TEC. Spanish authorities had informed the Commission that the manufacturer was a public undertaking devoted entirely to arms, munitions and tank manufacture such that its activities were covered by Article 296(1) TEC.¹⁵⁴

whether the non-application of the Directive is necessary for the protection of those interests. Again, the level of scrutiny applied to the necessity of the exclusion is likely to be limited. *ibid*, 8

¹⁵⁰ See Case C-252/01 *Commission v. Belgium* [2003] ECR I-11859

¹⁵¹ Case T-26/01 *Fiocchi Munizioni SpA v Commission* [2003] E.C.R. I-11859

¹⁵² Article 87(1) provided: “Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.”

¹⁵³ Article 88(1) provided: “The Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the common market.”

¹⁵⁴ Spain further argued at para 7 that its activities were recognized by Spanish law as being in the interest of Spain’s national defence, that its factories were the property of the Spanish Ministry of Defence in accordance with Spanish law relating to the reorganization of the arms industry and that its production was intended principally to meet its army’s requirements. Spain also claimed that the company’s activities were subject to Spanish law on state secrets

Having not defined its position after 15 months, Fiocchi brought an action against the Commission for failure to act.¹⁵⁵

After clarifying a number of procedural points in relation to Article 346(1)(b) TFEU,¹⁵⁶ the CFI found that the Commission had not failed to act.¹⁵⁷ Whilst *Fiocchi* is a case decided on procedural grounds and did not necessitate review of whether Spain's reliance on Article 346 TFEU was justified, Fiocchi's submissions merit specific consideration. Before doing so, it is important to observe that the CFI emphasized that Article 346(1)(b) TFEU confers on the Member States a "particularly wide discretion in assessing the needs receiving such protection".¹⁵⁸

With regard to the substance of Fiocchi's submissions, Fiocchi disputed the specifically military nature of the products, arguing that these were intended for both military and civilian purposes.¹⁵⁹ Fiocchi contended that in order to be regarded as "specifically military" within the meaning of Article 296, the products must be intended

¹⁵⁵ Article 232(1) TEC provided: "Should the European Parliament, the Council or the Commission, in infringement of this Treaty, fail to act, the Member States and the other institutions of the Community may bring an action before the Court of Justice to have the infringement established."

¹⁵⁶ The procedural clarifications were as follows. First, where a Member State considers it necessary to invoke Article 296(1)(b) TEC, it does not have to notify the Commission in advance as the rules on competition do not apply (para 59). Second, the Court emphasized that two specific remedies are prescribed by the Treaty in relation to measures adopted by Member States on the basis of Article 296(1)(b) TEC: bilateral examinations according to Article 298 subparagraph 1 TEC and court proceedings according to Article 298 subparagraph 2 TEC (paras 62 and 63). Within the context of bilateral examinations, it is within the Commission's discretion to decide whether the invocation by the Member State concerned is *prima facie* credible (para 63). Contrary to the situation in the context of Article 88 TEC, the Commission was under no obligation to adopt a decision concerning the measure at issue. Moreover, it has no power to address a final decision or directive to the Member State concerned (para 74)

¹⁵⁷ At para 78, the Court found that that the Commission had: (i) clearly informed Fiocchi of its decision to open the special procedure for bilateral examination with the Spanish authorities under Article 298(1) TEC; (ii) informed Fiocchi of the state of progress of the examination as well as the Commission's right to bring the matter before the Court in a case of allegedly improper use by Spain; (iii) the Commission had provided sufficient information on the legal remedies reserved to the Commission in cases where, considering that it was *prima facie* plausible to invoke Article 296(1)(b) TEC, the Commission decides not to resort to the ordinary rules for monitoring state aid; and (iv) finally the Commission had clearly indicated that in view of the procedure under Article 298, it had no intention of informing Fiocchi of its final position

¹⁵⁸ See *Fiocchi*, para 58. The reference to "needs receiving protection" is, however, equivocal

¹⁵⁹ *Fiocchi*, paras 52 and 53

solely for the domestic market.¹⁶⁰ Further, this was demonstrated by the condition “protection of the essential interests of national security”.¹⁶¹ The Spanish manufacturer had successfully participated in invitations to tender for the supply of armaments in other Member States (including for the supply of NATO material) because it had been strengthened by the subsidies.¹⁶² Thus, the subsidies materially improved its ability to produce and market munitions intended for export, which had the effect of distorting competition in the context of EU invitations to tender for the supply of munitions. Consequently, Fiocchi argued that there was no “military use for national defence covered by the derogation”.¹⁶³

According to one view, it is possible, on the basis of the general rule that exemptions have to be narrowly interpreted, that Member States are only able to argue that it is necessary to protect essential security interests where production and trade of defence material is intended for its own armed forces.¹⁶⁴ However, it has also been argued that it is possible for the protection of essential security interests to extend to the export of defence material (rather than to meet domestic needs) on the basis that there is no such limitation expressed in the wording of Article 346 TFEU itself and the CFI did not expressly preclude such a possibility.¹⁶⁵ It has been suggested that a Member State might consider a national defence industrial capability to be essential for its national security interests and which might not be economically viable if dependent solely on the producing Member State’s own demand or if the Member

¹⁶⁰ *ibid*

¹⁶¹ *ibid*

¹⁶² *ibid* para 52 and para 88

¹⁶³ *ibid* para 88

¹⁶⁴ Trybus, *European Union Law and Defence Integration* (n 47) 159

¹⁶⁵ *ibid*

State relies excessively on imports from other Member States or third countries.¹⁶⁶ However, it is open to question the extent to which this argument prioritises economic considerations above security considerations. Further, in light of the adoption of the Defence Procurement Directive, an economic reason may no longer be sufficient, in and of itself, to justify recourse to Article 346 TFEU, although it is unclear whether this position presumes that a discrete separation of economic and security considerations is possible and/or necessary.

It has also been suggested that it may be possible to justify State aid where the sale of equipment serves “strategic objectives”, although it has been acknowledged that this would be a difficult argument to sustain.¹⁶⁷ Again, in light of the Defence Procurement Directive, a very precise reason would be required.

Nevertheless, *Fiocchi* provokes consideration of the extent to which, if at all, Article 346 TFEU is able to admit the relevance of ‘external’ factors (howsoever defined), including reference to third countries, to a determination of the necessity of Member State action in protection of essential security interests.¹⁶⁸ As will be discussed in Section 4.5 below, Member States have sought a broader interpretation of the interests implicated by Article 346 TFEU and which raises questions relevant to a transatlantic defence procurement analysis.

¹⁶⁶ Trybus, *European Union Law and Defence Integration* (n 47) 160. As will be discussed this argument has also been considered by AG Kokott in Case C-615/10 *Insinööri Oy v. Puolustusvoimat* at para 66, discussed at Section 4.5 below

¹⁶⁷ See EDA (Commissioned Study), ‘Level Playing Field for European Defence Industries: The Role of Ownership and Public Aid Practices’ (16 March 2009) 29-30, para 2.6.1.1 <http://www.eda.europa.eu/docs/documents/Level_Playing_Field_Study.pdf> accessed 20 September 2013.

¹⁶⁸ This aspect will be examined in more detail in the discussion of the enforcement cases and Communication on Article 346 TFEU in Sections 4.5 and 5 below

4.3. Agusta Helicopters

In 2009, the ECJ gave two rulings in *Commission v. Italy I and II*.¹⁶⁹ Italy directly awarded helicopter contracts for the military and civilian corps to Agusta SpA (an Italian company). In Article 226 TEC proceedings, the Commission argued that, in accordance with the then Supplies Directive,¹⁷⁰ the contracts should have been subject to an open¹⁷¹ or restricted¹⁷² procedure. Italy did not contest that it had, for a long time, awarded such contracts to Agusta using the negotiated procedure¹⁷³ but argued that the helicopters intended for the military corps were covered by Article 296(1)(b) TEC and Article 3¹⁷⁴ of the Supplies Directive because they were “dual-use” items. Further, the confidential nature of the information obtained by Agusta for production purposes justified the negotiated procedure pursuant to Article 2(1)(b) of the Supplies Directive, a provision permitting exclusion *inter alia* where contracts are

¹⁶⁹ Case C-337/05 *Commission v Italy* [2008] ECR I-2173 and Case C-157/06 *Commission v Italy* [2008] ECR I-7313. *Commission v. Italy II* is substantially identical except that it concerned a Ministerial Decree authorizing derogation from EU public procurement rules (Decree No.558/A/04/RR/EC of the Minister for the Interior of 11 July 2003). In contrast, *Commission v. Italy I*, simply concerned a longstanding and consistent practice of direct awards. For a useful case summary, see D McGowan, ‘A note on Commission v. Italy (C-157/06): Helicopters (Part II)’ (2009) 2 PPLR 59. For general commentary on these cases, see B Heuninckx, ‘Case Comment, A note on Case Commission v. Italy (C-337/05) (Agusta Helicopters case) (2008)’ 5 PPLR 187; M Trybus, ‘Case C-337/05, Commission v. Italy (Agusta and Agusta Bell Helicopters), judgment of the Court (Grand Chamber) of 8 April 2008, not yet reported; and Case C-157/06, *Commission v. Italy*, judgment of the Court (Second Chamber) of 2 October 2008, not yet reported’ (2009) CML Rev 973

¹⁷⁰ See the former Supplies Directive (n 107)

¹⁷¹ For the purposes of Article 1(d) Supplies Directive, an open procedure was a national procedure whereby all interested suppliers may submit tenders. For commentary on the open procedure, see C H Bovis, *EU Public Procurement Law* (Edward Elgar: 2007) 229-230

¹⁷² For the purposes of Article 1(e) Supplies Directive, a restricted procedure was a procedure whereby only those suppliers invited by the contracting authorities may submit tenders. For commentary on the open procedure, see CH Bovis, *EU Public Procurement Law* (n 171) 231-236

¹⁷³ The negotiated procedure without prior call for tender is the least competitive procedure provided for in EU public procurement law. It allows negotiating a contract with a single company, provided the requirements of one of the clearly listed situations allowing the use of this procedure are met and the other rules of the relevant Directive are followed. For commentary on the negotiated procedure without publication, see CH Bovis, *EU Public Procurement Law* (n 171) 250-53. The corresponding provision of the Defence Procurement Directive permitting use of the negotiated procedure without publication of a contract notice is contained in Article 28

¹⁷⁴ Article 3 Supplies Directive provided that: “[w]ithout prejudice to Articles 2, 4 and 5(1), this Directive shall apply to all products to which Article 1(a) relates, including those covered by contracts awarded by contracting authorities in the field of defence, except for the products to which Article [296](1)(b) [EC] applies.”

declared secret.¹⁷⁵ In addition, Italy argued that due to the technical specificity of the helicopters and nature of the relevant supplies, Italy could rely on Article 6(3)(c)¹⁷⁶ and (e)¹⁷⁷ of the Supplies Directive, provisions which are not exclusions but which permit use of the negotiated procedure without publication on defined grounds. It appears that Italy employed these arguments not to legitimate the use of the negotiated procedure within the regime of the Directive, but to justify direct awards outside that regime.¹⁷⁸ Finally, Italy argued that its relations with Agusta were “in-house”, thereby precluding the Directive’s application.¹⁷⁹

The Court reaffirmed its earlier *Commission v. Spain* reasoning regarding use of security exclusions in clearly defined cases only and which must be subject to strict interpretation.¹⁸⁰ With regard to the “dual-use” classification of the helicopters, the Court held that in accordance with the clear wording of Article 346(1)(b) TFEU, the products must be intended for “specifically military purposes” and that where this use

¹⁷⁵ Article 2(1)(b) Supplies Directive provided that the Directive did not apply to: “[...] supply contracts which are declared secret or the execution of which must be accompanied by special security measures in accordance with the laws, regulations or administrative provisions in force in the Member States concerned or when the protection of the basic interests of the Member State’s security so requires.” This exception is now contained in Article 14 Public Sector Directive. This exception was successfully relied on in Case C-252/01 *Commission v. Belgium* [2003] ECR I-11859 (n 150)

¹⁷⁶ Art. 6(3)(c) provided that the contracting authorities may award their supply contracts by negotiated procedure without prior publication of a tender notice when: “[...] for technical or artistic reasons, or for reasons connected with protection of exclusive rights, the products supplied may be manufactured or delivered only by a particular supplier [...]”

¹⁷⁷ Art. 6(3)(e) provided that the contracting authorities may award their supply contracts by negotiated procedure without prior publication of a tender notice: “[...] for additional deliver[ies] by the original supplier which are intended either as a partial replacement of normal supplies or installations or as the extension of existing supplies or installations where a change of supplier would oblige the contracting authority to acquire material having different technical characteristics which would result in incompatibility or disproportionate technical difficulties in operation and maintenance. The length of such contracts as well as that of recurrent contracts may, as a general rule, not exceed three years.”

¹⁷⁸ See Trybus, ‘Commission v Italy I and II’ (n 169), 975

¹⁷⁹ In accordance with Case C-107/98 *Teckal Srl v Comune di Viano and Azienda Gas-Acqua Consorziale (AGAC) di Reggio Emilia* [1999] ECR I-8121, para 50. On the ECJ’s finding rejecting the applicability of the “in-house” exemption on the basis of the fact that Agusta was in part open to private capital, see paras 36-41 and Heuninckx, ‘Case Comment, A note on Case Commission v. Italy’ (n 169) 188

¹⁸⁰ Case C-337/05 *Commission v Italy* (n 169) paras 43-44

is “hardly certain”, the purchase must necessarily comply with the Directives.¹⁸¹ It was uncontested that the helicopters were for civilian use and possibly for military use.¹⁸² Therefore, their military use was “hardly certain”.¹⁸³ It has been argued that the “hardly certain” criterion merely confirms the strict reading of Article 346(2) TFEU.¹⁸⁴

With regard to the protection of confidential information, the Court reasoned that Italy had not stated precisely why confidentiality would be less well guaranteed were production entrusted to other EU companies.¹⁸⁵ The Court determined that a confidentiality obligation in no way prevented use of competitive tendering.¹⁸⁶ Therefore, recourse to Article 2(1)(b) was considered to be disproportionate.¹⁸⁷ It has been argued that this reasoning is convincing on grounds that, generally, confidentiality can be accommodated in negotiated procedures with prior publication and tenderers are normally able to adhere to strict confidentiality regimes.¹⁸⁸

Finally, with regard to Italy’s arguments concerning technical specificity, the Court ruled that the negotiated procedure may only be applied in cases exhaustively defined in Article 6(2) and (3) of the Supplies Directive.¹⁸⁹ Further, that derogations from the rules on public contracts must be strictly interpreted.¹⁹⁰ Member States

¹⁸¹ *ibid* para 47

¹⁸² *ibid* para 48

¹⁸³ *ibid* para 49

¹⁸⁴ See Trybus, ‘Commission v Italy I and II’ (n 169) 986-988

¹⁸⁵ Case C-337/05 *Commission v Italy* (n 169) para 51

¹⁸⁶ *ibid*, para 52

¹⁸⁷ *ibid* para 53

¹⁸⁸ Trybus, ‘Commission v Italy I and II’ (n 169) 989

¹⁸⁹ Case C-337/05 *Commission v Italy* (n 169) para 56

¹⁹⁰ *ibid*, para 57; Case C-57/94 *Commission v. Italy* [1995] ECR I-1249, para 23; Case C-3 18/94 *Commission v. Germany* [1996] ECR I-1949, para 13; and Case C-3 94/02 *Commission v. Greece* [2005] ECR I-4713, para 33

cannot use the negotiated procedure in cases not provided for by the Directive or add new conditions to existent cases which make that procedure easier to use.¹⁹¹ In addition, Member States bear the burden of proving exceptional circumstances.¹⁹² Italy had not demonstrated why only helicopters produced by Agusta would have the requisite technical specificities,¹⁹³ nor how a change of supplier would have resulted in incompatibility or disproportionate technical difficulties.¹⁹⁴ Italy had merely identified the advantages of interoperability.¹⁹⁵

It has been suggested that *Commission v. Italy* demonstrates that both exclusions and provisions restricting competition within the regime of a Directive must be subjected to the same level of scrutiny, a logic justified by the fact that the only material distinction between the two provisions is that one mechanism operates inside the Directives, whereas the other takes the contract outside the regime.¹⁹⁶ On this view, *Agusta* may therefore provide a potential insight into how rigorous the Court's scrutiny will be in relation to the exclusions and provisions on the use of negotiated procedure without publication under the Defence Procurement Directive.¹⁹⁷

¹⁹¹ Case C-337/05 *Commission v Italy* (n 169) *ibid*, citing Case C-84/03 *Commission v. Spain* [2005] ECR I-139, para 48

¹⁹² Case C-337/05 *Commission v Italy* (n 169) *ibid*, para 58 citing Case 199/85 *Commission v. Italy* [1987] ECR 1039, para. 14 and Case C-394/02 *Commission v. Greece* [2005] ECR I-4713, para. 33

¹⁹³ Case C-337/05 *Commission v Italy* (n 180)

¹⁹⁴ *ibid*

¹⁹⁵ It has been argued that this aspect of the ruling is significant in light of the fact that the military often procures its most expensive defence equipment in tranches, through separate contracts over a number of years. See Heuninckx 'Case Comment, A note on Case *Commission v. Italy*' (n 169) 192

¹⁹⁶ Trybus, 'Commission v Italy I and II' (n 169) 988-989

¹⁹⁷ For a discussion of the circumstances permitting use of the negotiated procedure without publication under the Defence Procurement Directive in the context of a comparison of limitations placed on competition under U.S. law, see Chapter 10

4.4. Customs Exemptions

More recently, the ECJ issued several judgments concerning failures by Italy,¹⁹⁸ Finland,¹⁹⁹ Greece,²⁰⁰ Germany,²⁰¹ Sweden²⁰² and Portugal²⁰³ to pay customs duties on imports of military (and, in the case of Sweden, also dual-use) material in accordance with EU customs legislation.²⁰⁴ All Member States sought to rely on Article 346(1)(b) TFEU. In response, the Commission issued Article 226 TEC proceedings. Greece and Germany raised an objection of inadmissibility on the ground that the Commission was obliged, and failed, to use the Article 348 TFEU procedure.²⁰⁵ The ECJ rejected this submission on the ground that the Commission had not, in fact, alleged the improper use of Article 346 TFEU but rather sought simply to enforce payment.²⁰⁶

Before examining the ECJ's judgments, it is instructive to outline the submissions of the Member States. These may be grouped as follows. Firstly, Member States simply argued, with varying degrees of specificity, that payment of import duties rendered

¹⁹⁸ Case C-239/06 *Commission v. Italy* [2009] ECR I-11913

¹⁹⁹ Case C-284/05 *Commission v. Finland* [2009] ECR I-11705

²⁰⁰ Case C-409/05 *Commission v. Greece* [2009] ECR I-11859

²⁰¹ Case C-372/05 *Commission v. Germany* [2009] ECR I—11801

²⁰² Case C-294/05 *Commission v Sweden* [2009] ECR I-11777

²⁰³ Case C-38/06 *Commission v. Portugal* [2010] ECR I-1569

²⁰⁴ See Articles 2, 9, 10 and 11, Council Regulation (EEC, Euratom) No 1552/89 of 29 May 1989, implementing Decision 88/376/EEC, Euratom on the system of the Communities' own resources [1989] OJ L 155/1 (as amended)

²⁰⁵ Case C—372/05 *Commission v. Germany* (n 201), para 28; Case C-409/05, *Commission v. Greece* (n200), para 23

²⁰⁶ See Case C—372/05 *Commission v. Germany*, paras. 29 and 30 and Case C-409/05, *Commission v. Greece*, para 25

equipment acquisition more expensive, thus reducing the operational capacity of armed forces.²⁰⁷

Secondly, Member States raised arguments in relation to confidentiality. Of particular relevance, certain Member States argued that “confidentiality obligations” owed to third parties must be respected. For instance, Sweden argued that because of its military neutrality, national defence has a strategic role within its security policy and that because of its “surface area” Sweden is dependent on cooperation at the international level if it is to meet its national security and defence objectives.²⁰⁸ Therefore, its confidentiality obligations precluded it from communicating information about the imported goods and that any failure to honour them would be likely to jeopardize the pursuit of cooperation and trading relations in the military field with certain third countries.²⁰⁹ Finland also argued that in order to maintain security of supply of high-technology defence material, it had to adhere very strictly to confidentiality agreements entered into with vendor States before it became a Member State.²¹⁰

Thirdly, certain Member States also placed additional emphasis on their individual characteristics. Finland argued that the need to rely on Article 346 TFEU when military equipment is imported depends principally on the size of Member State’s

²⁰⁷ Case C-294/05 *Commission v. Sweden*, para 36; Case C-372/05 *Commission v. Germany*, para 56; Case C-409/05 *Commission v. Greece*, para 45

²⁰⁸ Case C-294/05 *Commission v. Sweden*, para 37

²⁰⁹ *ibid.* By contrast, the Commission argued that Sweden had not established in what respect the commitments it entered into under international agreements, on the one hand, and its obligations with regard to own resources, on the other, were incompatible. Further, that Sweden had not established how Sweden’s international cooperation projects and essential interests of its security and defence policy were seriously jeopardised by those obligations. See Case C-294/05 *Commission v. Sweden*, para 31

²¹⁰ Case C-284/05 *Commission v. Finland*, para 40

military industry, the nature of the imported defence material and the extent to which that Member State is reliant on imports.²¹¹

With regard to the ECJ's judgments, prior to publication, it had been suggested that two main options were available to the ECJ. The first option, described as 'the *status quo* option', was to consider these cases as merely concerning the EU's own resources whilst assigning a minor role to Article 346 TFEU arguments.²¹² The second option would be to consider these as major cases pertaining to the interpretation of Article 346 TFEU in which the ECJ would define the limits of the Member States' competences.²¹³ The first option accurately summarises the course taken. In light of the fact that *Commission v. Spain* had similarly concerned VAT exemptions, the ECJ reiterated that a Member State could not plead the resulting increased cost of military material in order to avoid payment.²¹⁴ The ECJ also reinforced that the EU customs procedure was sufficiently capable of protecting confidentiality and safeguarding security interests.²¹⁵

In light of the fact that the cases merely concerned non-payment of customs duties, the ECJ did not address the question of whether any of the Member States' submissions could, in a compelling case, provide legitimate recourse to Article 346 TFEU. Building on the observations in relation to *Fiocchi* above, it is therefore unclear to what extent it may be possible for Member States to rely on factors

²¹¹ Case C-284/05 *Commission v. Finland*, para 37

²¹² Aalto, 'Interpretations of Article 296' (n 81) 113

²¹³ *ibid*

²¹⁴ *Commission v. Germany*, para 73; *Commission v. Finland*, para. 50 ; *Commission v. Sweden*, para 48; *Commission v. Greece*, para 55; *Commission v. Portugal*, para 67

²¹⁵ *Commission v. Sweden*, para 49; *Commission v. Finland*, para 55; *Commission v. Greece*, para 56; *Commission v. Germany*, para 74, *Commission v. Portugal*, para 68

pertaining to third countries when determining the basis for derogation under Article 346 TFEU.

4.5. Finnish Turntables

The latest ruling of the CJEU is *Insinööri-toimisto InsTiimi Oy v. Puolustusvoimat*.²¹⁶ In this case, the Finnish Defence Forces technical Research Centre issued a call for tenders for the supply of tiltable turntable equipment for the purposes of simulating combat situations, without prior publication and used a form of negotiated procedure which did not comply with the Public Sector Directive. One of the unsuccessful contractors challenged the award on this basis. The Finnish Court of First Instance dismissed the challenge on grounds that Article 346 TFEU could be relied on because the equipment was primarily for military purposes and that this was the contracting authority's intended use.²¹⁷ The unsuccessful contractor appealed arguing *inter alia* that Article 346 TFEU did not apply because the turntable was a technical innovation from the civilian sector.²¹⁸

Reiterating its earlier case law, the Court first confirmed that Article 296(1)(b) cannot be read so as to confer a power to depart from the EC Treaty based on no more than reliance on those interests.²¹⁹ Secondly, the Court determined that it is for the referring court to determine whether a product may be classified in one or other

²¹⁶ Case C-615/10 *Insinööri-toimisto InsTiimi Oy v. Puolustusvoimat*, Judgment of the Court (Fourth Chamber), not yet reported, June 7, 2012. For a useful case summary, see S Smith, 'Defence Purchasing of Material which Has Both Military and Civilian Applications – Tiltable Turntables in Finland – Case C-615/10' (2012) 5 PPLR 245

²¹⁷ Case C-615/10 *Insinööri-toimisto InsTiimi Oy v. Puolustusvoimat*, para 16

²¹⁸ *ibid* para 19

²¹⁹ *ibid* para 35

categories featuring in the 1958 list.²²⁰ Thirdly, the Court cited *Commission v. Italy (Agusta Helicopters)* as authority for the proposition that a contracting authority cannot invoke Article 296(1)(b) TEC when material is certainly for civilian use and possibly for military use.²²¹ Importantly, however, unlike in *Commission v. Italy*, the equipment was purchased for purely military purposes. The Court then stated that even if a product with technical applications for civilian use comes within one of the categories of the 1958 list, it can only be considered to be intended for “specifically military purposes” if it “results from the intrinsic characteristics of a piece of equipment specially designed, developed or modified significantly for those purposes”.²²² The Court further emphasized that the words “military”, “insofar as they are of a military nature” and “exclusively designed” in the 1958 list indicate that the products must have, in objective terms, a specifically military nature.²²³

It should be observed that the Court provides a ruling that pre-empts the adoption of the Defence Procurement Directive by emphasizing Recital 10 in which the EU legislature identifies that the term “military equipment” as used in the Directive should cover products which, although initially designed for civilian use, are later adapted to military purposes to be used as arms, munitions and war material.²²⁴

On the basis of this guidance, the Court left it to the referring court to determine whether the equipment met the above criteria,²²⁵ as well as whether the Member State can show that it is necessary to have recourse to Article 296(1)(b) TEC and

²²⁰ *ibid* para 37

²²¹ *ibid* paras 38-39, citing at 39 Case C-337/05 *Commission v. Italy* [2008] ECR I-2173, paras 48 and 49

²²² *ibid* para 40 citing point 48 of the Opinion of Advocate General Kokott

²²³ *ibid* para 41

²²⁴ *ibid* para 42

²²⁵ *ibid* para 43

whether the need to protect essential interests could not have been addressed within a competitive tendering procedure.²²⁶

Again, whilst the specific relevance of this case to a transatlantic defence procurement analysis may not be immediately apparent, AG Kokott made several statements relevant to “non-member countries”. Her observations related to the possibility that Finland might seek to argue that derogation was necessary to ensure confidentiality in relation to certain military information. This aspect was not expressly considered by the CJEU. Whilst AG Kokott identified that any such requirement does not, in itself, prevent the use of a competitive tendering procedure,²²⁷ she also stated that certain derogations from the EU procurement procedures may nevertheless be justified by the fact that a Member State does not wish simply to disclose security-related information to “foreign undertakings or undertakings controlled by foreign nationals, in particular undertakings or persons from non-member countries”.²²⁸ Further, that a Member state can also legitimately ensure that it does not “become dependent on non-member countries or on undertakings from non-member countries for its arms supplies” and that both points were “rightly highlighted” by an observing Member State.²²⁹

²²⁶ *ibid* para 46 citing *Commission v Finland*, para. 49 and *Commission v Italy*, para.53. Consistent with the generality of Member State practice in this regard, Finland had not actually specified explicitly which essential security interest was connected with the procurement of the turntable equipment, nor why the non-application of the Public Sector Directive was necessary in the specific case. The order of reference of the referring court stated that the Defence Forces had failed to specify these determinations as recommended by the European Commission. See Opinion of AG Kokott, para 29 and judgment, paras 25-32

²²⁷ Opinion of AG Kokott, para 64 citing at fn43 Case C-337/05 *Commission v. Italy* in particular para 52 and Case C-157/06 *Commission v Italy*, para.30. See also para 64, fn44

²²⁸ *ibid*, para 77

²²⁹ *ibid*, citing the Czech Government. The submissions of the Czech Government are not rehearsed in the Opinion

It should be observed that AG Kokott does not, in fact, cite any substantial authority for, or elaborate on, the references to “certain derogations” or justifications in support of their use. Further, AG Kokott does not explain the references to “foreign undertakings” and “foreign nationals” nor the issue of “dependence” on “non-member countries”.

Again, this reinforces earlier observations in this Chapter concerning the extent to which factors pertaining to third countries may or may not be relevant to a Member State’s individual assessment of Article 346 TFEU and which have not been examined in any detail. As will be discussed below, these observations are particularly pertinent in light of the fact that the Commission and European legal commentary has sought to prioritise the importance of shared European security interests in the assessment of Article 346 TFEU. It is this issue to which this Chapter now turns.

5. Interpretative Communication

Whilst the European Parliament had regularly argued for the deletion of Article 346 TFEU, the most decisive actor has been the Commission.²³⁰ In a 2003 Communication, the Commission identified defence procurement as an area for action towards the establishment of a European Defence Equipment Market.²³¹ This

²³⁰ See for instance, Resolution A3-0260/92 on the Community’s role in the supervision of arms exports and the armaments industry [1992] OJ C/284/138 at 142 and Resolution on the need for European controls on the export or transfer of arms [1995] OJ C/43/89, 90

²³¹ Commission, ‘European Defence – industrial and market issues. Towards an EU defence Equipment Policy’ (Communication) COM (2003) 113 final. For an analysis, see A Georgopoulos, ‘Industrial and Market Issues in European Defence: the Commission Communication of 2003 on Harmonisation and Liberalisation of Defence Markets’ (2003) 12 PPLR 82

precipitated a 2004 Green Paper,²³² and a public consultation on options for improving transparency and openness.²³³ The Commission concluded that the existing legislative framework did not function properly and that appropriate initiatives were required. This culminated in the adoption of the Defence Directives. In the interim, in 2006, the Commission adopted an Interpretative Communication on the application of Article 296 TEC (“Communication”).²³⁴ In 2007, the EU launched its “defence package”.²³⁵

As this Section will indicate, the Communication contains certain references which are relevant to a transatlantic defence procurement analysis. Before examining the Communication, it should be observed that this document is not legally binding and so cannot give an interpretation of Member States’ essential security interests nor determine *ex ante* the contracts to which Article 346 TFEU applies.²³⁶ Further, it does not deal with third country arms trade to which it refers as being “governed by WTO rules, in particular, the GPA”.²³⁷

²³² Commission, ‘Green Paper on Defence Procurement COM’ (2004) 608 final. For an analysis, see A Georgopoulos, ‘The Commission’s Green Paper on Defence Procurement’ (2005) 14(2) PPLR 34

²³³ Commission, ‘Results of the consultation launched by the Green Paper on Defence Procurement and on the future Commission initiatives’ (Communication) COM(2005) 626. For an analysis, see A Georgopoulos, ‘Commission’s Communication on the Results of the Consultation Process on European Defence Procurement’ (2006) 4 PPLR 119

²³⁴ Commission, ‘Interpretative Communication on the Application of Article 296 of the Treaty in the field of defence procurement’ (Communication) COM (2006) 779 final. For a useful analysis of the Communication, see A Georgopoulos, ‘The Commission’s Interpretative Communication on the application of Article 296 EC in the field of defence procurement’ (2007) 3 PPLR, 43

²³⁵ Commission, ‘A Strategy for a Stronger and More Competitive European Defence Industry’ (n 19). For a useful overview of this package, summarizing developments largely covered in this Chapter, see See P Koutrakos, ‘Editorial: The Commission’s “Defence Package”’ (2008) 33 EL Rev 1

²³⁶ Commission, ‘Interpretative Communication on the Application of Article 296 of the Treaty in the field of defence procurement’ (n 234) 3

²³⁷ *ibid*

5.1. Procurements of the Highest Importance

The Communication acknowledges that Member States retain responsibility to define their security interests but also states that Article 346 TFEU is limited to cases where Member States have “no other choice than to protect their security interests nationally”.²³⁸ Importantly, the Communication emphasises that protection of essential security interests is the only objective capable of justifying recourse to the derogation.²³⁹ This makes it clear that the specific military nature of the equipment is not, by itself, sufficient.²⁴⁰ The Communication specifies that the word “essential” limits exemptions to procurements of the “highest importance” for Member States’ military capabilities.²⁴¹ This also means that other interests, “in particular”, industrial and economic interests, although connected with the production of, and trade in, defence material cannot justify, by themselves, use of Article 346(1)(b) TFEU.²⁴² However, it has been observed that the Commission leaves unresolved the issue of what will happen if the measures are linked both with essential security interests and also with other economic and industrial interests, for example direct and indirect military offsets.²⁴³ It has been argued that such industrial or economic interests

²³⁸ *ibid* 5

²³⁹ *ibid* 7

²⁴⁰ *ibid*

²⁴¹ *ibid*

²⁴² Georgopoulos, ‘The Commission’s Interpretative Communication on the application of Article 296 EC in the field of defence procurement’ (n 234) 47-48

²⁴³ For a discussion of so-called “offsets”, see Chapter 7 and Chapter 11, Section 3. It is by no means clear that a discrete separation between security and other interests can be made. For instance, Georgopoulos, ‘The Commission’s Interpretative Communication on the application of Article 296 EC in the field of defence procurement’ (n 234) 48 states: “Let us take for example the decision of a national MoD to allocate directly a contract for the construction of submarines to a national champion in order to maintain national capabilities (aiming at the independence or limited dependence from foreign sources of supply). This measure is linked with both security concerns (domestic capability in a given field, security of supply) and has also industrial consequences (maintenance of post of employment), etc. This duality of concerns is self-evident. It should be remembered that this immediate link between capabilities and security considerations is advocated at the EU level by the European Commission itself and other actors with regard to the importance of maintaining a healthy and vibrant European Defence Industrial and Technological Base [...] Ultimately the issue of whether specific cases are linked more with industrial concerns rather than security concerns is a matter of judgment.”

cannot justify recourse to Article 346 TFEU even if they are connected with the production of, and trade in, arms, munitions and war material.²⁴⁴

5.2. Security Interests from a European Perspective

Another interesting aspect is the Communication's statement that security interests should be considered from a "European perspective."²⁴⁵ The Communication acknowledges that whilst security interests may vary, for example, for geographical or historical reasons, European integration has led to an "ever-growing convergence of national interests".²⁴⁶ The Commission cites the CFSP and ESDP in this regard.²⁴⁷ It continues that Member States share the objective of developing a European defence equipment market ("EDEM") and European Defence Technological and Industrial Base ("EDTIB"), which should be taken into account when assessing whether essential security interests would be undermined.²⁴⁸

However, the policy bias and function of the Communication should not be overlooked in its overt promotion of a European conception of security. Academic commentators have similarly adverted to this possibility. For instance, prior to the adoption of the Communication, EU legal commentary had argued that the emergence of a common European defence identity might shift the emphasis away from the national security interests of the individual Member States to a common concept of security and that the result could be that the mere possibility of national

²⁴⁴ Koutrakos, *European Foreign Policy: Legal and Political Perspectives* (n 56) 253

²⁴⁵ Commission, 'Interpretative Communication on the Application of Article 296 of the Treaty in the field of defence procurement' (n 234) 7

²⁴⁶ *ibid*

²⁴⁷ *ibid*

²⁴⁸ *ibid*

security implications would not be sufficient to invoke the exemption.²⁴⁹ More recently, it has been argued that there should be a “new” notion of “essential security interest” predicated on the ostensible emergence of the “Europeanization”²⁵⁰ of national security interests.²⁵¹ More generally, it has been argued that whilst the definition of essential security interests should be left to a Member State’s discretion, it is becoming increasingly less possible to look at the security of a State in isolation due, in particular, to the fact that State security is closely linked to the security of the international community at large, especially within the EU since the creation of the CFSP and ESDP.²⁵²

Notwithstanding the argument of, or for, convergence, it is important to observe that there has never been a comprehensive examination of the conceptual underpinnings of the supposedly “old” notion of essential security interests, an issue exposed in Section 2.4 of this thesis. Further, the idea of a “europeanized” conception of security has not been specifically endorsed by the ECJ and which is difficult to empirically validate. This might also appear to be inconsistent with judicial statements which specifically emphasise the fact that a Member State exercises a “unilateral” decision

²⁴⁹ M Trybus, ‘Case Comment: ‘On the Application of the EC Treaty to Armaments’ (2000) 25(6) EL Rev 663, 667

²⁵⁰ For a useful discussion of this phenomenon in the political science literature, see generally, K Featherstone and C M Radaelli (eds) *The Politics of Europeanization* (OUP, 2003). For a legal discussion of the phenomenon, see J Wouters, A Nollkaemper and E de Wet (ed) *The Europeanisation of International Law* (T.M.C. Asser Press 2008) 4-6

²⁵¹ See Eisenhut, ‘The Special Security Exemption of Article 296 TEC’ (n 117) 577-585

²⁵² According to this view, the same approach should also be taken when seeking to exclude an economic operator under the Defence Procurement Directive on the grounds that it has been found, on the basis of any means of evidence including protected data sources, not to possess the reliability necessary to exclude risks to the security of one of the EU Member States concerned. See B Heuninckx, ‘The EU Defence and Security Procurement Directive: Trick or Treat?’ (2011) 20 PPLR 9, 18-19 citing Article 39(2)(e) and Recital 67. These provisions are examined in Chapter 5, Section 5

to take measures under Article 346 TFEU, a position established as early as *Costa v Enel*.²⁵³

The above appears to prioritize an assessment of Article 346 TFEU which is focused exclusively on the interdependence of Member State security interests and which correspond to a convergent “European” interest. This underplays the equally valid independence of those interests as well as the interdependence of those same interests on third countries. Such interests might be served or realised outside the institutional framework of the EU e.g. through NATO,²⁵⁴ outside the EU and NATO, or bilaterally with third countries. Therefore, it is suggested that unsubstantiated notions of convergence risk illegitimately constraining the scope of Article 346 TFEU in a way that is not expressly mandated by the terms of the provision.

Interestingly, prior to the adoption of the Defence Procurement Directive, it was argued that one of the disadvantages of extending the Public Sector Directive to expressly cover defence contracts was that the award of a contract to promote a strategic alliance especially with powerful States outside the EU, such as the U.S., Russia or China could not constitute a legitimate award sub-criteria or parameter for assessment under the “most economically advantageous tender” (“MEAT”) award criterion, in particular, because award criteria must be justified by the subject matter of the contract in question.²⁵⁵ This observation does not necessarily suggest that the

²⁵³ See A-G Kokott, Case C-615/10, *Insinööri Oy v. Puolustusvoimat* (n 216) para 24, citing at fn14 Case C/64 *Costa v Enel* [1964] ECR 585

²⁵⁴ Article 42(2) subparagraph 2 TEU provides: “[t]he policy of the Union in accordance with this Section shall not prejudice the specific character of the security and defence policy of certain Member States and shall respect the obligations of certain Member States, which see their common defence realised in the North Atlantic Treaty Organisation (NATO), under the North Atlantic Treaty and be compatible with the common security and defence policy established within that framework.”

²⁵⁵ Georgopoulos, ‘European Defence Procurement Integration: Proposals for Action within the European Union’ (n 75) 100

promotion of a strategic alliance should constitute a legitimate sub-award criterion under a procurement procedure. No such provision is included in the Defence Procurement Directive. As will be discussed in the remaining Chapters of this Part, the Defence Procurement Directive also appears to require any justification under Article 346 TFEU to refer to the subject matter of the contract. Notwithstanding, this kind of insight is thought provoking in raising the issue as to whether it is possible to invoke Article 346 TFEU in consideration of matters pertaining to third countries. As will be discussed in this thesis, it is not impossible to conceive of such instances, although the legitimacy of which is open to debate.

5.3. Enforcement and Alliance Commitments

Finally, the Communication states that it is for the Member States to provide information at the Commission's request and prove that an exemption is necessary.²⁵⁶ Importantly, as indicated above, in the absence of a pre-or post-notification requirement, information is not required every time Article 346 TFEU is invoked.²⁵⁷

In terms of evidence, the Communication specifies that “general references to geographical and political situations, history and Alliance commitments” are insufficient,²⁵⁸ but does not identify whether specific references might be sufficient

²⁵⁶ Commission, 'Interpretative Communication on the Application of Article 296 of the Treaty in the field of defence procurement' (n 234) 8

²⁵⁷ For a discussion of the absence of a pre-notification requirement in this regard, see Georgopoulos, 'The Commission's Interpretative Communication on the application of Article 296 EC in the field of defence procurement' (n 234) 50

²⁵⁸ Commission, 'Interpretative Communication on the Application of Article 296 of the Treaty in the field of defence procurement' (n 234) 9. It is observed that the Commission refers to “Alliance” commitments in capitals. It is unclear whether the Commission is referring expressly to NATO (to which such reference is often made), or whether other “alliances” are also covered by this reference. This is a curious and imprecise term. For a

and, if so, the type and/or specificity of information that might be deemed sufficient in this regard.²⁵⁹ This issue may be problematic.²⁶⁰ It is suggested that there may be a basis for arguing, in an exceptional case, that Article 346 TFEU could be invoked in order to exclude the award of a contract because to award the contract in accordance with EU law could compromise a particular alliance commitment (with another Member State(s) or third country(ies)), which is, in turn, essential to a Member State's security. As indicated by the enforcement judgments, the ECJ has neither considered nor expressly rejected specific arguments relating to third countries. However, the possibility of raising arguments relating to non-European alliances may also be affected by the extent to which Europeanized conceptions of essential security interests are prioritised above non-European alliances in any justification posited. Much may also depend on the extent to which any consideration can be said to refer to the subject matter of the contract.

It was initially suggested that the Communication would become significant, opening the floodgates to repeated disputes before the ECJ.²⁶¹ However, as this Chapter has demonstrated, the effect of the Communication has, to date, been limited. Most importantly, the ECJ has not used the Communication as an explicit reference point in its judgments.

discussion of references to "alliances" in the context of application of the Defence Procurement Directive, see Chapter 5, Section 7.2.2

²⁵⁹ Georgopoulos, 'The Commission's Interpretative Communication on the application of Article 296 EC in the field of defence procurement' (n 234) 51

²⁶⁰ For a contrary view, see Georgopoulos, 'The Commission's Interpretative Communication on the application of Article 296 EC in the field of defence procurement' (n 234) 51 who states that it sends a message to Member States that have taken the view that they have different security concerns from other Member States that they must articulate their particular security interests more clearly. He identifies, in particular, countries at the borders of the EU, for example, Spain, Greece and Poland. Further, that new EU Member States who have also joined NATO should not consider their NATO membership as a justification for exemption

²⁶¹ S N Ferraro, 'The European Defence Agency: Facilitating Defense Reform or Forming Fortress Europe?' (2006-2007) 16 *Transnat'l L & Contemp Probs* 560, 595, fn269

6. Conclusions

Whilst Article 346 TFEU has exercised a formative impact on the development of an EU defence market, through a restrictive judicial interpretation, the issuance of interpretative guidance and the adoption of the Defence Procurement Directive, the EU is primed to develop a competitive internal market for defence material. The EU, its Member States and the U.S. must work out the implications of, and adapt to, any change in regulatory dynamics. As the remaining Chapters of the thesis will demonstrate, this is complicated by a host of factors.

Notwithstanding, European commentary has suggested that the likelihood of deleting Article 346 TFEU is still “close to zero” and that amendment would necessitate the complex task of revising the Treaties.²⁶²

A more penetrating analysis has revealed legal uncertainty which is directly relevant to a transatlantic defence procurement analysis. It is recalled that a high level NATO study has attributed significant weight to the effect of Article 346 TFEU in inhibiting a more competitive EU defence market, and in turn, the transatlantic defence market and recommends the need for a definition of “legally acceptable” interpretations of “essential security interest”.²⁶³ The preceding analysis signals caution regarding the complexity of this task.

The case law provides only the general interpretative context for a more limited application of Article 346 TFEU in light of the Defence Procurement Directive.

²⁶² Aalto, ‘Interpretations of Article 296’ (n 81) 35-36

²⁶³ NIAG High Level Advice Study No 154 (n 60)

Member States will have to provide specific justifications for non-compliance with EU law, necessitating more specific reasoning by national and EU courts. To date, absent a credible case, it has been unnecessary for the EU courts to engage the substance of Article 346 TFEU. It has been suggested that it by no means follows that the ECJ would adopt an intrusive and activist approach once substantive policy choices are properly explained.²⁶⁴

Further, there appears to be an increasing focus on the notion that essential security interests should be viewed from the perspective of the attainment of European defence and security objectives. As a result, little consideration has been given to the relevance of third countries in the assessment of Article 346 TFEU. It should also be observed that, similarly, no consideration has been given to third country perspectives on the role of Article 346 TFEU. For instance, the U.S. Fortresses and Icebergs Study has stated that the Defence Procurement Directive will likely accelerate the increasing use of competition in national defence procurement and make it harder for U.S. firms to obtain sole source contracts in Europe; however, the same Study states:

Perversely, U.S. defense firms will likely be major beneficiaries of individual national governments' continued willingness to invoke Article 296 EC Treaty to buy on a non-competitive basis from the United States (e.g., to fill urgent needs).²⁶⁵

²⁶⁴ Koutrakos (ed), *European Foreign Policy: Legal and Political Perspectives* (n 56) 252

²⁶⁵ *Fortresses and Icebergs* (Vol I) (n 12) 32. Whilst reference to "urgent needs" is not unequivocal, Article 28 of the Defence Procurement Directive, for example, only permits use of the negotiated procedure without publication of a contract notice in two circumstances. The first concerns the instance in which the periods laid down for use of the other stipulated procedures are incompatible with the "urgency resulting from a crisis" (Article 28(c)). The second concerns the instance in which its use is strictly necessary "for reasons of extreme urgency brought about

U.S. commentary has also referred to:

[t]he fact that a country may invoke the application of Article 296 of the EU Treaty to procure outside of EU Community law [...] (therefore being free to accept or refuse U.S. bidders).²⁶⁶

These views appear to envisage that Member States will be able to continue to invoke Article 346 TFEU with the effect of enabling awards to U.S. contractors. Importantly, however, these views do not elucidate: (i) whether it is necessary to invoke Article 346 TFEU at all; (ii) if so, the circumstances in which Article 346 TFEU would be invoked (reference only being made to the fulfilment of “urgent needs”) and whether such invocation would likely be deemed legitimate; and (iii) whether any invocation would need to make specific reference to third countries.²⁶⁷ The position could also be complicated by the fact that the Defence Procurement Directive permits Member States to determine whether or not to permit third countries to participate in contract award procedures.²⁶⁸

At the least, it is clear that there ought to be greater focus on the possible role of Article 346 TFEU in relation to matters pertaining to third countries. This Chapter has identified a risk that the jurisprudence, official documents and EU commentary may

by events unforeseeable by the contracting authorities/entities in question” (Article 28(d)). Therefore, EU law attempts, in the first instance, to restrict use of such grounds as a means of limiting competition by regulating these circumstances within the scope of the Directive

²⁶⁶ I Maelcamp, ‘European Union EU Defense Procurement Directive’, U.S. Commercial Service, August 2009, MR-131, 3 (available on request) <<http://export.gov/europeanunion/marketresearch/securityanddefensesector/index.asp>> accessed 20 September 2013

²⁶⁷ The above U.S. commentary appears to suggest that Article 346 TFEU can be invoked on certain grounds without reference to third countries, and that once successfully invoked, a Member State is then able to determine whether or not to permit a third country operator to bid or to award the contract to a third country operator

²⁶⁸ See Recital 18, para 2 of the Defence Procurement Directive, discussed in Chapter 4, Section 2.2

endorse a Euro-centric interpretation which may not accord adequate and sufficient weight to issues which implicate transatlantic defence trade interests (howsoever defined).

This thesis now turns to examine the relevance of certain other exclusions contained in the Defence Procurement Directive.

3

“Safe Harbours”

Contracts Excluded under the Defence Procurement Directive

1. Introduction

Whilst Chapters 4, 5 and 6 will accord due consideration to U.S. claims regarding the Defence Procurement Directive’s potential discriminatory application, it is important to recognize at the outset that the limitations on the Directive’s scope are equally significant. The possibility for the Directive’s exclusions to exempt the most organisationally complex and politically and economically significant forms of procurement from compliance with the Directive, raises real questions about the extent to which the Directive is therefore likely to appreciably impact on transatlantic defence trade. However, exclusion is not automatic. On a legal analysis, it is necessary to determine the extent to which Member States continue to retain freedom to conduct their defence procurement relations with the U.S. and transatlantic defence organisations such as NATO. In turn, this requires legal certainty regarding the scope, conditions for, and limitations on the use of the Directive’s exclusions. This Chapter examines the Directive’s provisions on excluded contracts.

It should be observed that the Directorate General on Internal Market and Services issued seven Guidance Notes to coincide with the Directive's transposition.²⁶⁹ In the absence of definitive judicial interpretations of the exclusions, this Chapter will seek to draw on the Guidance Note on Defence and Security Specific Exclusions.²⁷⁰

It should be further observed that this Chapter focuses only those exclusions most liable to directly implicate transatlantic defence trade, specifically contracts awarded in accordance with an international agreement, arrangement or organization, collaborative procurement and government-to-government contracts.

2. Residual Application of EU Treaty Principles and Provisions

Before examining the content of the exclusions, it is first necessary to clarify the legal relationship between the exclusions and the broader principles of the EU Treaties.

Legitimate recourse to one of the Directive's exclusions only excepts a measure from compliance with the Directive's provisions.²⁷¹ Any measure taken must still comply with EU Treaty principles as well as other EU Treaty provisions, unless a valid treaty derogation can be invoked such as Article 346 TFEU.²⁷²

²⁶⁹ This development is unprecedented. The Guidance Notes cover: (1) the Directive's field of application; (2) defence and-security-specific exclusions; (3) security of supply; (4) security of information; (5) subcontracting; (6) research and development and (7) offsets. In total, the Guidance Notes comprise 80 pages. It should be observed that the Guidance Notes reflect the views of the services of DG MARKT and are not legally binding. As this thesis is cautious to observe, other interpretations of the Directive's provisions are possible

²⁷⁰ All references to the "Guidance Note" will concern the Guidance Note on Defence and Security Specific Exclusions unless otherwise stated

²⁷¹ For a discussion of the ways in which such exclusions may operate in this context, see the discussion of Case C-337/05 *Commission v Italy* [2008] ECR I-2173 in Chapter 2, Section 4.3

²⁷² For a useful discussion of the applicability of EU law to defence procurement in light of the exclusions from the Public Sector and Defence Procurement Directives as well as the residual application of Article 346 TFEU and EU Treaty principles, see B Heuninckx, 'The Law of Collaborative Defence Procurement Through International Organisations in the European Union' (Ph.D Thesis submitted to the University of Nottingham, July 2011) 37-61

2.1. Compliance with EU Treaty Procurement Principles

Even if it is possible to rely on an exclusion contained within an EU procurement Directive to prevent application of its rules, the award of a public contract must nevertheless comply with the specific EU Treaty principles applicable to public procurement, which, in turn, derive from the general principles of EU law.²⁷³ It must be observed that recognition of these principles continues to be controversial.²⁷⁴ However, there appears to be increasing recognition of the following which include: non-discrimination on the grounds of nationality,²⁷⁵ equal treatment of economic operators;²⁷⁶ a positive obligation of transparency;²⁷⁷ a principle of mutual recognition;²⁷⁸ proportionality²⁷⁹ and effective judicial protection.²⁸⁰ It will only be

For a redacted version of this discussion, see B Heuninckx, 'Applicable law to the procurement of international organisations in the European Union' (2001) 4 PPLR 103, 115-121

²⁷³ These include: Article 18 TFEU (ex Article 12 TEC) relating to the prohibition of discrimination on grounds of nationality; Article 28-32 TFEU (ex Articles 23-31 TEC) on the free movement of goods; Articles 49-55 TFEU (ex Article 43-48 TEC) on the freedom of establishment; Article 56-62 TFEU (ex Articles 49-55 EC) on the freedom to provide services. See B Heuninckx, 'Applicable law to the procurement of international organisations in the European Union' (n 272) 117 cited at fn 124. More generally, see Commission, 'Interpretative Communication on the Community law applicable to contract awards not or not fully subject to the provisions of the Public Procurement Directives' (Communication) [2006] OJ C 179/2

²⁷⁴ Heuninckx, 'Applicable law to the procurement of international organisations in the European Union' (n 272) 118 and citations at fn 125

²⁷⁵ Case 21/88 *Du Pont de Nemours Italiana S.p.A. v Unità Sanitaria Locale No. 2 di Carrara* [1990] E.C.R. I-889, para 18; Case C-113/89 *Rush Portuguesa Lda v Office national d'immigration* [1990] E.C.R. I-1417, para 19; Case C-243/89 *Commission v Denmark (Storebaelt)* [1993] E.C.R. I-3353, para 45. Discussed in Heuninckx, 'The Law of Collaborative Defence Procurement Through International Organisations in the European Union' (n 272) 51-52

²⁷⁶ Case C-3/88 *Commission v Italy (Data Processing)* [1989] ECR 4035, 8; Case C-458/03 *Parking Brixen GmbH v Gemeinde Brixen and Stadtwerke Brixen AG* [2005] ECR I-8585, paras 46-49; Case C-410/04 *Associazione Nazionale Autotrasporto Viaggiatori (ANAV) v Comune di Bari and AMTAB Servizio SpA* [2006] ECR I-3303, paras 18-23. Discussed in discussion in Heuninckx, 'The Law of Collaborative Defence Procurement Through International Organisations in the European Union' (n 272) 53. See also Case C-410/04, *ANAV v Comune di Bari and AMTAB Servizio ("ANAV")* [2006] ECR I- 3303, para 20

²⁷⁷ Case 45/87 *Commission v Ireland (Dundalk)* [1988] ECR 4929, para 16; Case C-275/98 *Unitron Scandinavia A/S and 3-S A/S, Danske Svineproducenters Serviceselskab v Ministeriet for Fødevarer, Landbrug og Fiskeri* [1999] ECR I-8291, para 31; Case C- 324/98 *Telaustria and Telefonadress v Telekom Austria* [2000] ECR I-10745, paras 60-62; Case C-231/03 *Consorzio Aziende Metano (Coname) v Comune di Cingia de' Botti* [2005] ECR I-7287, para 16; C-260/04 *Commission v Italy* [2007] ECR I-7083, paras 22-24; Case C-91/08 *Wall AG v Stadt Frankfurt am Main and Frankfurter Entsorgungs- und Service (FES) GmbH* [2010] ECR I-02815, para 36. Discussed in Heuninckx, 'The Law of Collaborative Defence Procurement Through International Organisations in the European Union' (n 272) 52

²⁷⁸ Case C-340/89 *Irène Vlassopoulou v Ministerium für Justiz, Bundes- und Europaangelegenheiten Baden-Württemberg* [1991] ECR I-2357; Case C-76/90 *Manfred Säger v Dennemeyer & Co. Ltd* [1991] ECR I-4421, para 15; Case C- 59/00 *Bent Moustén Vestergaard v Spøttrup Boligselskab* [2001] ECR I-9505, para 23; Case

necessary to comply with these principles if the contract evidences a “certain cross border interest” capable of engaging contractors from other Member States.²⁸¹

Further, the subject of the obligation may also determine the applicability of the EU procurement principles. The Public Sector Directive only applies to procurement activities performed by ‘contracting authorities’.²⁸² It appears that contracting authorities must also comply with the procurement principles where the Directives do not apply.²⁸³ The ECJ has also held that ‘public authorities’ which otherwise do not fall within the definition of ‘contracting authority’ must also comply with these principles.²⁸⁴ As will be discussed below, an authority’s status may be relevant to determining the extent to which EU law applies to certain types of international organisation.

45/87 *Commission v Ireland* (Dundalk)) (n 278), para 22. Discussed in Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations in the European Union’ (n 272) 52

²⁷⁹ Case 122/78 *SA Buitoni v Fonds d’orientation et de régularisation des marchés agricoles* [1979] ECR 677, para 16; Case 66/82 *Fromançais SA v Fonds d’orientation et de régularisation des marchés agricoles (FORMA)* [1983] ECR 395, para 8; Case 15/83 *Denkavit Nederland BV v Hoofdprodukschap voor Akkerbouwprodukten* [1984] ECR I-2171, para 25. Discussed in Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations in the European Union’ (n 272) 52

²⁸⁰ Case C- 324/98 *Telaustria and Telefonadress v Telekom Austria* (n 279), para 62; Case C-231/03 *Consorzio Aziende Metano (Coname)* (n 279), para 21. Discussed in Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations in the European Union’ (n 272) 52-53

²⁸¹ Case C-507-03 *Commission v. Ireland* [2007] ECR I-9777, paras 25-31; Joined Cases C-147/06 and C-148/06 *SECAP SpA and Santorso Soc. Coop. arl v. Commune di Torino* [2008] ECR I-3565, paras 21, 24-26. For general commentary, see Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) points 4.25 and 4.34

²⁸² According to Article 1(9), “contracting authorities” means: “the State, regional or local authorities, bodies governed by public law, associations formed by one or several of such authorities or one or several of such bodies governed by public law.” The Defence Procurement Directive also only applies to contracting authorities or entities which are defined by reference to Article 1(9) Public Sector Directive

²⁸³ Case C-507-03 *Commission v. Ireland* (n 281) para 26

²⁸⁴ Case C-91/08 *Wall* (n 277), paras 47-52 and 60; Case C-26/03 *Stadt Halle, RPL Recyclingpark Lochau GmbH v Arbeitsgemeinschaft Thermische Restabfall-und Energieverwertungsanlage TREA Leuna* [2005] E.C.R. I-1, paras 48-50. For a discussion in this regard, see Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 49-50

2.2. Compliance with International Obligations Owed to Third Countries

As indicated above, in addition to the applicability of EU Treaty principles, a Member State will also have to comply with other TFEU provisions. An important provision in this regard is Article 351 TFEU (ex 307 EC).²⁸⁵ Article 351 TFEU provides in relevant part that:

The rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties [...]

In light of the above, post 1 January 1958 or accession, Member States cannot enter a commitment within the framework of an agreement that could conflict with an EU obligation nor adopt a measure contrary to EU law where it is permitted (but not required) by an agreement.²⁸⁶ Relevant to the present discussion, is the issue of international agreements concluded between one or more Member States and one of more third countries after 1958.

It is generally understood that Member States may not conclude international agreements on matters falling within the EU's exclusive competence without

²⁸⁵ For a detailed discussion of this provision, see J Klabbers, *Treaty Conflict and the European Union* (CUP 2009) Ch. 6, 8 and 9

²⁸⁶ See respectively Joined Cases 3, 4 and 6/76, *Officier van Justitie v. Kramer* [1976] E.C.R. 1279, paras 44-45 and Case C-324/93 *R. v. Secretary of State for the Home Department, ex p. Evans Medical and MacFarlane Smith Ltd* [1995] ECR I-563, para cited by Heuninckx, 'The Law of Collaborative Defence Procurement Through International Organisations' (n 272) 83, fns 325 and 326

authorization.²⁸⁷ However, Member States may conclude agreements on matters of shared competence.²⁸⁸ The internal market constitutes a shared competence.²⁸⁹ It follows that public procurement is a shared competence.

However, when rules are adopted for the attainment of EU Treaty objectives, the Member States are prohibited from assuming obligations which might affect those rules or alter their scope.²⁹⁰ This would preclude the conclusion of an agreement by an EU Member State with third parties contrary to EU law.²⁹¹ In addition, Article 4(3) TEU provides that:

Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties.

The Member States shall take any appropriate measure, general or particular, to ensure fulfillment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union.

²⁸⁷ Article 3(1) TFEU provides that: “[t]he Union shall have exclusive competence in the following areas: (a) customs union; (b) the establishing of the competition rules necessary for the functioning of the internal market; (c) monetary policy for the Member States whose currency is the euro; (d) the conservation of marine biological resources under the common fisheries policy; (e) common commercial policy.” Article 3(2) further provides that: “[t]he Union shall also have exclusive competence for the conclusion of an international agreement when its conclusion is provided for in a legislative act of the Union or is necessary to enable the Union to exercise its internal competence, or in so far as its conclusion may affect common rules or alter their scope.”

²⁸⁸ Article 4(1) TFEU provides that: “[t]he Union shall share competence with the Member States where the Treaties confer on it a competence which does not relate to the areas referred to in Articles 3 and 6.” Article 4(2) further provides that: “[s]hared competence between the Union and the Member States applies in the following principal areas: (a) internal market; (b) social policy, for the aspects defined in this Treaty; (c) economic, social and territorial cohesion; (d) agriculture and fisheries, excluding the conservation of marine biological resources; (e) environment; (f) consumer protection; (g) transport; (h) trans-European networks; (i) energy; (j) area of freedom, security and justice; (k) common safety concerns in public health matters, for the aspects defined in this Treaty.”

²⁸⁹ *ibid*

²⁹⁰ *Case 22/70 Commission v Council (AETR)* [1971] ECR 263, paras 21-22

²⁹¹ *Joined Cases C-176/97 and C-177/97 Commission v. Belgium and Luxemburg* [1998] ECR I-3557, para 42

The Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives.

The above obligations are specifically relevant to a transatlantic defence procurement analysis. As will be discussed below, Article 351 TFEU may be relevant to determining which types of international organization may legitimately be excluded from compliance with EU law. Further, as will be discussed in Chapter 4, it is generally considered that Member States are prohibited from concluding international agreements with third countries in the field of public procurement on the basis that the EU has exercised its exclusive competence in the field of common commercial policy.²⁹² In the absence of a similar exercise of EU exclusive competence in the field of defence procurement, Member States could conceivably conduct their procurement relations with third countries in a way determined to be incompatible with EU law. An important question, therefore, is whether the Defence Procurement Directive provides an effective means of ensuring compatibility between Member State international obligations and their obligations under EU law. It is this issue to which this Chapter now turns.

2.3. Use of Exclusions under the Defence Procurement Directive

Unlike the Public Sector Directive, the Defence Procurement Directive contains a specific provision on the use of exclusions. Article 11 provides:

²⁹² See Chapter 4, Section 2.1

None of the rules, procedures, programmes, agreements, arrangements or contracts referred to in this section may be used for the purpose of circumventing the provisions of this Directive.

The inclusion of such a provision is likely due not simply to the additional number of exclusions contained in the Defence Procurement Directive but the greater perceived susceptibility for such exclusions to be misused in light of the historical experience identified in Chapter 2 regarding the use of exceptions and Article 346 TFEU. The Guidance Notes describe Article 11 as a “general safeguard clause”.²⁹³ Article 11 is said to serve as an explicit reminder of the ECJ case law prohibiting the use of legal structures that are exempt from EU public procurement rules with the principal aim of avoiding transparent and competitive contract award procedures without objective reasons.²⁹⁴ The Guidance Note reiterates that such exceptions must be strictly interpreted.²⁹⁵ Contracting authorities bear the burden of proving that the procurement falls under one of the specified exclusions.²⁹⁶

It is clear that Article 11 is intended to have declaratory, rather than any substantive, effect. For instance, it is not clear what is meant by “used” for the purpose of “circumventing” the Directive’s provisions. Further, there is no pre- or post-

²⁹³ See Guidance Note, Research and Development, 4, point 12 and Guidance Note, Security of Information, 11, point 26

²⁹⁴ Guidance Note, Defence- and security- specific exclusions, 1, point 2, para1 citing Judgment of 9 June 2009 in Case C-480/06 *Commission v. Germany* [2009] ECR I-04747, para.48

²⁹⁵ Guidance Note, Defence- and security- specific exclusions, 1, point 2, para. 2 citing at fn 2 Case C-480/06 *Bayerischer Rundfunk* [2007] ECR I-11173, para 64

²⁹⁶ Guidance Note, Defence- and security-specific exclusions, 1, point 2

notification requirement of use.²⁹⁷ The Directive also expressly excludes review of their use.²⁹⁸ In addition, Article 11 does not refer to the requirement to ensure that any rule, procedure, programme, agreement, arrangement or contract, must be concluded or otherwise be in conformity with EU law.²⁹⁹

The above is particularly stark given the historical tendency of Member States to misuse exceptions to the procurement Directives. Further, the Guidance Note specifically envisages the possibility that Member States may enter into agreements which specify rules or procedures or permit measures which would be contrary *inter alia* to Article 4(3) TEU.³⁰⁰

Therefore, it is submitted that Article 11 cannot be said to enable adequate monitoring, regulation or resolution of compatibility and conflict issues. This may be indicative of a more general and fundamental uncertainty regarding the precise relationship between Member States' international and EU law obligations in the field of defence procurement.

²⁹⁷ The Guidance Note, Defence- and security- specific exclusions, 2-3, point 2, para 3 simply states that contracting authorities intending to rely on one of the exceptions "might consider" publishing a voluntary *ex ante* notice under Articles 60(4) and 64 Defence Procurement Directive. The Guidance encourages this option on the basis that such publication at least formally announces and justifies its decision to award a contract without prior publication of a contract notice in the Official Journal. It also attempts to highlight as an incentive that if the contracting authority has published an *ex ante* notice and observed a standstill period of 10 days following publication, the contract cannot be determined to be ineffective by application of Article 60(1)

²⁹⁸ Article 55(1) Defence Procurement Directive

²⁹⁹ By contrast, Article 15(a) Public Sector Directive expressly includes a reference to "an international agreement concluded in conformity with the Treaty." It is not clear why such an explicit reference is not made either in Article 11 or the exclusions of the Defence Procurement Directive. Such a reference is not strictly necessary as a Directive cannot oust the overriding EU Treaty principles. Notwithstanding, such a reference would emphasise the positive obligation to ensure conformity

³⁰⁰ See Guidance Note, Defence- and security- specific exclusions, 2, point 3, para 4

3. International Agreements and Arrangements

Both the Public Sector and Defence Procurement Directives contain exclusions concerning the award of contracts governed by international agreements. According to Article 12(a), the Defence Procurement Directive will not apply to contracts governed by:

[...] specific procedural rules pursuant to an international agreement or arrangement concluded between one or more Member States and one or more third countries [...] ³⁰¹

According to the Commission Report on the Directive's transposition, most Member States have transposed this provision without changing the material scope of Article 12.³⁰² Described in the Guidance Note as "very generic",³⁰³ Article 12(a) is broader than its Public Sector Directive comparator in a number of respects. Firstly, the Public Sector Directive exclusion is confined to the exploitation of a "work" or "project" whereas Article 12(a) contains no restriction as to subject matter. Secondly, the Public Sector Directive exclusion refers to contracts concluded between "a" Member State and one or more third countries whereas Article 12(a) applies to agreements and arrangements involving one or more Member States and third

³⁰¹ Cf Article 15(a) Public Sector Directive which provides: "[t]his Directive shall not apply to public contracts governed by different procedural rules and awarded [...] pursuant to an international agreement concluded in conformity with the Treaty between a Member State and one or more third countries and covering supplies or works intended for the joint implementation or exploitation of a work by the signatory States or services intended for the joint implementation or exploitation of a project by the signatory States [...]". For general commentary, see S Arrowsmith, *The Law of Public and Utilities Procurement* (n 119), 358-9, point 6.109

³⁰² See Commission, Report to the European Parliament and The Council on transposition of directive 2009/81/EC on Defence and Security Procurement, Brussels COM(2012) 565 final, 5

³⁰³ See Guidance Note, Defence- and security- specific exclusions, 3, point 4, para 2

countries.³⁰⁴ Thirdly, the Public Sector Directive exclusion only refers to international “agreements” whereas Article 12(a) additionally excludes “arrangements”, the significance of which is addressed below.

3.1. Scope of the Term “international Agreement”

The Public Sector and Defence Procurement Directives do not define an “international agreement”. Similarly, the ECJ has never issued a judgment on its meaning for EU law purposes.

3.1.1. Contracts Awarded Through NATO Procurement Procedures

Whilst Article 12(a) does not expressly refer to international organizations, it has been argued that given that an international organization can be created by an international agreement through its constituting instrument, Article 12(a) most likely covers contracts awarded under the procurement procedures of organizations comprised of one or more EU Member States and one or more third countries.³⁰⁵ Importantly, on this interpretation, the operational procurement activities of NATO could be excluded.³⁰⁶

³⁰⁴ It is not clear whether reference to “a” in Article 15(a) permits the exemption of multilateral agreements between more than one EU Member State and one or more third countries or is confined to agreements involving a single Member State and one or more third countries. There is no ECJ case law directly confirming either interpretation. See B Heuninckx, ‘Lurking at the Boundaries: Applicability of EU Law to Defence and Security Procurement’ (n 80), 105. It is therefore unclear whether the addition of “one or more Member States” under Article 12(a) constitutes a clarification of, or qualitative difference to, the provision in Article 15(a)

³⁰⁵ Heuninckx, ‘Applicable law to the procurement of international organisations in the European Union’ (n 272)

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³⁰⁶ *ibid*

3.2. Classification as an Automatic Basis for Exclusion

It has been questioned whether the term “international agreement” contained in the Public Sector Directive exclusion could incorporate international arrangements.³⁰⁷ The express addition of “international arrangement” renders it unnecessary to seek a similarly broad interpretation of “international agreement” under Article 12(a).

However, this does raise the question as to whether the fact of constituting an international arrangement would be sufficient, in and of itself, to legitimate exclusion under Article 12(a).

For instance, it has been argued that, for the purposes of the Public Sector Directive exclusion, “international agreement” could incorporate not only “binding” treaties but also “non-binding international arrangements” in the form of Memoranda of Understanding (“MOUs”).³⁰⁸ In relation to the Defence Procurement Directive, it has been stated that “international arrangements” are seen a “distinct category” from international agreements;³⁰⁹ further, that the EU legislator expressly included the term “international arrangement” to distinguish between legally binding international agreements and non-binding arrangements, in particular, MOU’s.³¹⁰ The significance of these references concerns the fact that the U.S. and certain EU Member States are signatories to a number bilateral reciprocal defence procurement Memoranda of Understanding or “RDPs” which, as will be discussed in Chapter 11, U.S. legal

³⁰⁷ Heuninckx, ‘Lurking at the Boundaries’ (n 304)

³⁰⁸ *ibid* and fn92 citing A Aust, *Modern Treaty Law and Practice* (CUP 2000) 26-30 on non-binding international agreements

³⁰⁹ Heuninckx, ‘Lurking at the boundaries’ (n 80) 110

³¹⁰ *ibid* citing at fn 124 a Private communication from I Maelcamp d'Opstaele, United States Mission to the European Union, November 17, 2009

commentators have identified as playing a potential role in transatlantic defence procurement in light of the adoption of the Defence Procurement Directive. It has been stated that Article 12(a) “by its terms” confirms exclusion of the RDPs.³¹¹

It is observed that these views appear to be predicated on the assumption that the categorization of an instrument as an “international agreement” or “international arrangement” is a sufficient basis to legitimate exclusion. The assumption appears to be that an international agreement is legally binding and, therefore, an international arrangement is not; further, if the former is excluded, it must follow that the latter is similarly excluded.

However, the Defence Procurement Directive does not, itself, draw a legal distinction between “international agreements” and “international arrangements”. Further, the Directive does not necessarily identify legal status as constituting the sole basis for exclusion.³¹² It is conceivable that “international arrangement” could have been included to indicate that such arrangements require a separate and discrete assessment, irrespective of legal status.

To this extent, it is submitted that other criteria for exclusion have possibly been overlooked, an issue to which this Chapter now turns.

³¹¹ C Yukins, ‘The European Defence Procurement Directive: An American Perspective’ (2009) *The Government Contractor* Vol 51 (41), 5

³¹² Recital 26 merely states that “[...] provision should be made for cases where this Directive does not apply because specific rules on the awarding of contracts which derive from international agreements or arrangements between Member States and third countries apply [...]”

3.2.1. Basis for Exclusion: “Specific Procedural Rules”

To an extent, presumptions about the automatic exclusion of international arrangements are understandable. For instance, the Guidance Note states that inclusion of the term “arrangement” makes it “very clear” that this provision covers not only international treaties ratified by national parliaments but also MOUs concluded at the level of the ministries concerned.³¹³

Importantly, however, according to the Guidance Note, exclusions under Article 12 are only possible if the contract falls within the scope of international rules which provide a specific procedure for the award of the contract.³¹⁴ On this interpretation, it is the requirement of “specific procedural rules” that ultimately determines the validity of the exclusion.³¹⁵ In this regard, the Guidance Note states that “specific procedural rules” should be understood as requiring:

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.³¹⁶

Importantly, the Guidance Note states that the term must be interpreted restrictively.³¹⁷

³¹³ Guidance Note, Defence- and security- specific exclusions, 3, point 4, para 2

³¹⁴ *ibid*, 2, point 3, para 2

³¹⁵ This is arguably supported by Recital 26 (n 312)

³¹⁶ Guidance Note (n 313)

³¹⁷ *ibid*

It is not clear whether the reference to “specific” as opposed to “different” (the wording used in the Public Sector Directive exclusion) is material or what accounts for the change in language. This may constitute further evidence of the importance of the specificity of procedural rules as an independent exclusion criterion. Commentators had previously addressed the reference to “different” procedural rules in the Public Sector Directive exclusion. It had been suggested that this exclusion appears to apply only when it is intended that “their” procedures should govern, or where no other formal procedures have been set out.³¹⁸ Although not specified, “their” appears to refer exclusively to a procedure set by a third country. For instance, it has been argued that if the international agreement foresees that contracts will be awarded in accordance with the U.S. Federal Acquisition Regulation, and assuming that the other conditions for invoking the exclusion are satisfied, the exclusion would be permitted.³¹⁹ Conversely, it has been argued that if the agreement prescribes that contracts will be awarded on the basis of the law of an EU Member State, then the Public Sector Directive would probably have to be complied with.³²⁰

However, it is difficult to apply this interpretation to Article 12(a). The Guidance Note refers to “specific procedural rules set by an international agreement or arrangement or by an international organisation.”³²¹ This may require the international agreement to prescribe its own independent procedure.³²² It similarly follows that the requirement of “specific procedural rules” would preclude exclusion of a contract

³¹⁸ Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 358-359, 6.109

³¹⁹ Heuninckx, ‘Lurking at the boundaries’ (n 80) 105-106. Heuninckx does not specify the “other conditions” to which he refers

³²⁰ *ibid*

³²¹ Emphasis added. See Guidance Note, 2, point 3, para. 2.

³²² Clarity is not aided by references to contracts “governed” by different or specific procedural rules “pursuant” to an international agreement or arrangement and specific procedural rules “of” an international organisation. Similarly, Recital 26 only refers to specific rules which “derive” from international agreements or arrangements

under Article 12(a) simply on the basis that no other formal procedures have been identified.

Further, there is also a more general uncertainty as to what will constitute “specific procedural rules” sufficient to validate exclusion. As the Guidance Note observes, Article 12(a) contains no specific requirements regarding the content of the procurement rules.³²³

The Guidance Note only provides the following hypothetical illustration of the requirement for “specific procedural rules”:

If, for example, Member States and third countries concluded a Memorandum of Understanding (MoU) on the pooling or sharing of certain capabilities which are still to be procured, these procurements would be covered by Article 12(a) only if the MoU contained specific procurement rules and procedures to be applied to these purchases. If not, the Member States concerned would have to award the relevant procurement contracts following one of the procedures of the Directive.”³²⁴

Whilst not unequivocal, it appears that the above scenario would require a contracting authority of a Member State to award a contract to a national or EU contractor in compliance with the Directive.³²⁵

³²³ Guidance Note, Defence- and security specific exclusions, 2, point 3, para 4

³²⁴ *ibid*, para 3

³²⁵ Given that the Defence Procurement Directive provides that Member States retain power to determine whether or not to permit third countries to participate in contract award procedures, it is not clear that Member States could then be required to award the contract to a third country in accordance with the Directive. For a more detailed discussion of the Directive’s formal position with regard to third countries, see Chapter 4

However, it appears to be implicit in the Guidance that the fact that the Member States concerned would have to procure according to the Directive would not affect, or would be without prejudice to, any procurement undertaken by cooperating third countries under the arrangement. Yet, it is not clear whether the requirement to comply with the Directive may undermine the objectives pursued.³²⁶ Further, if the purpose of the MOU is to share capabilities, it cannot be presumed that it would be feasible or practical for the MoU to specify a discrete set of its own procurement procedures where procurement serves merely an instrumental function to the pooling and sharing objective. Thus, it is unclear the extent to which legal uncertainty of this kind may impact on the practical implementation of procurement undertaken within transatlantic programmes. Whilst, as will be discussed below, it may be possible to have recourse to Article 13(c) Defence Procurement Directive which excludes contracts awarded in the framework of cooperative programmes, this exclusion only applies to programmes based on R&D. Therefore, an MOU for simple purchases of developed equipment i.e. without R&D content would not likely benefit from this exclusion. Further, such cooperative transatlantic R&D programmes have, to date, been limited.³²⁷

In addition to the issues identified, the reference to “specific procedural rules” also raises the question of whether the RDPs meet the requirements for

³²⁶ For instance, if the Directive’s application is considered, for whatever reason, to unduly prejudice or compromise the conduct of the arrangement or organization and efficiency of programmes, certain procurement functions may have to be reallocated to cooperating third countries that may, under their arrangements, have a greater degree of flexibility. Further, it may not be possible to coordinate procurement procedures between cooperating States to ensure a degree of compatibility or logistical practicability. An alternative might be for the MoU to adopt the rules of the Defence Procurement Directive as a uniform procurement model. However, it is open to question whether relevant third countries would consent to such use. In addition, by the very fact of the Directive’s exclusions on cooperative procurement, the Directive’s rules are not necessarily suited for application to pooling and sharing functions

³²⁷ See J P Bialos, C E Fisher S L Koehl, *Fortresses and Icebergs* (Vol I) (n 12) 146-148

exclusion. This analysis is postponed until Chapter 11 which examines the RDP procurement provisions in detail.

4. International Organisations

The Public Sector and Defence Procurement Directives both exclude contracts governed by rules of an international organisation. Article 12(c) provides that the Defence Procurement Directive does not apply to contracts governed by:

[...] 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.”³²⁸

According to the Commission Report on transposition, most Member States have transposed this provision without changing the material scope of Article 12.³²⁹

Before examining the scope of Article 12(c), it is important to clarify that this part of the analysis draws heavily on recent research which has assessed the extent to which EU public procurement law is *prima facie* applicable to certain international organisations in the field of defence.³³⁰ Such analysis is technical and is appropriately qualified by its recognition of the fact that there is no substantial CJEU

³²⁸ Article 15(a) Public Sector Directive provides that the Directive does not apply to public contracts governed by: “[...] different procedural rules and awarded [...] pursuant to the particular procedure of an international organisation.”

³²⁹ However, at least one Member State has broadened the scope of the exclusion of Article 12(c). Its national implementing measure does not restrict the exclusion to purchases for an international organisation's purposes. See Commission, Report to the European Parliament and The Council on transposition of directive 2009/81/EC on Defence and Security Procurement (n 302) 5

³³⁰ See Heuinckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) and Heuinckx, ‘Applicable law to the procurement of international organisations in the European Union’ (n 272)

case law directly on this issue. It is nevertheless necessary to provide a synthesis of this research in order to identify the extent to which major European and transatlantic defence procurement institutions could be said to be subject to EU law.

In order to aid clarity, it is useful to keep the following in mind. Firstly, the EU procurement Directives only apply to “contracting authorities” (and which includes, *inter alia*, “bodies governed by public law”). This raises the question as to whether international organisations, including those comprised of mixed EU-third country membership, constitute contracting authorities and may therefore be subject to the Directive. Secondly, even if international organisations do not meet the definition of contracting authority, it is recalled from Section 2 that the EU Treaty procurement principles may still apply if an international organisation satisfies the definition of a “public authority”. Finally, if an international organisation satisfies the definition of “contracting authority”, the question remains as to whether it could rely on the relevant international organisation exclusion. Again, it is recalled from Section 2 that that even if legitimate recourse to an exclusion is possible, the EU Treaty procurement principles may still apply. Having examined the scope of Article 12(c), this section concludes by summarizing the extent to which EU law applies to three key international organisations in the field of defence procurement.

4.1. International Organisations as Bodies Governed by Public Law

The Public Sector and Defence Procurement Directives only apply to procurement performed by “contracting authorities”.³³¹ As will be discussed in Section 4.2, the

³³¹ For the definition of “contracting authority”, see Article 1(9) Public Sector Directive and Article 1(17) Defence Procurement Directive. The definition is provided at (n 282)

questions of whether, and what types of, international organisations are capable of constituting contracting authorities such as to enable recourse to the international organisation exclusion are not settled. Prior to the adoption of the Defence Procurement Directive, it had been argued that international organisations could not constitute contracting authorities.³³²

More recently, it has been questioned whether international organisations could fall within the broader notion of “bodies governed by public law” and thus *prima facie* satisfy the definition of “contracting authority”.³³³ It has been argued that an international organisation comprised exclusively of EU Member States would meet the criteria.³³⁴ One specific criterion in this regard is that the body must be closely dependent on the State.³³⁵ The condition of close dependence can be met if the body has an administrative, managerial or supervisory board, more than half of whose members are State appointed.³³⁶ The supervisory bodies of international organisations are usually solely constituted by Member State appointed members.³³⁷

It has been argued that international organisations comprised exclusively of EU Member States could satisfy this requirement as well as international organisations

³³² Trybus, *European Union Law and Defence Integration* (n 47) 225. For an even earlier view, see Heuinckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 98 and citing at fn 391 *Public Procurement in the European Union - Guide to the Community Rules on Public Supply Contracts other than in the Water, Energy, Transport and Telecommunications Sectors (Directive 93/36/EEC)* (Commission: 1995), Ch.II §2.3, 25

³³³ Article 1(19) Public Sector Directive

³³⁴ For a discussion of these criteria, see Heuinckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 94-96; Heuinckx, ‘Applicable law to the procurement of international organisations in the European Union’ (n 272) 111-112

³³⁵ C-44/96 *Mannesmann Anlagenbau* [1998] ECR I-73, para 20; C-380/98 *R. v HM Treasury, Ex p. University of Cambridge* [2000] ECR I-8035, para 20, cited in Heuinckx ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 39 fn 80

³³⁶ See Article 1(9)(c) Public Sector Directive

³³⁷ Heuinckx, *The Law of Collaborative Defence Procurement Through International Organisations*’ (n 272) 96; see more specifically, Heuinckx, ‘Applicable law to the procurement of international organisations in the European Union’ (n 272) 112 citing at fn 89 H G Schermer and N M Blokker, *International Institutional Law*, 4th edn (Nijhof, 2003) ss.771-887

comprised of a mixed EU and third country membership, where the latter constitutes less than half of total membership.³³⁸ However, it has been suggested that it is likely that this would be based on the premise that decisions of such boards are made by majority voting when the reality is that most decisions are by unanimity; further, third countries may possess a veto power on the organisation's decisions, thereby reducing any influence exerted by EU Member States on the organisation's procurement decisions.³³⁹

Thus, it is arguable that organisations controlled by EU Member States would constitute contracting authorities with the consequence that the Public Sector and Defence Procurement Directives *prima facie* apply, unless an exemption applies.³⁴⁰ The converse is likely to be the case for organisations in which third countries hold at least a blocking minority.³⁴¹

4.2. International Organisations as Public Authorities Subject to EU Procurement Principles

It is recalled from Section 2.1 that even when the EU procurement Directives do not apply, contracting authorities and “public authorities” must nevertheless comply with

³³⁸ Heuinckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 97; Heuinckx, ‘Applicable law to the procurement of international organisations in the European Union’ (n 272) 112

³³⁹ See Heuinckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 97 citing at fn 385 Case C-237/99 *Commission v France* [2001] ECR I-939, para 48-49. On the decision-making of international organisations in this context, see Heuinckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 70-73; Heuinckx, ‘Applicable law to the procurement of international organisations in the European Union’ (n 272) 112-113 and fn90

³⁴⁰ Heuinckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 97; Heuinckx, ‘Applicable law to the procurement of international organisations in the European Union’ (n 272) 113

³⁴¹ Heuinckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 98; Heuinckx, ‘Applicable law to the procurement of international organisations in the European Union’ (n 272) 113

the EU procurement principles. It has been argued that international organisations in which EU Member States control the decision-making process (where non-EU Member States do not hold a blocking minority) would quite clearly qualify as public authorities.³⁴² In particular, it has been argued that a customary privilege exempting the procurement rules of such organisations from compliance with EU procurement principles would be inconsistent with, *inter alia*, the obligation under Article 4(3) TEU.³⁴³

By contrast, it has been argued that where EU Member States do not control the decision-making process of an international organisation (e.g. where it also comprises third country membership and/or unanimity is required), it is appropriate that a customary privilege exists in order to prevent EU Member States from affecting the independence and proper functioning of the organisation on procurement matters.³⁴⁴

Thus, international organisations comprised exclusively of EU membership may have to comply with the EU procurement principles (unless a valid derogation can be invoked).³⁴⁵ The converse is likely to be the case for international organisations comprising a mixed membership with third countries.³⁴⁶

³⁴² Heuninckx, 'Applicable law to the procurement of international organisations in the European Union' (n 272) 119

³⁴³ For the reasons against recognition of a customary privilege that is able to exempt the procurement rules of international organisations from compliance with EU procurement principles, see Heuninckx, 'Applicable law to the procurement of international organisations in the European Union' (n 272) 119-120

³⁴⁴ Heuninckx, 'The Law of Collaborative Defence Procurement Through International Organisations' (n 272) 107

³⁴⁵ *ibid* 106

³⁴⁶ *ibid* 107

4.3. Application of the Exclusion to International Organisations

In light of the above, this Section examines the scope of the international organisation exclusion. This raises two discrete issues. Firstly, if international organisations are capable of constituting contracting authorities, a debate exists as to whether the exclusion covers international organisations comprising both mixed (i.e. EU and third country) membership and exclusive EU membership, or whether it should be confined to excluding mixed membership organisations.³⁴⁷ Secondly, a question arises as to the precise scope of activity covered by the exclusion. It is to these issues which this Chapter now turns.

4.3.1. Organisations Comprising Exclusive EU and Mixed Membership

EU law does not define the term “international organization”.³⁴⁸ A fundamental argument often cited in support of excluding only mixed membership organisations is that if the exclusion also applies to international organisations comprised exclusively of EU Member States, it would provide a simple means by which Member States can avoid their EU law obligations.³⁴⁹

However, in support of excluding both forms of organisation, it has been argued *inter alia* that most international organisations are created for a genuine purpose, such as

³⁴⁷ For arguments for and against both propositions, see Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 99-102

³⁴⁸ The Guidance Note, Defence- and security specific exclusions, 4, point 2.4, para 6 identifies an international organisation as a permanent institution with separate legal personality, set up by a treaty between sovereign states or intergovernmental organisations and having its own organizational rules and structures. However, the Guidance Note does not identify the nationality of constituent membership

³⁴⁹ Trybus, *European Union Law and Defence Integration* (n 47) 225; Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 99

to conduct collaborative defence procurement to increase interoperability of the armed forces and optimise defence budgets.³⁵⁰ Further, the EU Treaties contain no provision preventing the EU legislator from exempting all international organisations from compliance with a Directive.³⁵¹ In addition, existing ECJ case law appears to support the view that the Directives would not be applicable to international bodies set up by the EU institutions.³⁵² This is also said to be supported by the fact that the procurement activities of the EU institutions are regulated by specific rules that do not have to comply with the Public Sector Directive.³⁵³

Whilst there is no definitive CJEU ruling on this issue, it has been argued that application of the Public Sector Directive exclusion to all international organisations would seem logical but is in need of clarification.³⁵⁴ Similarly, it has been suggested that the same analysis should apply to Article 12(c).³⁵⁵

4.3.2. Purchasing for the Organisation's Purposes

Article 12(c) refers to an international organisation “purchasing for its purposes”. This raises the question as to what kinds of procurement would be covered for an organisation’s “purposes”. Commentary has distinguished between “administrative”

³⁵⁰ Heuninkx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 100

³⁵¹ *ibid*

³⁵² Heuninkx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 101-102 citing Case T-411/06 *Società generale lavori manutenzioni appalti Srl. (Sogelma) v European Agency for Reconstruction (EAR)* [2008] ECR II-2771, para 115; Case T-70/05 *Evropaiki Dynamiki – Proigmena Systemata Tilepikoinonion Pliroforikis kai Tilematikis AE v European Maritime Safety Agency (EMSA)* [2010] ECR II-00313

³⁵³ Heuninkx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 101 who observes that if the EU institutions do not have to comply with the EU public procurement Directives, it is questionable why other international organisations would be similarly obliged

³⁵⁴ Heuninkx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 115

³⁵⁵ Heuninkx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 273) 115, 116, on the basis that the definition of contracting authority under the Defence Procurement Directive corresponds to that under the Public Sector Directive

and “operational” activities. For instance, whilst it has been acknowledged that such a distinction is not always easy to make, administrative expenditure would cover the procurement of office equipment whilst operational expenditure would cover procurement for the benefit of the Member States’ armed forces.³⁵⁶

It has been suggested that Article 12(c) is probably narrower than the Public Sector Directive exclusion.³⁵⁷ This view appears to be based on the understanding that Article 12(c) aims to cover mainly administrative procurement activities even though it would be extremely rare that administrative procurement covers military equipment.³⁵⁸ Notwithstanding, it has been suggested that Article 12(c) would apply to the few but significant items owned and managed by international organisations.³⁵⁹ This narrow interpretation also appears to be predicated on the suggestion that Article 12(a) most likely covers contracts awarded through the procurement procedures of certain international organisations such as NATO.³⁶⁰

However, it continues to remain uncertain precisely what is meant by “purchasing for its purposes”. Further, it is not clear that Article 12(c) only covers administrative procurement.³⁶¹

³⁵⁶ Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 73-74

³⁵⁷ *ibid*

³⁵⁸ *ibid* 103

³⁵⁹ For instance, NATO AWACS (Airborne Warning and Control System) have been cited as an example in this regard. See Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 103

³⁶⁰ *ibid* 103

³⁶¹ For instance, as Heuninkx ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) observes at 47 fn 129: “it is interesting to note that the French version of the Directive mentions that this exemption concerns “les règles de procédures spécifiques d’une organisation internationale achetant pour l’accomplissement de ses missions” (the specific procedural rules of an international organisation purchasing for the accomplishment of its missions), which would seem to be wider than the English version, as for instance operational procurement performed for the benefit of its Member States by a collaborative defence procurement organisation would probably be found to be performed for the accomplishment of its missions”

The Guidance Note states that purchases made by an international organisation in its own name and for its own purposes are outside the scope of the Directive.³⁶² However, it also states that by referring explicitly to “specific procedural rules of an international organisation purchasing for its purposes”, the provision points to the fact that purchases made by an international organisation for the purpose of its members or of third parties may not be excluded.³⁶³ Yet, construed in its broadest sense, any purchase by an international organization for its purposes is not only for the benefit of its own purposes but also for the purposes of the Member States generally.

It is therefore submitted that the relation between Article 12(a) and (c) is unclear. Further, the distinction between “operational” and “administrative” procurement is not explicit. In addition, the differentiation between purchasing for an organisation’s own “purposes” and that of its members is not defined. These issues are symptomatic of the degree of interpretational overlap between the Defence Procurement Directive’s exclusions and give rise to legal uncertainty.

4.3.3. Contracts Awarded by a Member State

In addition to the circumstance in which an international organisation purchases for its purposes, Article 12(c) also excludes “contracts which must be awarded by a Member State” in accordance with the procedural rules of an international organisation. According to the Guidance Note, this can be the case, for example,

³⁶² Guidance Note, Defence- and security- specific exclusions, 4, point 2.4, para 7

³⁶³ The Guidance Note cites two scenarios in this regard. The first is when an international organisation acts only as an intermediary on behalf of one of its members (with the procurement contract concluded between the member and the supplier). The second is when the organisation simply resells to one of its members supplies, works or services (which it procured from economic operators at the request of that member). The Guidance Note further states in reference to Article 11 that Member States may not, in any case, use contract awards via international organisations for the purpose of circumventing the provisions of the Directive. Ibid

when a Member State acts on behalf of an international organisation or receives a financial contribution from that international organisation for the execution of the contract.³⁶⁴ In such circumstances, the specific procedural rules imposed by the organisation preclude the use of award procedures under the Directive.

4.4. Application of EU Procurement Law to International Organisations

Having outlined the potential applicability of EU procurement law to international organisations, this Section turns to briefly consider its specific application to certain international organisations.

4.4.1. Organisation for Joint Armament Cooperation

With specific regard to international organisations comprised exclusively of EU Member States, one such example is the Organisation for Joint Armaments Cooperation (“OCCAR”).³⁶⁵ In 1998, France, Germany, Italy and the United Kingdom (“UK”) (later joined by Belgium and Spain) founded OCCAR to manage more efficiently collaborative and nationally assigned armaments programmes and to strengthen the competitiveness of the EDTIB.³⁶⁶ It is beyond the scope of this thesis to engage a detailed analysis of OCCAR.³⁶⁷ Notwithstanding, whilst OCCAR has been the subject of relatively limited focus by commentators (in comparison to the

³⁶⁴ Guidance Note, Defence- and security- specific exclusions, 4, point 2.4, para 6

³⁶⁵ See the OCCAR Convention, signed by the defence ministers of the founding nations at the Farnborough Air Show on 9 September 1998. Belgium and Spain joined OCCAR on May 27 2003 and January 2005, respectively

³⁶⁶ At the time of writing, Finland, Luxembourg, the Netherlands, Poland, Sweden and Turkey participate in OCCAR managed programmes but are not members

³⁶⁷ For a detailed discussion of OCCAR, in particular, its procurement function, see Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 121-150

EDA, for example), OCCAR's importance is signified by the fact that its annual budget is higher than the defence budgets of most EU Member States.³⁶⁸ OCCAR expenditures in 2009 amounted to approximately 40% of collaborative equipment procurement and R&D within the EU.³⁶⁹

On the basis of the preceding analysis, OCCAR would likely constitute a body governed by public law and thus be subject to the procurement Directives.³⁷⁰ However, it could be possible for OCCAR to rely on the Public Sector Directive exclusion (and corresponding Defence Procurement Directive exclusion) relating to international organisations and/or Article 13(c) of the Defence Procurement Directive, which is discussed below.³⁷¹ Further, in light of the fact that the purpose of the Public Sector and Defence Procurement Directives is to coordinate national laws, it is possible to argue that because the Directives do not apply to international bodies set up by the EU institutions, the same reasoning should be applied to other international organisations such as OCCAR.³⁷² However, if OCCAR qualifies as a public authority, OCCAR would likely have to comply with EU procurement principles.³⁷³ Further, OCCAR is unlikely to be able to invoke Article 346 TFEU.³⁷⁴

³⁶⁸ According to Heuinckx, if OCCAR were an EU Member State it would rank 9th in terms of total defence expenditures and 4th in terms of equipment procurement and R&D after the UK, France and Germany. See Heuinckx, 'The Law of Collaborative Defence Procurement Through International Organisations' (n 272) 122-123 and fn 469

³⁶⁹ Heuinckx, 'The Law of Collaborative Defence Procurement Through International Organisations' (n 272) 123

³⁷⁰ Heuinckx, 'The Law of Collaborative Defence Procurement Through International Organisations' (n 272) 128

³⁷¹ *ibid*

³⁷² Heuinckx, 'The Law of Collaborative Defence Procurement Through International Organisations' (n 272) 100-101 and 128-9 citing *Sogelma* and *ESMA* (n 352) [115] and [126] respectively

³⁷³ Heuinckx, 'The Law of Collaborative Defence Procurement Through International Organisations' (n 272) 129

³⁷⁴ As Heuinckx observes, unless EU Member States delegate to an international organisation the power to decide which measures are necessary for the protection of the essential interests of security, the most likely proposition is that only EU Member States may invoke Article 346 TFEU. See Heuinckx, 'The Law of Collaborative Defence Procurement Through International Organisations' (n 272) 129. This is also consistent with *GEC-Siemens/Plessey* (Case IV/33.018) Commission Notice relating to a proceeding under Articles 85 and 86 of the EEC-Treaty [1990] OJ C-239 identified in Chapter 2, Section 2 (n 86)

4.4.2. European Defence Agency

It is also necessary to consider the legal position of the EDA. In 2004, the EU Council created the EDA to support Member States in their effort to improve EU defence capabilities in the field of crisis management and to sustain the CSDP.³⁷⁵ As will be discussed in Chapters 5 (Section 7.3.1), 6 (Section 2.1 and 2.3) and Chapter 7, the EDA has developed a range of initiatives in the field of defence procurement.

On the basis of the preceding analysis, it is similarly likely that the EDA would constitute a body governed by public law and thus be subject to the procurement Directives.³⁷⁶ However, it could be possible for the EDA to rely on the Public Sector Directive exclusion (and correspondingly the Defence Procurement Directive exclusion) relating to international organisations.³⁷⁷ Further, the fact that the EDA is said to act within the single institutional framework of the EU could mean that it would not qualify as an international organisation, but rather an agency of the EU.³⁷⁸

With specific regard to the Defence Procurement Directive, most defence contracts concluded by the EDA would likely be excluded under Article 13(c) (discussed below).³⁷⁹ Further, in accordance with Article 12(c), the Defence Procurement Directive does not apply to international organisations procuring for their own purpose which would also exempt the EDA from compliance with the Directive when

³⁷⁵ See Council Joint Action 2004/551/CFSP of 12 July 2004 on the establishment of the European Defence Agency, OJ L 245/17, amended by Council Joint Action 2008/299/CFSP of 7 April 2008, OJ 2008 L 102/34

³⁷⁶ Heuinckx, 'The Law of Collaborative Defence Procurement Through International Organisations' (n 272) 183

³⁷⁷ Heuinckx, 'The Law of Collaborative Defence Procurement Through International Organisations' (n 272) 183-4

³⁷⁸ Heuinckx, 'The Law of Collaborative Defence Procurement Through International Organisations' (n 272) 184

³⁷⁹ *ibid*

it procures specific studies within its general budget.³⁸⁰ In addition, in light of the fact that the purpose of the Defence Procurement Directive is to coordinate national laws, it is possible to argue that it is not applicable to international bodies set up by the EU institutions.³⁸¹ However, if the EDA qualifies as a public authority, the EDA would likely have to comply with the EU procurement principles.³⁸² Finally, similar to OCCAR, the EDA is unlikely to be able to invoke Article 346 TFEU.³⁸³

4.4.3. North Atlantic Treaty Organisation and Its Agencies

Finally, it is necessary to consider the legal position of international organisations (and their corresponding agencies) comprising mixed membership.

It has been suggested that NATO and agencies such as the NATO Maintenance and Supply Organisation (“NAMSO”)³⁸⁴ would not likely constitute contracting authorities or public authorities and so neither the Directives nor the EU procurement principles are likely to apply.³⁸⁵ Specifically, the Public Sector Directive would not apply to NAMSO procurement in light of the fact that some NAMSO members are not EU Member States.³⁸⁶ Further, it has been argued that because NAMSO was created by an international agreement and some NAMSO members are non-EU Member States, Article 12(a) likely excludes all contracts awarded through the procurement rules of

³⁸⁰ *ibid*

³⁸¹ *ibid*

³⁸² *ibid* 185-6

³⁸³ *ibid* and see (n 374)

³⁸⁴ NAMSO is a subsidiary agency of NATO. NAMSO is tasked to provide logistics support which includes supply management, maintenance management, procurement and technical assistance. For a detailed discussion of NAMSO, in particular with regard to its procurement aspect, see Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 150-176

³⁸⁵ *ibid* 175

³⁸⁶ Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 158

NAMSO.³⁸⁷ In addition, in light of the fact that important NAMSO decision making is by unanimity, EU Member States do not control the decision-making. Therefore, NAMSO is unlikely to qualify as a public authority and would not have to comply with the EU procurement principles.³⁸⁸ Finally, similar to OCCAR and the EDA, NAMSO is unlikely to be able to invoke Article 346 TFEU.³⁸⁹

The legal analysis above is indicative of the complexity that will necessarily be entailed in determining the general applicability of EU law to international organisations in the field of defence procurement as well as its application in the specific instance of purported exclusion.

For the purposes of a transatlantic defence procurement analysis, a provisional indication appears to be that whilst the precise legal bases for excluding procurement are not explicitly clear, it is likely that most forms of contracting engaged by, and on behalf of, NATO and its agencies would be excluded. To this extent, procurement performed and managed through transatlantic defence agencies will most probably not have to comply with EU law.

A more difficult issue concerns the extent to which it will be possible to exclude procurement undertaken within the context of European organisations such as OCCAR and the EDA on the basis of Article 12(c). Prior to the adoption of the Defence Procurement Directive, it had been observed that the Commission did not

³⁸⁷ *ibid*

³⁸⁸ *ibid*

³⁸⁹ Heuinckx, 'The Law of Collaborative Defence Procurement Through International Organisations' (n 272) 159 and see (n 374)

appear to be sure about the application of the procurement Directives to the EDA.³⁹⁰ Yet the Defence Procurement Directive emphasizes the *prima facie* exclusion of these organisations both on the basis of the scope of authorities covered as well as by excepting their procurement activities.³⁹¹ Therefore, any attempt to enhance legal certainty in this area is vital.³⁹²

Overall, it is difficult to discern what effect the international organisation exclusion will have in practice as compared, for example, to the international agreement exclusion under Article 12(a), the cooperative programme exclusion under Article 13(c) and the government to government sales exclusion under Article 13(f), discussed in Sections 5 and 6 below. The Guidance Note nevertheless appears to conceive of a risk that this exclusion could be utilised to circumvent compliance with the Defence Procurement Directive. From a transatlantic perspective, this raises questions concerning the overall legal coherence of the EU defence procurement architecture, as well as its external relation.

5. Cooperative Programme Procurement

It is recalled that whilst Article 12 Defence Procurement Directive could potentially exclude forms of collaborative defence procurement, Article 13(c) contains a specific

³⁹⁰ See Trybus, *EU Law and Defence Integration* (n 47) 226

³⁹¹ For instance, Recital 28 presumptively excludes the EDA. Recital 28 expressly states that the Directive should not apply to contracts awarded by international organizations such as OCCAR, NATO, its agencies, or the EDA within the scope of cooperative programmes

³⁹² For useful preliminary recommendations exploring the options for ensuring greater conformity in this regard, see Heuninckx, *The Law of Collaborative Defence Procurement Through International Organisations*' (n 272) 205-254

exclusion relating to cooperative programmes.³⁹³ Before examining the exclusion, it is useful to place U.S. and EU cooperation in context.

5.1. Increased Recourse to European Cooperation

Most Member States no longer have the financial, technical and industrial capabilities to procure, develop and produce complex weapons systems. This will often necessitate a choice to weigh up the advantages and disadvantages of engaging cooperative programmes at all.³⁹⁴ If so, the choice is generally between purchasing from third country defence producers (historically predominantly the U.S.) or sharing costs with other European countries.³⁹⁵

Cooperation can take a number of forms. One form is reciprocal trade in which each participating country agrees to procure equipment or systems developed and produced by the other partner(s), which have comparable and complementary uses.³⁹⁶ A second form is co-production in which contractors from one or more participating countries produce (often under licence) a weapon system developed by firms of one other participating country, mostly on the basis of the individual requirements of the latter.³⁹⁷ A third form is co-development in which defence contractors from participating countries jointly develop, and usually produce, a

³⁹³ Again, the possibility for interpretative overlap between this provision and the exclusions in Article 12(a) and (c) cannot be excluded

³⁹⁴ There is some debate within the defence community as to whether cooperative programmes yield any specific overall benefits. For a useful discussion of the perceived advantages and disadvantages in this regard, see B Heuinckx, 'A primer to collaborative defence procurement in Europe: troubles, achievements and prospects' (2008) 3 PPLR, 123, 131-139

³⁹⁵ See Heuinckx, 'A primer to collaborative defence procurement in Europe: troubles, achievements and prospects' (n 394) 125

³⁹⁶ *ibid* 126

³⁹⁷ *ibid*

weapon system on the basis of harmonised military requirements.³⁹⁸ The first two types have regularly been used in collaborative procurement involving the U.S. and other countries, with the U.S. almost always playing the senior partner, while the third type is mostly used among European countries.³⁹⁹

As indicated above, both OCCAR and the EDA exercise competences in relation to collaborative procurement. In 2011, 27.1% or €7.9 billion of total defence equipment procurement expenditure was spent on collaborative projects, 92.7% (€7.3 billion) of which comprised European collaborations.⁴⁰⁰ Even though differences between EU Member States remain in terms of both the number of collaborative procurements undertaken, and with which States, collaborative defence procurement between European countries has significantly increased since the 1990's.⁴⁰¹ In turn, collaboration with the U.S. is decreasing, although again this varies between individual Member States.⁴⁰²

The Fortresses and Icebergs Study indicates that cooperative European programmes largely exclude U.S. defence firms from significant participation and, for those programmes in which the U.S. is able to participate, U.S. companies are generally excluded from lead positions and key subsystems being limited to the component

³⁹⁸ *ibid*

³⁹⁹ *ibid*

⁴⁰⁰ EDA Defence Data 2011, 4. See <http://www.eda.europa.eu/docs/default-source/eda-publications/eda_data2011_web> accessed 20 September 2003

⁴⁰¹ Heuninx, 'A primer to collaborative defence procurement in Europe: troubles, achievements and prospects' (394) 128 and citations therein. Heuninx states that France has evolved towards more collaborative procurement (almost exclusively with other European countries), which now represent about 48 % of its defence procurement programmes, while the UK used collaborative procurement for 19 % of its defence procurement programmes (in majority with other European countries), but imported 20 % of its major defence equipment from the US. Also citing at fn21 citing J Howe, "The French and British Customers for Defence" (2004) 7(2) *RUS/Defence Systems* 20

⁴⁰² Heuninx, 'A primer to collaborative defence procurement in Europe: troubles, achievements and prospects' (394) 128

level.⁴⁰³ The Study refers to a number of European cooperative programmes which have excluded the substantial participation of U.S. companies.⁴⁰⁴ However, importantly, the same Study also indicates that U.S.-EU cooperative Research, Development, Testing and Engineering (“RDT&E”) programmes are extremely limited.⁴⁰⁵ In particular, the Joint Strike Fighter programme alone accounted for \$1.99 billion or, in equivalent terms, 87% of the total U.S. cooperative engagement in RDT&E with Europe; excluding the Joint Strike Fighter, only approximately \$1 billion per annum out of a \$75 billion U.S. RDT&E budget, or in equivalent terms, around 1.3 % of the total, is performed on a cooperative basis.⁴⁰⁶

The Fortresses and Icebergs Study attributes the limited number of transatlantic cooperative programmes to several factors, including the absence of U.S. Department of Defense support for cooperative programmes,⁴⁰⁷ the ability of the U.S. to develop programmes without foreign participation and the sustained practical problems which have been encountered in major transatlantic cooperative

⁴⁰³ *Fortresses and Icebergs* (Vol I) (n 12) 139-140

⁴⁰⁴ One prime example is the multirole Eurofighter Typhoon in which the European Aeronautical, Defence and Space Company (“EADS”) acts as prime contractor while U.S. companies (mostly their European subsidiaries) provide a number of subsystems. Other examples of limited U.S. participation that are cited include the Meteor Beyond Visual Range Air-to-Air Missile (BVRAAM); the Advanced Short-Range Air-Air Missile (ASSRAAM); the A400M Future Large Airlifter; the Tiger Attack Helicopter; the F100 Aegis Frigate and the Multi-Role armoured vehicle (MRAV/GTK). For criticism of the absence of U.S. participation, see *Fortresses and Icebergs* (Vol I) (n 12) 139-142

⁴⁰⁵ The *Fortresses and Icebergs* Study provides a list of virtually all U.S. RDT&E programmes that have a cooperative or international component. These include: (1) coalition warfare; (2) DIRCM; (3) Foreign Comparative Testing; (4) Joint Strike Fighter; (5) JTRS; (6) MEADS; (7) MIDS; (8) Missile Defence; (9) MLRS; (10) NATO Evolved Sea Sparrow; (11) Patriot PAC-3; (12) Rolling Airframe Missile and (13) Standard Missile. See *Fortresses and Icebergs Study* (Vol I), 145, Table 18, U.S. Cooperative RDT&E Programs in Millions of Dollars (\$), source derived from U.S. Department of Defense, Biennial Budget Estimates, FY 2008. The Study states that the above cooperative programmes, with a few exceptions, were negotiated in the 1980’s and 1990’s when the U.S. sought a greater degree of transatlantic defence cooperation to develop new technologies and capabilities in an affordable manner, and that there have been few cooperative programme starts other than Missile Defence in recent years. See *Fortresses and Icebergs* (Vol I) (n 12) 146

⁴⁰⁶ *ibid*, which also observes that the same type of analysis could also be undertaken for the limited European R&T funding, which is also done primarily on a national basis

⁴⁰⁷ According to the Study, this means that DoD components will seek the alternative of cooperation only if they really need to e.g. in order to lower costs per unit or obtain needed funding from foreign partners. A prime example cited in this regard is the F-35 Joint Strike Fighter. See *Fortresses and Icebergs* (Vol I) (n 12) 147

programmes.⁴⁰⁸ Further, the Study indicates that due largely to budgetary constraints, the number of major European programmes being initiated each year has fallen from an average of 5 or 6 per year in 1995-1996 to only one or two per year today and that this alone reduces the opportunity for U.S. companies to compete in the European market.⁴⁰⁹

5.2. Cooperative Programmes Based on Research and Development

Having outlined the context of collaborative procurement, Article 13(c) provides that the Defence Procurement Directive does not apply to:

“[...] contracts awarded in the framework of a cooperative programme based on research and development,⁴¹⁰ 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 [...]”

According to the Commission Report on transposition, all Member States have correctly transposed Article 13(c).⁴¹¹ The Guidance Note provides comparatively

⁴⁰⁸ The Study states at 148 that: “[v]irtually every major transatlantic cooperative programme has been plagued by a series of problems: differential levels of support for the programme in different countries; different budget cycles and unstable funding; changing requirements on one side or the other; serious problems over technology transfer, and serious cost overruns and schedule delays.”

⁴⁰⁹ *Fortresses and Icebergs* (Vol I) (n 12) 143

⁴¹⁰ Article 1(27) defines “research and development” as: “all activities comprising fundamental research, applied research and experimental development, where the latter may include the realisation of technological demonstrators, i.e., devices that demonstrate the performance of a new concept or a new technology in a relevant or representative environment.” See also Recital 13

⁴¹¹ Commission, Report to the European Parliament and The Council on transposition of directive 2009/81/EC on Defence and Security Procurement (n 302) 6. The only exception in this regard concerns the obligation to inform the Commission upon the conclusion of an agreement foreseen under Article 13(c), on which see below

detailed guidance with regard to this provision.⁴¹² As indicated by its terms, Article 13(c) refers to cooperative programmes based on R&D, conducted jointly by at least two Member States. However, the Guidance indicates that cooperative R&D based programmes with third country participation could also fall within the exclusion.⁴¹³ Certain OCCAR and NATO programmes involving third countries could therefore potentially be excluded.⁴¹⁴

Importantly, however, Article 13(c) is subject to the condition that the programme must be based on a “genuinely cooperative concept”.⁴¹⁵ In this regard, the Guidance Note states that the decisive criterion for the applicability of Article 13(c) is the nature of the programme and its purpose, namely the development of a new product.⁴¹⁶ This means that common purchases of off-the-shelf equipment cannot be excluded, even if technical adaptations are made to customise the equipment.⁴¹⁷

In order to ensure that Article 13(c) is applied exclusively to genuine cooperation, Article 13(c) further provides that on conclusion of a programme between Member States only, they shall notify the Commission, *inter alia*, of the share of R&D expenditure.⁴¹⁸ Therefore, it appears that notification is not necessary if one or

⁴¹² For a general discussion of this exclusion, see Trybus, ‘The tailor-made EU Defence and Security Procurement Directive (n 125) 15-16

⁴¹³ See also Guidance Note, Defence- and security specific exclusions, 7, point 16

⁴¹⁴ See for instance Recital 28 (n 391). See also Guidance Note, Defence- and security specific exclusions (n 413)

⁴¹⁵ In particular, the Guidance States that participation in a cooperative programme means more than just the purchase of equipment but also includes in particular the proportional sharing of technical and financial risks and opportunities, participation in the management of and the decision-making on the programme. See Guidance Note, Defence- and Security Specific Exclusions, 7, point 16

⁴¹⁶ *ibid*, 6, point 15

⁴¹⁷ *ibid*

⁴¹⁸ According to the Commission Report on transposition (n 302) 6, one Member State has not included this obligation. Further, one Member State has included an obligation to inform the Commission only when the cooperative programme ends

several third countries are involved in the programme.⁴¹⁹ The Guidance has also emphasised compliance with Article 11 Defence Procurement Directive.⁴²⁰

It is submitted therefore that most types of reciprocal trade and co-production i.e. those forms of cooperation most often undertaken between the U.S. and EU Member States cannot be excluded under Article 13(c). These forms of procurement rely primarily on off-the-shelf procurement and production under licence, the R&D and initial production phases having already been undertaken by the seller or licensor.⁴²¹ Thus, the exclusion is likely to be confined to co-development. Were a cooperative programme to involve third countries but only concern off-the-shelf purchases, a Member State may need to seek exclusion under an alternative provision, if possible.⁴²²

5.3. Maximum Flexibility: Minimum Certainty

It is submitted that Article 13(c) is unlikely to significantly affect the current *status quo* with regard to either European or transatlantic collaborative procurement. From an EU perspective, it has been argued that Article 13(c) will drive Member States towards more collaborative procurement in order to avoid compliance with the Directive's provisions.⁴²³ On the one hand, this is considered a positive development

⁴¹⁹ Guidance Note, Defence- and security specific exclusions, 7, point 17

⁴²⁰ See Guidance Note, Defence- and security specific exclusions, 7, point 17 and Guidance Note, Research and development, 1, point 3, para 1. For a discussion of the potential effectiveness of Article 11, see Section 2.3 above

⁴²¹ In fact, a particular criticism of co-production is that the technology transfer in the case of co-production remains limited, as the R&D work is mostly completed before the co-production arrangement is agreed. See Heuninx, 'A primer to collaborative defence procurement in Europe' (394) 126. Thus, mere receipt of off the shelf equipment and co-production is unlikely, in most instances, to fall within the notion of a "genuinely cooperative concept"

⁴²² See Heuninx, 'Lurking at the Boundaries' (n 80) 111 citing Article 12(a) as a possibility in this regard

⁴²³ Heuninx 'Lurking at the Boundaries' (n 80) 111 and fn 133 citing J Robinson, "To what extent will contracts

on grounds that collaboration can increase the cost-effectiveness of defence programmes,⁴²⁴ although it is difficult to empirically validate the extent to which cost-effectiveness is achieved. On the other hand, it has been argued that Member States may misuse the possibility to extend into later phases of all or part of the life-cycle in order to favour national preferences.⁴²⁵

More fundamentally, whilst the Directive states in Recital 55 that this important field of procurement continues to be governed with “maximum flexibility”, collaborative procurement remains an area that is substantially excluded from the scope of application of detailed regulatory regimes. It has been argued that this development is problematic given the legal uncertainty into which most of these programmes are developed and managed.⁴²⁶ For instance, prior to the adoption of Defence Procurement Directive, it had been suggested that Member States routinely invoked Article 346 TFEU for the collaborative procurement of major weapon systems.⁴²⁷ Similarly, notwithstanding the predominantly intergovernmental character of collaborative defence procurement, the EDA has not developed substantial guidelines on best practices in procurement.⁴²⁸ In addition to the above, it is not clear that any notification obligation will necessarily provide an effective check against

remain outside the defence procurement regime”, presentation at the C5 Forum on EU Defence & Security Procurement, November 17, 2009 and B. Giles, “R&D in the Defence Directive”, presentation at the C5 Forum on EU Defence & Security Procurement, November 18, 2009

⁴²⁴ See Heuinckx ‘Lurking at the Boundaries’ (n 80) 111

⁴²⁵ Center for Strategic & International Studies (“CSIS”), European Defense Trends, ‘Budgets, Regulatory Frameworks and the Industrial Base’, A Report of the CSIS Defense-Industrial Initiatives Group (November 2010) 43 <http://csis.org/files/publication/101025_EuroDefenseTrends_web.pdf> accessed 20 September 2013

⁴²⁶ *ibid*

⁴²⁷ Heuinckx, ‘A primer to collaborative defence procurement in Europe’ (394) 140 citing at fn88 Maulny *et al.*, “Cooperative Lessons Learned”, Final Report for Study 06-EDA-008, IRIS/CER/DGAP/IAI (November 30, 2006) 18-19

⁴²⁸ For a discussion of the EDA initiatives generally, see Chapter 7, in particular, Section 2.3

abuse.⁴²⁹ Finally, the Commission may find it difficult to determine and prove that the conditions of the exclusion are met.⁴³⁰ The last two issues may be particularly acute in light of the fact that, as indicated in Section 5.2, this notification requirement is not necessary if third countries are involved.

From a U.S. perspective, Article 13 (c) does not appear to suggest any additional effects on collaborative programmes in which third countries participate. It has been argued that programmes involving third countries would likely be excluded under Article 12(a),⁴³¹ although, as indicated in Section 3.2.1, any emphasis placed on a requirement for specific procedural rules may place a constraint on the measure of flexibility that is perceived to be accorded to Article 12.

It is therefore possible to suggest that any comparative advantage to be gained by a specific exclusion designed to encourage EU cooperative programmes, might, to some extent, be counterbalanced by the fact that it is similarly possible to exclude cooperative programmes involving third countries under alternative provisions. It has even been suggested that Member States may use Article 12 to conduct such collaborative procurement with third countries with the objective of circumventing the Directive's primary competition objective.⁴³²

⁴²⁹ Although this appears to be the view of certain commentators. According to Heuninckx, this requirement was introduced by the European Parliament in order to verify that the exemption would not be abused by the EU Member States. See Heuninckx, 'Lurking at the Boundaries' (n 80) 111 citing at fn 136 Giles, "R&D in the Defence Directive", presentation at the C5 Forum on EU Defence & Security Procurement, November 18, 2009 136

⁴³⁰ Heuninckx, 'Lurking at the Boundaries' (n 80) 111. Heuninckx also observes that it is not clear how the Commission would identify an abuse, as the exemption does not require a minimum amount of R&D. He states that it is, however, likely that the most obvious abuses could still be detected through this reporting

⁴³¹ Heuninckx, 'Lurking at the Boundaries' (n 80) 111

⁴³² Center for Strategic & International Studies, 'European Defense Trends, Budgets, Regulatory Frameworks and the Industrial Base' (n 425) 44

However, it should be observed that a consequence of the exclusion is that practices such as *juste retour* continue to operate unchecked.⁴³³ Under this principle, the amount of work allocated to the industry of a participating State is calculated to match as closely as possible the State's financial contribution to the programme.⁴³⁴ It has been argued for many years that this constitutes a discriminatory trade practice that is contrary to EU law.⁴³⁵ Importantly, such practices have been criticized not only by smaller EU Member States who feel that this principle is used to favour industries of larger Member States as a result of their founding Membership of collaborative procurement organizations, but also by U.S. contractors who claim that *juste retour* limits their effective participation in European programmes.⁴³⁶

In addition, as will be discussed in Chapter 5, the ICT Directive permits Member States to exempt cooperative programmes from prior authorization concerning the transfer of defence products within EU territory.⁴³⁷ It also permits optional publication of general licences for the execution of intergovernmental cooperation programmes.⁴³⁸ These provisions, alongside the exclusions of the Defence Procurement Directive, could enable the prioritization of European collaborative procurement through procedural relaxation of procurement and transfer rules. An unresolved question is the extent to which the "benefits" of enabling such exclusions outweigh any "costs" which could result from the possible limiting of competition

⁴³³ For an early discussion of *juste retour*, see M Trybus, *European Defence Procurement Law: International and National Procurement Systems as Models for a Liberalised Defence Procurement Market in Europe* (Kluwer Law International: 1999) 39-42

⁴³⁴ Heuninkx, 'A primer to collaborative defence procurement in Europe' (394) 135

⁴³⁵ See Trybus, *European Defence Procurement Law* (n 433)

⁴³⁶ *Fortresses and Icebergs* (Vol I) (n 12) 82

⁴³⁷ Article 2(c) ICT Directive

⁴³⁸ Article 5(3) ICT Directive

through non-application of the Defence Procurement Directive.⁴³⁹

In light of the above, it is submitted that the primary significance of Article 13(c) is simply its confirmation that the most organizationally complex, R&D intensive, and high value procurement is *prima facie* excluded from the Defence Procurement Directive.⁴⁴⁰ From a transatlantic perspective, an discernable emphasis on European collaboration is discernable. However, the reality is that the U.S. substantially excludes European contractors from U.S. R&D projects. Similarly, the extent of transatlantic cooperative programmes is limited. It is suggested that in the short-term, the Directive's exclusions implicating NATO and government-to-government sales are likely to be of greater relevance to the U.S. An important question in the medium-long term is whether the Defence Procurement Directive, the ICT Directive and EDA initiatives will incentivize intra-EU collaboration to such an extent that it will appreciably affect the U.S.

6. Government-to-government contracts

A final important exception relating to third countries concerns government-to-government sales. As will be examined in detail in Chapters 7 and 11, government-to-government sales constitute a significant feature of transatlantic defence procurement practice, in particular, for the U.S. Its distinct role in defence

⁴³⁹ According to the CSIS report (n 425) 44: "[...] the projected fiscal gains from open competition are expected to exceed the cost savings from such collaboration, therefore making this loophole less desirable from the standpoint of overall efficiency [...] Nevertheless, for some states the prospect of a guaranteed work share for the domestic industrial base might outweigh the associated cost inefficiencies." (footnote omitted)

⁴⁴⁰ Trybus, 'The tailor-made EU Defence and Security Procurement Directive' (n 125) 15

procurement is reflected by the absence of a comparable provision in the Public Sector Directive.

Article 13(f) provides that the Directive does not apply to:

[...] 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 [...]

According to the Commission Report on transposition, all Member States have correctly transposed Article 13(f).⁴⁴¹

Importantly, the term “government” is defined in Article 1(9) as meaning ‘the State, regional or local government of a Member State or third country’.

Further, it should be borne in mind that the exclusion only covers the contract between the two governments, and not any related contracts concluded between the selling government and an economic operator.⁴⁴²

⁴⁴¹ Commission, Report to the European Parliament and The Council on transposition of directive 2009/81/EC on Defence and Security Procurement (n 302), 6

⁴⁴² Guidance Note, Defence- and security specific exclusions, 10, point 26, para 2

6.1. Contracts for Surplus and New Material

Article 13(f) does not define the types of equipment which may be covered by the exclusion. According to the Guidance Note, Article 13(f)(i) is primarily intended for sales of equipment delivered from existing stocks such as surplus.⁴⁴³ However, the Guidance Note also states that it also includes, in principle, purchases of new material.⁴⁴⁴ Articles 13(f)(ii) and (iii) concern, respectively, contracts awarded to provide installation or other “works” related support for equipment purchased under the supply contract as well as specialist training or services support and contracts for specialist works or services that are not related to the initial supply contract.⁴⁴⁵

6.2. Purchases From Third Country Governments

Whilst the Defence Procurement Directive contains no substantial reference as to the conduct of government-to-government contracts, the Guidance Note states that if a Member State purchases new military equipment from a third country government, it must do so with due regard to its obligation under Article 11 not to use such contracts for the purpose of circumventing the Directive’s provisions;⁴⁴⁶ further, that this is particularly relevant in situations where market conditions are such that competition within the internal market would be possible.⁴⁴⁷ It should be observed that the Commission Report on transposition singles Article 13(f) out above the other specific exclusions as requiring close monitoring and verification of its use in order to prevent

⁴⁴³ *ibid*, point 26, para 1

⁴⁴⁴ *ibid*

⁴⁴⁵ *ibid*, point 25, para 2

⁴⁴⁶ *ibid* 10 point 26, para 2

⁴⁴⁷ *ibid*

circumvention of the rules of the Directive.⁴⁴⁸

A number of observations can be made in this regard. Firstly, it is not clear whether, and if so, why, Member States would be any more or less inclined to have recourse to third country sales simply to avoid compliance with the Defence Procurement Directive.⁴⁴⁹ Secondly, the Guidance Note appears to suggest that Member States have an obligation to consider whether competition within the internal market would be possible before having recourse to a third country purchase. It is arguable that any competition law-style assessment of whether internal market competition is possible is problematic for a host of reasons. For instance, it could be difficult to prove as a matter of evidence. Further, the mere possibility of internal market competition should not necessarily preclude the acquisition of a more economically advantageous third country solution (howsoever determined). Most importantly, any such requirement is not mandated by the wording of Article 13(f) itself.

6.3. Transatlantic Importance of Government-to-Government Sales

It has been suggested that Article 13(f) is an important exclusion because a significant part of defence procurement is performed between States, for instance, through United States' Foreign Military Sales ("FMS").⁴⁵⁰ This programme is administered by the Defense Security Cooperation Agency ("DSCA") for the Department of Defense ("DoD") which enables approved countries to obtain defence

⁴⁴⁸ Commission, Report to the European Parliament and The Council on transposition of directive 2009/81/EC on Defence and Security Procurement (n 302) 6

⁴⁴⁹ The same observation can be made in relation to the suggestion in Section 5.3 above that Member States could have increased recourse to third country collaboration in order to avoid compliance with the Directive

⁴⁵⁰ Heuinckx, 'Lurking at the Boundaries' (n 80) 111

articles and services on payment through national funds or U.S. approved funds.⁴⁵¹ In addition, Article 13(f) could also allow open intergovernmental arrangements allowing States to procure from each other or exchange military equipment, for example, through the NATO Logistic Stock Exchange.⁴⁵² Thus, the exclusion of government-to-government contracts is a specific recognition of the transatlantic importance of this type of defence trade activity.

However, the potential for transatlantic trade to be adversely affected in the context of government-to-government contracts has also been observed. Even though government-to-government contracts may be excluded from the scope of the Defence Procurement Directive, it has been suggested that a government could still be a candidate or tenderer for a contract to be awarded in line with the provisions of the Directive, notwithstanding the uncertainty surrounding the question of whether such an award could arguably constitute provision of State aid.⁴⁵³ In particular, it has been suggested that the U.S. fears that the Directive would require EU Member States to reject offers made by the U.S. through its FMS arrangement when EU Member States intend to award contracts in line with the provisions of the Directive, thereby creating some form of “fortress Europe.”⁴⁵⁴

A more significant issue concerns contracts related to the foreign military sale. Government-to-government sales may often be accompanied by so-called “offset” agreements which are intended to compensate the purchasing Member State for

⁴⁵¹ For information on the U.S. FMS programme, see <<http://www.dsca.mil/programs/fms>> accessed 20 September 2013

⁴⁵² Heuinckx, ‘Lurking at the Boundaries’ (n 80) 111

⁴⁵³ *ibid*

⁴⁵⁴ Heuinckx, ‘Lurking at the Boundaries’ (n 80) 111 citing at fn141 citing a Private communication from I. Maelcamp d’Opstaele, United States Mission to the European Union, November 17, 2009

sourcing its requirements from a foreign, as opposed to domestic, operator. As will be discussed in Chapters 7 and 11, offsets are generally considered to be incompatible with EU law. Similarly, the U.S. does not officially endorse such agreements. The fact that a government-government contract could legitimately be excluded raises the question as to whether any accompanying offset agreement could similarly be excluded. According to the Guidance Note on Offsets, whilst government-to-government sales are excluded from the Directive, possible related offset requirements would have to be separately justified on grounds that they are “necessary for the protection of the essential interests of the purchasing Member State”.⁴⁵⁵ In light of the general significance of this issue within the wider debate on offsets, this issue is reserved for discussion in Chapter 7.

7. Conclusions

The overriding message of this Chapter is that whilst U.S. claims focus predominantly on the possibility for the Defence Procurement Directive to discriminate against U.S. contractors, the reality is that substantial forms of procurement are likely excluded from compliance with the competitive disciplines of the Directive.

One U.S. legal commentator has identified that the exclusions will likely provide U.S. contractors with important “safe harbors against discrimination”.⁴⁵⁶ Yet, as this Chapter has demonstrated, considerable legal uncertainty exists on a number of key issues which could conceivably impact on transatlantic defence procurement.

⁴⁵⁵ Guidance Note, Offsets, 7, point 24

⁴⁵⁶ See C Yukins, ‘The European Defence Procurement Directive: An American Perspective’ (n 311) 5

Firstly, in certain instances, there appears to be an operative assumption that the exclusions provide “safe harbours” because they provide automatic exclusions from compliance with the Directive. However, as indicated in this Chapter, certain conditions may limit the flexibility that is perceived to be afforded under these exclusions. Much depends on the emphasis to be placed on requirements for specific procedural rules, for example. In addition, the Guidance Notes, whilst not legally binding, place a particular emphasis on third countries when identifying that the exclusions must not be used to circumvent the Directive’s provisions.

Secondly, an important question is which harbour does one choose? In a storm, the choice of several may seem appealing. However, as indicated in this Chapter, there is a considerable degree of interpretative overlap between certain exclusions, in particular Articles 12(a), 12(c) and 13(c). Whilst this may presume a degree of flexibility, it also generates legal uncertainty, in particular when combined with the emphasis on preventing circumvention of the Directive.

Thirdly, whilst it may be argued that in certain areas the Directive preserves the “status quo”, the substantial exclusion of cooperative procurement under Article 13(c), for example, means that an open question remains as to whether, in the broader context of EU initiatives, an incentive towards European collaboration could effect a particular change in procurement practices which could impact on the U.S. Importantly, this field continues to remain substantially unregulated. It is not clear to what extent (if at all) the exclusions will effectuate a shift towards greater intra-EU

collaboration or towards even greater individual Member State or European collaboration with the U.S.

Finally, as indicated, legal uncertainty also surrounds Article 13(f) on government-to-government sales, in particular, with regard to third countries. Given the prevalence of the U.S. in the field of FMS, any emphasis on third country sales is most likely directed towards the U.S.

To this extent, whilst the *prima facie* exclusion of major forms of procurement may, at a superficial level, signal that the Directive is “without prejudice” to the conduct of transatlantic defence trade relations, the legitimate scope of the exclusions and conditions for their use is not fully defined. Further, exclusion also means that politically and economically contentious fields of activity continue to be subject to uncoordinated legal regimes.

As a result, the external coherence of the EU defence procurement regime is called into question and which, in turn, creates significant uncertainty in the conduct of transatlantic defence procurement relations.

This thesis now turns to the issue of third country access to the EU procurement market in pre-emption of the substantive analysis of the Directive’s provisions in Chapters 5 and 6.

Access and Treatment of Third Countries Within the EU Procurement Market

1. Introduction

Before the final text of the Defence Procurement Directive had even been adopted, U.S. commentary had suggested that certain provisions created a possibility of “implied European preferences”, which could become “subtle and disguised market access barriers” used by EU-based contracting authorities to “discriminate” against U.S. contractors and subcontractors.⁴⁵⁷ In particular, the security of supply, security of information and technical specification provisions might be exploited to justify excluding U.S. bidders,⁴⁵⁸ or which may provide a legitimate basis for discrimination.⁴⁵⁹

Conversely, as indicated in Chapter 1, Section 5.1, official EU publications, commissioned studies and commentaries have not examined the ways in which the Directive relates to, or could otherwise affect, third countries. For instance, official EU publications merely state that the Directive is not intended to “impact” on third

⁴⁵⁷ *Fortresses and Icebergs* (Vol I) (n 12) 221

⁴⁵⁸ NATO, NIAG SG- Consultancy Advice Study, Transatlantic Defence Industrial Cooperation, Final Report, February 8 2008, 15, fn22 citing “Brussels Told Arms Rules will Hurt Trade”, December 5, 2007, 2 <https://www.ncoic.org/apps/group_public/download.php/8434/> accessed 20 September 2012

⁴⁵⁹ C Yukins, ‘Barriers to International Trade in Procurement After the Economic Crisis, Part II: Opening International Procurement Markets: Unfinished Business’ (2009) The George Washington University Law School Public Law and Legal Theory Working Paper No. 530, Legal Studies Research Paper No. 530, Int’l 2-22 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1772922> accessed 20 September 2013

countries, in particular transatlantic defence trade relations.⁴⁶⁰ The stated basis for this determination is two-fold. The first is that arms trade with third countries remains governed by WTO rules.⁴⁶¹ The second, which is said to relate to the first, is that Member States retain the power to determine whether or not to open competition to non-EU suppliers.⁴⁶² Similarly, academic commentary has suggested that the Defence Procurement Directive does not “directly affect” the position of third country economic operators, a conclusion based on the fact that the Directive does not specify any conditions in relation to third country access.⁴⁶³ It has also been stated that whilst third countries may fear that the Directive could be used as a protectionist measure to favour EU companies, this is not the Directive’s aim and does not introduce more opportunities for protectionism than were possible prior to its adoption.⁴⁶⁴

Chapters 4, 5 and 6 will examine these claims. However, it is notable that the above does not expressly differentiate the legal basis for any “discrimination” claim from any *de facto* consequence of an otherwise legitimate application of the Directive. Further, whilst the emphasis has been on the absence of intentional and direct “impact”, there has been no focus on the possible unintentional, indirect and incidental effects. This Chapter will aim to clarify whether, and the extent to which, U.S. firms participating in

⁴⁶⁰ See Commission, ‘Proposal for a Directive of the European Parliament and of the Council on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts in the fields of defence and security’, COM(2007) 766 final, 7; Commission Staff Working Document, ‘Annex to the Proposal for a Directive of the European Parliament and of the Council on the coordination of procedures for the award of certain public works contracts, public supply contracts and public service contracts in the fields of defence and security’ (Impact Assessment) SEC(2007)1589, December 5, 2007, 56-57 <http://ec.europa.eu/internal_market/publicprocurement/docs/defence/impact_assessment_en.pdf> accessed 20 September 2013

⁴⁶¹ *ibid.* This statement is somewhat curious given the *prima facie* exclusion of defence procurement from the scope of the WTO GPA and the existence of Art. XXIII(1) WTO GPA identified in Chapter 2, Section 2.1. It is recalled that the Interpretative Communication similarly asserts that arms trade is governed by WTO rules, in particular, the WTO GPA as a basis for excluding its consideration. See Chapter 2, Section 5

⁴⁶² *ibid.* See also Recital 18

⁴⁶³ B Heuninckx, ‘trick or treat?’ (n 252) 12

⁴⁶⁴ Heuninckx, ‘trick or treat?’ (n 252) 27

contract award procedures derive legally enforceable rights under international agreements, arrangements, EU law and national law. Further, by expanding the field of enquiry to an examination of access beyond the archetype of the third country economic operator directly submitting an EU tender, it is possible to begin to discern the broader remit of EU law and its possible wider effects. As will be discussed, this is also necessary in order to understand how EU law may affect third countries through its application to subjects of EU law.⁴⁶⁵

It should be borne in mind that the task of the present Chapter is necessarily complicated and limited by the fact that there is no substantial existent research which is able to provide insight into how Member State laws and policies have been applied in relation to third countries in the field of defence procurement. It therefore difficult to gauge a formative impression of the extent to which the institution of the Defence Procurement Directive will effectuate any change in national regulatory approaches and practices.

2. Third Country Access Under The Public Sector and Defence Directives

The EU has become the main legal and policy actor with regard to the conduct of relations between Member States and third countries in the field of public procurement.⁴⁶⁶ This is largely attributable to the conclusion by the European

⁴⁶⁵ For instance, as will be discussed in Chapter 5, whilst the Directive may not apply directly to third countries, the assessment of a tender submitted by an EU economic operator may implicate considerations relating to third countries. EU economic operators may also impose specific requirements on third countries pursuant to the Directive's provisions

⁴⁶⁶ For general commentary on third country relations in the field of public procurement, see Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) Ch 20

Community of the WTO GPA.⁴⁶⁷ As a matter of context, it is necessary to briefly discuss the legal basis on which the WTO GPA was concluded.

2.1. EU and Member State Competences in Defence Procurement

The EU does not have a general power to legislate. Under the principle of conferral, it must act within the limits of competence conferred by the Member States under the EU Treaties for the purpose of obtaining the Treaties' objectives.⁴⁶⁸ It is recalled from Chapter 3, Section 2.2 that Article 3(1) TFEU confers exclusive competence on the EU in a number of areas. This includes the Common Commercial Policy ("CCP") under Article 207 TFEU (ex Article 133 TEC). Article 207 TFEU contains powers permitting the EU to take unilateral trade measures and to negotiate and conclude agreements with States and international organisations.⁴⁶⁹

Article 207 TFEU does not provide an exhaustive definition of commercial policy but merely provides a non-exhaustive list of examples of measures falling within its scope.⁴⁷⁰ Procurement is not expressly mentioned.

Whilst it is further recalled that internal market regulation of public procurement is said to be a shared competence, the question of whether procurement measures are

⁴⁶⁷ Agreement establishing the World Trade Organisation (WTO) [1994] OJ L336/273 (n 76). The Agreement was approved on behalf of the European Community by Council Decision 94/800/EC of 22 December 1994 concerning the conclusion on behalf of the European Community, as regards matters within its competence, of the agreements reached in the Uruguay Round multilateral negotiations (1986-1994) [1994] OJ L 336/1

⁴⁶⁸ Article 5(2) TEU (ex Article 5 TEC)

⁴⁶⁹ Article 207(3) and (4) TFEU

⁴⁷⁰ According to Article 207(1) TFEU, these include: (i) changes in tariff rates; (ii) the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of intellectual property; (iii) foreign direct investment; (iv) the achievement of uniformity in measures of liberalisation; (v) export policy and (vi) measures to protect trade such as those to be taken in the event of dumping or subsidies

capable of falling within the EU's exclusive competence under the CCP has been the subject of academic debate.⁴⁷¹ It is now generally accepted that procurement measures are of such type as to fall within the CCP.⁴⁷² On this basis, it has been argued that because the provisions of the GPA to some extent fell within the then European Community's exclusive competence under the CCP, the GPA was concluded under this provision.⁴⁷³ It follows that when the CCP applies, the measures in question fall within the EU's exclusive competence.⁴⁷⁴ The corollary is that only the EU can act; Member States are precluded from taking their own measures in the field of activity concerned (even if the EU has not yet exercised its powers, for example by adopting a common policy).⁴⁷⁵

Importantly, however, there is no definitive statement of EU law regarding defence procurement as a competence. The adoption of a Directive to regulate trade within the internal market indicates a shared competence. The starting point of the Directive (as indicated in Recital 18) appears to be that defence procurement is not an exclusive competence because it is not covered by the WTO GPA, as a result of which Member States "retain power" to decide whether or not to invite third country economic operators to participate in contract award procedures.

⁴⁷¹ For a discussion in this regard, see S Arrowsmith, 'Third country access to EC public procurement: an analysis of the legal framework' (1995) 1 PPLR 1, 2-4, 9-10

⁴⁷² S Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 1314, para 20.2 and citation at fn 3 referring to S Arrowsmith, 'Third country access to EC public procurement: an analysis of the legal framework' (n 471) 2-4

⁴⁷³ Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 1327, para 20.11

⁴⁷⁴ *ibid* 1314

⁴⁷⁵ S Arrowsmith, 'Third country access to EC public procurement' (n 471) 1 citing at fn 1 Opinion 1/75 [1975] ECR 1355 at 1364; Case 41/76 *Criël, nee Donckerwolke v. Procureur de la République au Tribunal de Grande Instance, Lille* [1976] ECR 1921, paras 31-32; Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 1356, para 20.35

In addition, Article 207(6) TFEU provides that the exercise of competences conferred under the CCP must not affect the delimitation of Member State and EU competences and must not lead to harmonization of legislative or regulatory provisions of the Member States in so far as the Treaties exclude such harmonization.

It follows that, as indicated above, in areas of exclusive competence, Member States may not take their own measures in the area concerned unless authorised to do so by the EU. It has been suggested that the EU's exclusive competence under the CCP means that Member States are substantially precluded from adopting their own measures which may discriminate against third countries.⁴⁷⁶ By contrast, it appears that Member States are free to adopt their own measures in the field of defence procurement provided they otherwise comply with EU law. However, this raises a number of questions which, as yet, have not been answered.

Firstly, it is not clear precisely what falls within the permissible range of measures which Member States can take in relation to third countries. The possibility for variable national approaches to the issue of third country treatment could affect the internal coherence of the EU defence procurement regime.

Secondly, a broader question is raised as to whether the EU could exercise its competence to regulate third country treatment in a way comparable to its role in the field of public procurement. It is beyond the confines of this thesis to examine the possibility of such a development. Notwithstanding, the asymmetry between the EU's

⁴⁷⁶ S. Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 1356, point 20.35

current approach in the field of defence procurement and that in the field of public procurement raises questions as to the external coherence of the EU procurement regime.

2.2. Third Country Provision Under the Public Sector and Defence Directives

Both the Public Sector and Utilities Directives⁴⁷⁷ provide that in view of the international rights and commitments devolving on the EU as a result of the acceptance of the GPA, the arrangements to be applied to tenderers and products from signatory third countries are those defined by the GPA.⁴⁷⁸ The GPA contains a number of obligations which, in theory, enable third countries to attain relative equivalence in terms of access and treatment in public contract awards.⁴⁷⁹ These include, *inter alia*, non-discrimination,⁴⁸⁰ most favoured nation treatment⁴⁸¹ and an obligation to provide timely, transparent and effective challenge procedures.⁴⁸²

As will be discussed in Chapter 11 of this thesis, whilst there remain questions about the extent to which these obligations are adequately enforceable and enforced, at least some level of provision is made in contrast to the legal position of third country providers concerned in the award of public defence contracts. State coverage under

⁴⁷⁷ Directive 2004/17/EC of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors [2004] OJ L 134/1 (“Utilities Directive”). The Utilities Directive contains a number of provisions in relation to third countries. For a useful discussion see P Eeckhout, *The European Internal Market and International Trade: A Legal Analysis* (Clarendon 1994), 305-318

⁴⁷⁸ Public Sector Directive, Recital 7; Utilities Directive, Recital 14

⁴⁷⁹ On the WTO GPA generally, see Arrowsmith, *Government Procurement in the WTO* (Kluwer Law International, 2003) (n 77)

⁴⁸⁰ Article III. For commentary, see S Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 1330-1, point 20.14

⁴⁸¹ Article III. For commentary, see S Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 1331, point 20.15

⁴⁸² Article XX. For commentary, see S Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 1336-7, 20.18

the GPA substantially excludes matters of defence procurement.⁴⁸³ Similarly, the Defence Procurement Directive reinforces in Recital 18 that contracts relating to arms, munitions and war material awarded by contracting authorities/entities in the field of defence are excluded from the scope of the GPA.⁴⁸⁴ As will be discussed in Part III, a major policy question that has arisen for GPA members is whether to bring defence procurement within the scope of the GPA.

The EU's position of ostensible neutrality is confirmed by Recital 18, paragraph 2 Defence Procurement Directive which provides:

This exclusion means also that in the specific context of defence and security markets, Member States retain the power to decide whether or not their contracting authority/entity may allow economic operators from third countries to participate in contract award procedures. They should take that decision on the grounds of value for money, recognizing the need for a globally competitive European Defence Technological and Industrial Base, the importance of open and fair markets and the obtaining of mutual benefits. Member States should press for increasingly open markets. Their partners should also demonstrate openness, on the basis of internationally-agreed rules in particular as concerns open and fair competition.⁴⁸⁵

⁴⁸³ See for example the European Communities' Annex I to the WTO GPA which lists the European agencies and products open to competition from other GPA members and which covers only part of the defence market

⁴⁸⁴ Recital 18. Each Party to the WTO GPA defines its commitments in an appendix to the agreement. To this extent certain defence contracting authorities are expressly excluded

⁴⁸⁵ It is not clear to what internationally agreed rules Recital 18(2) refers in the absence of specific international agreements regulating defence procurement. The reference instead likely refers to the WTO GPA which, whilst excluding defence contracts, may, through its coverage of public procurement, provide a point of leverage to encourage greater reciprocal access in relation to defence contracts

U.S. commentary has suggested that Recital 18 could be read to countenance discrimination against foreign defence contractors.⁴⁸⁶ However, it may be suggested that whilst not constituting a third country policy, in and of itself, Recital 18 is simply consistent with the EU's longstanding policy of "reciprocity" in the context of external relations in public procurement.⁴⁸⁷

It is also important to observe that despite earlier proposals for the adoption of what were labelled "Buy European" and "reciprocity clauses",⁴⁸⁸ the EU has not mandated any formal "preferences" within the Directive.⁴⁸⁹

Further, the Directive requires that in restricted procedures, negotiated procedures with publication and competitive dialogues, contracting authorities may limit the number of suitable candidates that will be invited to tender or conduct a dialogue.⁴⁹⁰ However, the Directive prescribes that no less than three candidates must be invited, provided a sufficient number is available.⁴⁹¹ U.S. observers have identified that this could provide increased competition and opportunities for U.S. firms due to the fact

⁴⁸⁶ See C Yukins, 'The European Defence Procurement Directive: An American Perspective' (n 311), 5

⁴⁸⁷ In a 1988 Memorandum, the Commission announced that the EC would not adopt a protectionist approach but rather favour conditional access to the EU market on the basis that reciprocal access to the relevant third country market would be guaranteed. See Commission Memorandum of 1988, "Europe 1992: Europe World Partner", Commission Press Release, 17 of October 19 1988. For useful but by now dated discussions of EU external relations law and policy in the field of public procurement, see S Arrowsmith, 'Third country access to EC public procurement: an analysis of the legal framework' (n 471) 7-9; P Eeckhout, 'The External Dimension of the Internal Market and the Scope and Content of a Modern Commercial Policy in M Maresceau (ed) *The European Community's Commercial Policy after 1992: The Legal Dimension* (Martinus Nijhoff 1993), 89-90

⁴⁸⁸ U.S. legal commentary had indicated that after the U.S. Department of Defense decided to delay a major aerial refueling tanker award, the European Parliament Foreign Affairs Committee voted in favour of a so-called "Buy European" and "reciprocity" clause and that, if confirmed, Member States would be legally entitled to discriminate against bidders from third countries. See *W Hertel, F Schöning and D WBurgett*, New EU Legal Framework For The Defense Industry (2008) Vol 5(10) International Government Contractor, 2. However, U.S. commentary has also acknowledged the absence of any "Buy European" policy. See M Gabriel and K Weiner, 'The European Defence Procurement Directive: Toward Liberalization and Harmonization of the European Defense Market' (2010) 45(2) *The Procurement Lawyer*, 22. The aerial refueling contract identified above is discussed in Chapter 9, Section 3.3

⁴⁸⁹ See also the discussions in Chapters 5 and 6 in this regard

⁴⁹⁰ Article 38(3)

⁴⁹¹ *ibid*

that it is unlikely that for certain defence technologies three EU providers will always be available.⁴⁹²

3. Transposition of the Defence Procurement Directive into National Law

Member States had until 21 August 2011 to transpose the Defence Procurement Directive into national law.⁴⁹³ It appears that all Member States have now transposed the Directive.⁴⁹⁴

According to Article 288 TFEU (ex Article 249 TEC), a Directive is binding as to the result to be achieved but leaves the choice of form and methods to the national authorities.⁴⁹⁵ Therefore, Member States are not in fact required to introduce new legislation; existing laws and practices can be modified accordingly.

Prior to the Directive's adoption, it had been suggested that if a Member State decides to extend the Directive's application to third countries, a third country should benefit from the prohibition of discrimination on grounds of nationality and equivalent treatment afforded to EU economic operators under EU law, including the prohibition on discrimination on grounds of nationality.⁴⁹⁶ The legal basis for this suggestion is not entirely clear. In light of the above analysis, the starting point must be that even if

⁴⁹² I Maelcamp, 'EU Defense Procurement Directive 2009' (n 266) 8

⁴⁹³ Article 72

⁴⁹⁴ Initially, the Commission issued several warnings to Member States that failed to implement on time. See R Williams, 'Commission takes action on implementation of defence procurement rules' (2012) 21 PPLR, 223; Commission, Report to the European Parliament and The Council on transposition of directive 2009/81/EC on Defence and Security Procurement (n 302)

⁴⁹⁵ See Case 163/82 *Commission v. Italy* [1983] ECR 3723, 3286-3287

⁴⁹⁶ Statements of Burkhard Schmitt at a specialist seminar entitled: "The new EU Directive Towards Market-Based Defence and Sensitive Security Procurement" International Chamber of Commerce, Tuesday 1 February 2011. Notes on file with the author

the principle of non-discrimination contained in Article 18 TFEU (ex Article 12 TEC) could be considered equivalent to the WTO notion of “national treatment” for example, the WTO GPA does not apply and, in any event, EU law only applies to natural and legal persons of the EU Member States.⁴⁹⁷

A Member State could provide full equivalent treatment based, for example, on the commitments undertaken within a RDP to ensure non-discrimination and equal treatment. However, if such a guarantee is not given domestic legal effect such as to enable enforcement before a national court, its effect is necessarily limited. As will be discussed in Chapter 11, certain provisions in the RDPs have been given domestic legal effect under U.S. law, in particular with regard to U.S. buy national laws.⁴⁹⁸ However, the RDPs do not confer legally enforceable rights against non-discrimination and positive enforcement of rights to equal treatment more generally. To this extent, any reference to “discrimination” against third countries must be meant in a non-technical, non-legal sense.

3.1. The Position of Third Countries Under National Law

It is recalled from the Introduction that there is little understanding of national laws and practices with regard to access and treatment of third countries concerned in defence contracts. Further, at the time of writing, Member States have only recently transposed the Directive’s provisions. To this extent, it will likely be some time before the full extent of any modifications to national law and their effects will become

⁴⁹⁷ On any such equivalence generally, see P. Trepte, *Regulating Procurement: Understanding the Ends and Means of Public Procurement Regulation* (Oxford University Press, 2004), 251

⁴⁹⁸ Chapter 11, Section 4.3.1.4

apparent with regard to third countries. It is nevertheless useful to compare transposition by the UK and France, not least because of their historic and contemporary role in transatlantic defence cooperation.

3.1.1. Case Study 1: UK Defence and Security Public Contracts Regulations

In its transposition, the U.K. has adopted a specific set of Defence and Security Public Contracts Regulations (“DSPCR”) distinct from the Regulations applicable to public sector procurement.⁴⁹⁹ Similar to the DG Internal Market and Services Guidance Notes, the UK has also published a number of Chapters to provide guidance on interpreting and applying the provisions.⁵⁰⁰

Under the Regulations, the U.K. does not confer any legal rights on third countries or subject the U.K. to any corresponding legal obligations with regard to the DSPCR which are enforceable within U.K. courts.⁵⁰¹ The U.K. expressly states that its obligation to comply with the DSPCR is solely to “potential suppliers in the Member States of the European Union”.⁵⁰² The UK’s duty does not extend to potential suppliers established outside the EU, because such suppliers do not constitute economic operators as defined in the Regulations.⁵⁰³ Further, the Regulations do not include reference to any link which suppliers established within the EU may have with

⁴⁹⁹ The Defence and Security Public Contracts Regulations 2011, S.I. 2009/2743. The DSPCR are an adaptation of The Public Contracts Regulations 2006 (as amended) S.I. 1991/755

⁵⁰⁰ There are 19 Chapters in total which are also accompanied by a detailed glossary. Reference will be made to relevant Chapters in this thesis where necessary. These are available at: <<https://www.gov.uk/government/publications/the-european-union-defence-and-security-public-contracts-regulations-dsPCR-2011>> accessed 20 September 2013

⁵⁰¹ There is not a single reference to third countries in the DSPCR

⁵⁰² The Defence and Security Public Contracts Regulations 2011, Chapter 1 – Overview, 2, point 12

⁵⁰³ Chapter 1 – Overview (n 502), 2 point 13. According to Section 5(1): “an “economic operator” means a contractor, a supplier or a services provider.”

third countries.⁵⁰⁴ Notwithstanding, the U.K. does state that procurers should allow potential suppliers from outside the EU to participate in a procurement procedure as a matter of policy.⁵⁰⁵

It follows that third countries do not have access to the UK remedies provisions except to the extent that procurers extend such rights contractually either expressly or by implication.⁵⁰⁶

Whilst not entirely unequivocal, the U.K. Guidance further states that:

[...] Procurers should be aware that where you seek and receive response to competitive tenders, an implied contract is very likely to come into existence where the procurer agrees to consider all tenderers fairly. This is very likely to apply to suppliers from outside the EU who you have allowed to participate in the procurement.⁵⁰⁷

The precise instances in which an implied contract may be found as well as the conceivable scope of any obligation to consider tenderers “fairly” raises the question as to whether it would require the provision of treatment to third country operators equivalent to that provided to EU economic operators.⁵⁰⁸ Whilst it is beyond the scope of this thesis to examine this issue in full, UK courts have had to consider the

⁵⁰⁴ Cf for example the provisions in Article 59(5) Utilities Directive discussed in Section 4.1 below

⁵⁰⁵ At the time of writing, to the present author’s knowledge, the U.K. has not adopted or published a specific policy, or amended existing policy, with regard to third countries, or more specifically, the U.S. in light of the Defence Procurement Directive setting the conditions for participation and treatment

⁵⁰⁶ Chapter 1 – Overview (n 502) 2-3 para 13

⁵⁰⁷ Chapter 1 – Overview (n 502) 3 para 15

⁵⁰⁸ The “implied tender contract” doctrine is said to derive from the case of *Blackpool and Fylde Aero Club v. Blackpool Borough Council* [1990] EWCA Civ 13, [1990] 1 WLR 1195. For a discussion of the general scope of this obligation, see S Arrowsmith, *The Law of Public and Utilities Procurement* (119) 107-110, paras 288-291

extent to which domestic legal obligations to consider tenders fairly should correspond with the EU Treaty procurement principles.⁵⁰⁹ The likelihood of such argument succeeding is open to question in light of the fact that its legal basis under English law is contentious. It is also not clear to what extent it is possible to prevent or limit the scope of any obligation by means of waiver or contractual exclusion. Nevertheless, this issue highlights just one of many which could theoretically arise as a result of the idiosyncratic features of each national legal system.

3.1.2. Case Study 2: Code Des Marchés Publics 2006 (Consolidées 2013)

Unlike the UK, France has not adopted a specific instrument to implement the Directive but has rather modified the Code des Marchés Publics.⁵¹⁰ Whilst the Code does not explicitly preclude third country operators from tendering for contracts in accordance with the Directive, it has been suggested that the cumulative effect of the Code's provisions is to presumptively exclude third countries from public procurement procedures.⁵¹¹ For instance, under the revised Code, if an authority wishes to open a procurement to third country operators, it must make its decision known in the notice of tender.⁵¹² Further, the Code contains particularly broad accessibility criteria which include reference to the obtaining of mutual advantages and reciprocity.⁵¹³ In addition, the signatory authority may require that third country

⁵⁰⁹ For a brief discussion of the potential scope of this obligation, see L R A Butler, 'Below Threshold and Annex II B Service Contracts in the United Kingdom: A Common Law Approach' in D Dragos and R Caranta (ed) *Outside the EU Procurement Directives – Inside the Treaty?* (Djof: 2012) 310-325 and citations therein

⁵¹⁰ Code des marchés publics (édition 2006), Version consolidée au 28 Juillet 2013

⁵¹¹ See L-X Simonel and B Touzanne, 'Defence and security public procurement contracts : counterpoint and harmony (article 215-1 PPC)', Thursday 19 January 2012 <http://www.kpratique.fr/Defence-and-security-public-procurement-contracts-counterpoint-and-harmony-article-215-1-PPC_a94.html> 20 September 2013

⁵¹² Article 215-I

⁵¹³ Article 215-II. These appear to directly incorporate the references in Recital 18 Defence Procurement Directive, discussed above. Article 218 further provides that third country operators must be able to provide all documents, information or evidence in support of their applications to assess whether they meet the accessibility

operators complete their applications within a maximum period of ten days where documents, information or evidence are lacking; failure to do so within the prescribed period will preclude further participation.⁵¹⁴ Finally, the signatory authority must establish a report containing *inter alia*, and as appropriate, the reasons that motivated its decisions relating to the third country operators' participation in the procurement process.⁵¹⁵

It has been suggested that these developments will produce significant effects on third country operators already established in the French defence and security market or willing to integrate into it.⁵¹⁶ In particular, commentary has highlighted the emphasis on satisfying the additional requirements to complete applications within a maximum period and the more fundamental observation that the number of markets opened to third countries will only be known *a posteriori*, after governmental decision.⁵¹⁷ Importantly, it has also been suggested that there is a need for a precise definition of the notion of third country economic operators.⁵¹⁸ It is recalled that the UK DSPCR similarly omits a detailed definition of economic operators.

Further, French commentary has also identified the need to study the legal feasibility of, and/or alternatively, the signing of a general subcontracting agreement with a European operator, the setting up of institutionalized co-contracting or the

criteria. Article 232-II provides that the signatory authority decides on the rights of third country operators to participate in the procurement process, in accordance with the specified accessibility criteria. The authority then considers applications by third countries that have not been excluded

⁵¹⁴ Article 232-I

⁵¹⁵ Article 252

⁵¹⁶ Simonel and Touzanne, 'counterpoint and harmony' (n 511)

⁵¹⁷ *ibid*

⁵¹⁸ *ibid*

establishment of a European branch.⁵¹⁹ This appears to recognize the continued necessity of partnering in order to leverage access into the national market.⁵²⁰

4. Differentiating Modes of Third Country Access

As indicated, the Defence Procurement Directive merely states that Member States retain power to decide whether or not to permit participation of “economic operators from third countries”.⁵²¹ This appears to envisage direct participation of a third country economic operator submitting a tender for a main contract subject to the Directive. However, for a host of reasons, certain of which are examined below, the reality is that direct access of this kind is unlikely to be common or, indeed, the most effective way of accessing the EU market. Further, whilst the Directive emphasizes ostensible neutrality with regard to third countries, it nevertheless contains specific provisions which make reference to third countries and, which, if applied directly to EU economic operators, may affect those third countries.⁵²²

To this extent, as indicated in the Introduction, whilst EU official publications and legal commentary refer to the absence of direct impacts, these determinations do not identify the indirect effects which may result and which can be discerned (if not measured) when third country access is viewed from a broader perspective. It is necessary to clarify at a relatively basic level of understanding the various ways in which third countries may access the EU market.

⁵¹⁹ *ibid*

⁵²⁰ For a discussion in this regard, see Section 4.4. below

⁵²¹ Recital 18

⁵²² As will be discussed in Chapter 5, these issues arise, in particular, when examining the Directive’s application to EU contractors which rely on third country supply chains

4.1. Third Country Economic Operators

The archetypal scenario which appears to be envisaged in official and other publications concerns the instance in which a third country economic operator submits a bid and also proposes to, or if awarded the prime contract, use either third country subcontractors, EU subcontractors or a combination.⁵²³ As indicated above, in this case, the legal position is likely to depend on the relevant Member State's decision as to whether or not to accord rights to third country operators which are enforceable under national law.

One important aspect which is not specified by the Directives nor the implementing national legislation concerns precisely what distinguishes an EU economic operator from a third country economic operator.⁵²⁴ By contrast, the Utilities Directive, for example, contains a specific provision originally included to enable the future suspension or restriction of the award of service contracts where it had been determined that third countries had not provided reciprocal access to EU economic operators.⁵²⁵ The Utilities Directive distinguishes between: (i) undertakings governed by the law of a third country;⁵²⁶ (ii) undertakings affiliated to those governed by the law of a third country, which have their registered office in the EU but no "direct and effective link" with the economy of a Member State⁵²⁷ and (iii) undertakings submitting tenders which have as their object services originating in the third

⁵²³ Of course, those subcontractors may be prime contractors on a different contract

⁵²⁴ According to Article 1(14) Defence Procurement Directive: "economic operator" means a contractor, supplier or service provider. It is used merely in the interests of simplification[.]"

⁵²⁵ 59(5) Utilities Directive

⁵²⁶ Article 59(5)(a)

⁵²⁷ Article 59(5)(b). According to this category, the links which such firms have with third countries may cause them to "import" services, so that despite their EC nationality, there is no benefit to the EC economy. For a discussion in this regard, see S Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 1359, para 20.37

country.⁵²⁸ The rationale supporting this definition is readily apparent in light of the possibility to provide services from a location without a physical presence in EU territory.

However, it is not clear what precludes a similar definition being adopted by both the Public Sector and Defence Procurement Directives. It is likely that the place of establishment will be decisive for determining the scope *ratione materiae* of the Defence Procurement Directive's provisions. Nevertheless, as will be discussed below, the fact that third country operators may establish EU subsidiaries means that EU law may, in its direct application to subjects of EU law, also affect third country operators. Further, beyond determining the applicability of the Directive, the issue of establishment is also relevant to substantive assessments of tenders. For instance, as will be discussed in Chapter 5, Section 7.2.1, the Guidance Notes on the Directive contain specific references to the establishment of economic operators and "dependence" on third country supply chains.

In light of the above, questions arise regarding the extent to which degrees of ownership, affiliation and other links are, or ought to be, relevant in application of the Directive. It is suggested that the Directive, or at the least the Guidance Notes, might have better defined and delineated these aspects.

⁵²⁸ Article 59(5)(c). This category focuses on the nature of the service rather than the service provider. See S. Arrowsmith, *The Law of Public and Utilities Procurement* (n 527) and citations therein

4.2. EU Subsidiary of a Third Country Company

As indicated above, another form of access may involve an EU subsidiary of a third country parent company which submits a tender providing goods, works or services all or part of which originate from a third country or the EU. It is recalled that the Directive does not classify the origin of third country providers and makes no reference to State of nationality, establishment, degree of affiliation or other “direct and effective link”.

In correspondence with the position under the Public Sector and Utilities Directives, an EU subsidiary of a third country company will be considered (at least formally) equivalent to an EU economic operator for the purposes of EU law. Whilst it is not clear to what extent, if at all, U.S. establishment of subsidiaries within the EU will be affected by the introduction of the Defence Procurement and ICT Directives, U.S. companies with EU subsidiaries are likely to continue to take advantage of EU establishment in order to provide an important point of leverage into the EU procurement market in a way that has become vital for the success of the limited number of European defence companies that also operate within the U.S. market.

The result of this status is that whilst a third country parent cannot directly enforce EU law for the reasons explained above, a third country parent may be indirectly affected by the application of EU law to the EU subsidiary. The corollary of this position is that because the EU subsidiary will be able to challenge a decision under EU law, its third country parent may nevertheless derive a measure of incidental protection under EU law as a result.

With regard to a subcontractor, it has been observed that in case subcontracting obligations are part of the tendering process under the Directive, it is uncertain if a subcontractor of the tenderer would have a right to challenge procurement decisions of the contracting authority under the Directive, for instance, if the contracting authority rejects its selection by the tenderer.⁵²⁹ However, it has been submitted that subcontractors would have a right of challenge as they probably fit within the definition of “person having or having had an interest in obtaining a particular contract who has been or risks being harmed by an alleged infringement”.⁵³⁰ In any case, a subcontractor could not rely on the remedies provisions against a subcontracting decision of the tenderer itself.⁵³¹ To this extent, it may be possible to argue that an EU subsidiary of a third country economic operator acting as a subcontractor to an EU operator or other EU subsidiary of a third country economic operator may be able to challenge the decision of a contracting authority under the Directive. However, it is unlikely that a third country economic operator acting as subcontractor to either an EU operator or EU subsidiary of a third country parent could similarly challenge a decision under the Directive.⁵³²

As indicated in Section 3, it may be possible for a Member State to provide full equivalent treatment as a matter of national law but this does not affect the *prima*

⁵²⁹ B Heuninckx, ‘trick or treat?’ (n 252) 26

⁵³⁰ Article 55(4) provides that: “Member States shall ensure that review procedures are available, under detailed rules which Member States may establish, at least to any person having or having had an interest in obtaining a particular contract who has been or risks being harmed by an alleged infringement.”

⁵³¹ Article 55(1)

⁵³² Again, this may expose a degree of legal uncertainty. On a broad reading, a third country subcontractor may constitute a person having or having had an interest in obtaining a particular contract who has been or risks being harmed by an alleged infringement. However, it appears that a third country operator acting as a subcontractor could not challenge a decision of a contracting authority under the Directive simply by the fact of its constituting a “third country”. It could be argued that such a third country operator is incapable of having any legally enforceable rights under EU law and so cannot have an interest or suffer any harm that is legally recognised

facie position with regard to the scope of the Directive in its application to subjects of EU law.

4.3. EU Economic Operator Proposes Third Country Subcontractor

The preceding sections have considered the possibility of third country economic operators and EU subsidiaries of third country operators tendering for contracts. However, an EU economic operator with no apparent third country ownership or other affiliation may also submit a bid and proposes to, or if awarded the prime contract, use third country subcontractors, EU subcontractors (which may be EU subsidiaries of third country operators) or a combination. As will be discussed in Chapter 5, an EU economic operator may be affected by the Directive's provisions where, for example, a contracting authority takes into account issues relating to an EU tenderer's supply chain or imposes certain conditions on subcontracting.

4.4. Teaming Arrangements, Joint Ventures and Consortia

It has been suggested that notwithstanding the increasing encouragement of third country contractor participation in contract award procedures, Member States have expressed, and are likely to continue to express, informal preferences for tenders to include the involvement of local industries.⁵³³ Consequently, in order to avoid the risk of an unsuccessful individual tender, third country contractors may have no other credible option than to submit a joint bid with a local partner under a teaming arrangement.

⁵³³ See Van Bael & Bellis, 'White Paper on the Competition Law Assessment of Joint Bidding in European Defence Markets', 5 January 2011, 1 and 5 (on file with the author)

However, the Directive does not contain any specific provisions in relation to joint ventures, teaming or consortia bids.⁵³⁴ Whilst there is limited understanding of the application of EU procurement law to teaming arrangements in defence procurement, an EU competition law analysis nevertheless provides a useful insight into the complexities of the legal issues faced.⁵³⁵

For instance, it has been questioned whether a teaming arrangement involving a third country partner would infringe EU competition law.⁵³⁶ This determination requires an assessment of whether, absent the arrangement, the parties would be actual or potential competitors in the relevant market.⁵³⁷ If not, the teaming arrangement is likely to be permitted.⁵³⁸ The determining factor in establishing whether the non-EU supplier would be a potential competitor is whether there is a “quasi-legal bar” to the supplier’s independent entry in the form of an unstipulated

⁵³⁴ Recital 13 simply states that: ‘contractor’, ‘supplier’ and ‘service provider’ means any natural or legal person or public entity or consortium of such persons and/or bodies which offers on the market to execute works, supply products and provide services, respectively. Article 41(3) concerning economic and financial standing further provides: “[u]nder the same conditions, a consortium of economic operators as referred to in Article 4 may rely on the capacities of participants in the consortium or of other entities

⁵³⁵ The relevance of anti-trust considerations in teaming arrangements in the defence context is also consistently raised as an issue in the U.S. For example, see W B Burnett and W E Kovacic, ‘Reform of United States Weapons Acquisition Policy: Competition, Teaming Arrangements, and Dual-Sourcing’ (1989) 6 *Yale Journal on Regulation* 249; W E Kovacic, ‘Antitrust Analysis of Joint Ventures and Teaming Arrangements Involving Government Contractors’ (1990) 58 *Antitrust Law Journal* 1059; W E Kovacic, ‘Merger Policy in a Declining Defense Industry’ (1991) 36 *Antitrust Bulletin* 543; J Kattan, ‘The Declining Defense Sector and Federal Antitrust Enforcement’ (1993) 23 *Pub Cont LJ* 21; G R. Spratling, ‘Will Teaming Be a Problem?’ (Spring 1995) *Procurement Lawyer* 23; D A Yao and S S DeSanti, “Antitrust Analysis of Defense Industry Mergers” (1994) 24 *Public Contract Law Journal* 379; M Shwartz, Note, ‘The Not-So-New Antitrust Environment for Consolidation in the Defense Industry: The Martin Marietta-Lockheed Merger’ (1996) *Columbia Business Law Review* 329

⁵³⁶ The relevant provisions on EU competition law are contained in Articles 101-106 TFEU. For an authoritative work on EU competition law, see R Whish and D Bailey, *Competition Law* (7th ed. OUP 2012)

⁵³⁷ Van Bael & Bellis observe that non-EU suppliers will not currently be actual competitors of local suppliers in countries where, until now, they have not been permitted to participate in procurement procedures and where, therefore, they have been completely excluded from local markets. However, the White Paper notes that the more difficult determination to be made is whether non-EU suppliers could nonetheless be regarded as potential competitors of local suppliers in local markets to the extent that: (i) the non-EU suppliers are likely to be already active in the same relevant product markets in other aspects of the world and (ii) the non-EU suppliers are now at least nominally able to participate in procurement procedures in local markets. See Van Bael and Bellis, White Paper (n 533) 3

⁵³⁸ *ibid* 3

government preference for local suppliers to maintain a local defence industry.⁵³⁹ On one hand, it could be argued that a non-EU supplier would be reasonably entitled to conclude that where a contracting authority has expressed such a preference, an individual bid would be commercially pointless, thereby necessitating a teaming arrangement.⁵⁴⁰ On the other hand, it has been argued that where preferences for local suppliers are non-transparent, competition authorities could question their true impact and whether barriers for third countries in fact continue to exist.⁵⁴¹ There is also a risk that when investigated, contracting authorities could downplay the importance of having a local partner.⁵⁴² These factors may lead a competition authority to legitimately question whether a local partner and thus a teaming arrangement was in fact necessary or whether a third country contractor is capable of independent entry into the relevant market.

Finally, it has been observed that even if the possibility remains for Member States to invoke Article 346 TFEU to justify the teaming arrangement, it would have to be proven that a Member State required or encouraged the arrangement.⁵⁴³ Further, as an “ex-post immunization” it would not provide the kind of *ex-ante* legal certainty which suppliers seek.⁵⁴⁴

539 *ibid* 5

540 *ibid* 3

541 The White Paper also suggests that if Member State governments invite or encourage a non-EU company to submit a bid, this could be construed as an indication that barriers to entry are diminishing. See *ibid* 6

542 *ibid*

543 *ibid*

544 *ibid* 7

Therefore, again, on a broader understanding of third country access, it is possible to discern particular issues of legal uncertainty in light of the adoption of the Defence Procurement Directive.

4.5. Products of Third Country Origin in Free Circulation

The primary focus of this analysis has concerned access of the economic operator. However, third country access also includes the provision and circulation of third country products. Prior to the adoption of the Defence Procurement Directive, academic commentary had considered the conceivable scope of application of EU law to third country products in tenders for contracts awarded in accordance with the Public Sector Directive.⁵⁴⁵ The Public Sector Directive contains no express provisions to deal with the treatment of third country products and so does not contain any provision precluding authorities from imposing conditions that prohibit the inclusion of third country products.⁵⁴⁶

Notwithstanding, it has been argued in the public procurement context that even if it could be suggested that Member States continue to have some measure of discretion to adopt discriminatory policies against third countries, entities may not exclude such products from their procurement, *inter alia*, on grounds that it would be contrary to the free movement of goods.⁵⁴⁷ Article 29 TFEU (ex Article 24 TEC) provides that third country products must be considered to be in free circulation in a Member State if they comply with the relevant formalities and applicable customs

⁵⁴⁵ See S Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 1352-1357, paras 20.32-20.35

⁵⁴⁶ This must be contrasted with the provisions contained in Article 58 Utilities Directive. For commentary, see Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 1352-1353, para 20.33

⁵⁴⁷ *ibid* 1354-1357, paras 20.34-20.35

duties and will therefore become subject to EU law. It follows that a product of U.S. origin that has been legally imported and complies with all necessary requirements for sale on the market of a Member State is a product in free circulation.⁵⁴⁸ Therefore, another Member State may not restrict access of that product to its market (i.e. exclusively on the basis of its third country origin) because to do so would be contrary to the free movement of goods.⁵⁴⁹ Importantly, this does not prevent an authority from discriminating against third country products imported directly.⁵⁵⁰ However, it has been argued that suppliers of third country products could evade such a policy by the simple expedient of offering products imported through other Member States.⁵⁵¹ Whilst this analysis might provide a possible solution for ordinarily commercial items, restrictions placed on defence products may not make this practicable, for example, where a Member State insists on the use of directly imported goods for security or other reasons.⁵⁵² This issue may also be compounded by any restrictions placed on third country products as a result of third country laws and policies.⁵⁵³

It should be observed that the Defence Procurement Directive does not contain any provision in relation to the determination of product origin. Further, given that third country products may circulate freely under EU law, their exclusion from a tender as well as any restriction on movement within the EU can only be justified by a

⁵⁴⁸ *ibid* 1352, para 20.32

⁵⁴⁹ For a more detailed discussion in this regard, see S Arrowsmith, 'Third country access to EC public procurement' (n 471) 13-16

⁵⁵⁰ For example, the Government could (subject to relevant international agreements) refuse to purchase products of U.S. origin imported through the discriminating Member State, since this does not affect trade in that product within the Community. See Arrowsmith, 'Third country access to EC public procurement' (n 471) 14

⁵⁵¹ *ibid*

⁵⁵² See e.g. Case C-367/89 *Criminal Proceedings against Aimé Richardt and Les Accessoires Scientifiques SNC* [1991] ECR I-4621 and generally I Govaere and P Eeckhout, 'On dual-use goods and dualist case law: the Aimé Richardt judgment on export controls' (1992) 29(5) CML Rev 941

⁵⁵³ A prime example that will be discussed in Chapter 5 concerns U.S. export control restrictions

recognized exception under EU law. Therefore, access of third country products raises a host of additional questions which could give rise to legal uncertainty.

5. Conclusions

Whilst the Public Sector Directive imposes obligations on Member States with regard to third countries as a result of incorporation of the WTO GPA, there is no equivalent under the Defence Procurement Directive. To this extent, the national laws will substantially determine the legal position of third countries. A cursory analysis of the Directive's transposition within UK and French law provides an indication of the potential variability of national legal approaches. Further, whilst the absence of any direct impact of the Defence Procurement Directive has been highlighted, on a broader conception of third country access, there is a possibility for EU law to indirectly affect third countries in a number of ways.

Nevertheless, the reality is that, historically, very little is known about national legal approaches to third country access and treatment in the field of both public and defence procurement. It is suspected that irrespective of whether or not national laws have formally regulated third country relations in the field of defence procurement, much procurement will have been conducted without regard to any applicable legal framework.

It is therefore uncertain what effect, if any, the Defence Procurement Directive will have on national legal approaches to third countries. For instance, it is unclear whether Member States will confer any legally enforceable rights on third countries or

continue to apply national policies. Under either option, it is not clear whether provision for third countries will result in equal, less, or more favourable treatment than that provided prior to the Directive.

It is also unclear whether the fact that the same regulatory regime will apply to domestic and EU economic operators will have any discernable effect on the ratio of third country : EU competition. Emphasis has been placed on the potential for the Directive to discriminate against third countries. However, in the public procurement context it has been suggested that given that the procurement Directives already constrain the freedom of Member State action, it must be seriously questioned whether Member States would place further limitation on their choices by discriminating against third countries.⁵⁵⁴

The above analysis therefore provokes the interesting question of whether the exercise of EU external relations competences in the field of defence procurement may become necessary or desirable. At present, there is a clear asymmetry in the external regulation of public and defence procurement. It should not be overlooked that U.S. contractors are currently required to comply with 28 national legal and policy regimes in the field of defence procurement.

Recently, the EU proposed a Regulation on access of third country goods and services to the EU's internal market in public procurement and procedures supporting negotiations on access of EU goods and services to third country public procurement

⁵⁵⁴ See S Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) 1353, para 20.33, fn 71

markets.⁵⁵⁵ The proposal is said to respond to “manifold restrictive procurement practices” faced by EU suppliers in many of the EU’s major trading partner countries.⁵⁵⁶ Certain observations about the necessity for, and timing of, the proposal are pertinent to the observations made in this Chapter. For instance, an important rationale which is said to necessitate the Regulation is that the Public Sector and Utilities Directives do not provide a general framework for dealing with bids containing foreign goods and services and that EU-based contracting authorities do not understand the scope of the EU’s international commitments.⁵⁵⁷ The International Chamber of Commerce (“ICC”) Task force responded to the Proposal by recommending that before adopting a Regulation, more in-depth analysis is necessary in order to assess how far Member States are open to third country tenders and to what extent they are legally able to reject bidders from countries who are yet to sign any trade agreements.⁵⁵⁸ Specifically, there should be greater focus on the production of significantly more guidance for contracting authorities and bidders about the legalities of accepting tenders from non-EU countries.⁵⁵⁹ These

⁵⁵⁵ See Commission ‘Proposal for a Regulation of the European Parliament and of the Council on the access of third-country goods and services to the Union’s internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries (2012) COM(2012) 124 final. For a useful summary of the proposal, see R Williams, ‘Commission Proposals in Relation to Third Country Access, Legislative Comment’ (2012) 4 PPLR 169-173. See also CCMI/082, ‘Opinion of the European Economic and Social Committee on Third Country State-Owned Enterprises in EU Public Procurement Markets’ (own initiative opinion), Brussels, 4 May 2011

⁵⁵⁶ ‘Proposal for a Regulation’ (n 555) 2. The proposal cites that some €352 billion of EU public procurement is open to bidders from WTO GPA States. By contrast, it cites, *inter alia*, the fact that the value of U.S. procurement offered to foreign bidders is currently just €178 billion. The proposal also indicates that this figure is just €27 billion for Japan. It also identifies that only a fraction of the Chinese public procurement market is open to foreign business. It projects that as a result only €10 billion of EU exports (0.08% of EU GDP) come from global procurement markets with an estimated €12 billion unrealized

⁵⁵⁷ According to the Impact Assessment, 28% of all contract award notices contain erroneous assessments of the coverage of the GPA. See Executive Summary of the Impact Assessment Accompanying the document Proposal for a Regulation of the European Parliament and of the Council establishing rules on the access of third country goods and services to the European Union’s internal market in public procurement and procedures supporting negotiations on access of European Union goods and services to the public procurement markets of third countries (Impact Assessment) COM(2012) 124 final

⁵⁵⁸ International Chamber of Commerce Task Force, Response to the Proposal for a Regulation of the European Parliament and of the Council on the access of third-country goods and services to the European Union’s internal market in public procurement and procedures supporting negotiations on the access of Union goods and services to the public procurement markets of third countries (COM (2012) 124 final), Paris 24 July 2012, 2, para 1

⁵⁵⁹ ICC Task Force (n 558) 4, para 7

observations corroborate the limitations of existing evidence identified in this thesis as well as the need for further research.

From the perspective of transatlantic defence procurement, it is submitted that an important issue that will need to be confronted concerns the extent to which the absence of a coordinated EU legal approach to the procurement relations of Member States with third countries is detrimental to the more effective functioning of a competitive transatlantic defence market. Of course, this raises a host of complex questions which fall beyond the intended aims of this thesis.⁵⁶⁰ However, at the very least, it is submitted that the EU should accord the same priority to third country issues in the field of defence procurement as it does to third country issues in the field of public procurement.⁵⁶¹ The external coherence of the EU defence procurement regime has a direct causal correspondence with the internal coherence of the regime. For the reasons identified in this Chapter and throughout this thesis, this issue is of specific concern to the development of the transatlantic defence market.

This thesis now turns to examine the substantive application of the Defence Procurement Directive.

⁵⁶⁰ The EU would have to decide to what extent (if at all) the EU would privilege the conduct of transatlantic defence procurement relations, in turn, necessitating confrontation of core issues about the division between Member State and EU competences, and, more fundamentally, how States see their defence (as distinct from their trade) objectives realised. Notwithstanding, if coherence and coordination of regulatory regimes could be deemed essential objectives of a transatlantic defence market, a serious question must be asked about whether the EU can or should develop an external relations policy which also covers defence procurement

⁵⁶¹ See also Trybus, 'The tailor-made EU Defence and Security Procurement Directive' (n 125) 29

5

Security of Supply

1. Introduction

It is recalled that U.S. commentary has identified the possibility for certain of the Directive's provisions to be used to discriminate against U.S. contractors and subcontractors. Particular emphasis has been placed on the security of supply and technical specifications provisions which form the subject of analysis in this and the following Chapter.⁵⁶²

This Chapter begins by examining the conceptual and definitional underpinnings of "security of supply". The Chapter then provides a brief overview of relevant U.S. export control laws as necessary context for the remaining Sections. As will be demonstrated, U.S. claims are largely predicated on concerns about the extent to which such laws and their effects will impact on security of supply assessments. Finally, the Chapter examines security of supply as a relevant factor in the assessment of a tenderer's supply chain.

At the outset, it must be qualified that the following analysis is based primarily on a textual analysis of the provisions and informed by the Guidance Notes, major studies and discussions with relevant officials. To this extent, any analysis must be cautious

⁵⁶² It is recalled that U.S. commentary has also identified the possibility for the Directive's security of information provisions to discriminate against U.S. contractors. These claims are considered in Chapter 9, Section 3.1

to appreciate the existing limitations of understanding of the correspondence between the prescription of formal legal rules and their use and effect in practice.⁵⁶³

Unsurprisingly, this and the following Chapter do not reveal an overt attempt by the EU legislator to mandate particular “preferences” through the provisions. Rather, the focus is on whether the Directive’s provisions have a *latent* potential to be utilised in a particular way so as to appreciably affect third countries, in particular, the U.S. e.g. through particular wording, conferred discretions or even guidance on how to apply the relevant provisions. This must be differentiated from any effects which may result to third countries from an otherwise legitimate application of ostensibly neutral provisions which reflect genuine considerations.

Whilst it is recognized that it will be some years before it will be possible to develop a clearer understanding of how the Defence Procurement Directive may affect transatlantic defence procurement practice, this should not detract from the importance of early assessment of the kind undertaken here.

2. Legislative Scheme of the Defence Procurement Directive

It is recalled that the Defence Procurement Directive is broadly modelled on the Public Sector Directive but is tailored to the specificities of defence procurement contracting.⁵⁶⁴

⁵⁶³ One side of the contracting equation, it is difficult to discern how contracting authorities exercise their decision-making, the factors which legitimately and contextually inform their decisions and the relative weight they accord to such factors. It also follows that it simply cannot be presumed that provisions will be utilised as expected by certain actors or in a particular way, or that there will be uniformity of practice in their use, especially in the individual circumstances of each procurement. On the other side of equation, it is also difficult to discern how (and how accurately) economic operators and industries perceive the decision-making exercised by contracting authorities and act accordingly. To this extent, caution must be observed when there is any reference to an emerging “trend” or the “development” of a “preference” which is said to reflect a consensus of opinion

At the outset, it is important to emphasise that, by definition, the Directive's provisions are directory. Whilst mandatory, they constitute general minimum obligations. They cannot be compared to a regulatory code similar to the U.S. Federal Acquisition Regulation that will be examined in Part II.

The Directive comprises 5 Titles and 8 Annexes. Title I concerns the Directive's general scope and identifies, *inter alia*, the types of defence and security contracts to which the Directive applies.⁵⁶⁵ It also specifies a set of procurement principles which are increasingly accepted as generally applicable to all forms of procurement under EU law;⁵⁶⁶ these principles provide that contracting authorities must treat economic operators equally, in a non-discriminatory and transparent manner.⁵⁶⁷

Title II governs rules on contracts. These concern, in particular, thresholds,⁵⁶⁸ contracts and framework agreements awarded by central purchasing bodies,⁵⁶⁹

⁵⁶⁴ For general commentary on the Directive, see A Georgopoulos, 'The European Commission proposal for the enactment of a Defence Procurement Directive' (2008) 17 PPLR 81; T Briggs, 'The New Defence Procurement Directive' (2009) 18 PPLR 129; M Gabriel and K Weiner, 'The European Defence Procurement Directive: Toward Liberalization and Harmonization of the European Defense Market' (n 488); B Heuinckx, 'Lurking at the Boundaries' (n 80); C Kennedy-Loest and N Pourbaix, 'The new Defence Procurement Directive' (2010) 11 ERA Forum 399; B Heuinckx, 'Trick or treat' (n 252); M Trybus, 'The tailor-made EU Defence and Security Procurement Directive' (n 125); M Trybus, 'The hidden Remedies Directive: review and remedies under the EU Defence and Security Procurement Directive' (2013) PPLR 4 135

⁵⁶⁵ Article 2

⁵⁶⁶ These principles were discussed in Chapter 3, Section 2.1

⁵⁶⁷ Article 4

⁵⁶⁸ Article 8. The Directive only applies to contracts above certain thresholds. The thresholds are periodically adjusted. For 2012, the Directive applies to contracts which have a value exceeding VAT of no less than € 400,000 for supply and service contracts and € 5,150,000 for works contracts. See Commission Regulation (EU) No 1251/2011 of 30 November 2011 amending Directives 2004/17/EC, 2004/18/EC and 2009/81/EC of the European Parliament and of the Council in respect of their application thresholds for the procedures for the awards of contract, Text with EEA relevance [2011] OJ L 319/43, Article 3

⁵⁶⁹ Article 10. For general commentary, C H Bovis, *EU Public Procurement Law* (n 171) 355

excluded contracts,⁵⁷⁰ technical specifications,⁵⁷¹ conditions for the performance of contracts⁵⁷² and subcontracting.⁵⁷³

A specific innovation concerns the provisions on security of information,⁵⁷⁴ and security of supply,⁵⁷⁵ in recognition of the implication of these interests in defence contracts.

Title II also sets out the applicable procedures. Unlike the Public Sector Directive, the open procedure is not available.⁵⁷⁶ A contracting authority may opt to use either the restricted procedure or the negotiated procedure with publication of a contract notice.⁵⁷⁷ The negotiated procedure with publication is the “default” procedure⁵⁷⁸ and, unlike the Public Sector Directive, does not require justification for its use.⁵⁷⁹ The omission of an open procedure has been described as “strange”.⁵⁸⁰ It is possible that the EU legislator has simply determined that defence contracts are too complex for its use.⁵⁸¹ However, it is possible for such a procedure to be used in practice and

⁵⁷⁰ Articles 11-13. For a discussion of certain of these exclusions, see Chapter 3

⁵⁷¹ Article 18. For a general commentary on the technical specifications provisions, see Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’ (n 125) 21-22. For a further discussion of these provisions, see Chapter 6

⁵⁷² Article 20

⁵⁷³ Article 21

⁵⁷⁴ Article 22. For guidance on this provision, see Guidance Note, Security of Information, Directorate General Internal Market and Services. For general commentary, see Heuninckx, ‘Trick or treat’ (n 252) 21-22. These provisions are examined briefly in Chapter 9, Section 3.1

⁵⁷⁵ Article 23. For generally commentary, see Heuninckx, ‘Trick or treat’ (n 252) 22-25. These provisions are examined in detail in this Chapter

⁵⁷⁶ The open procedure is contained in Article 1(11)(a) Public Sector Directive. For a comparison in this regard, see Heuninckx, ‘Trick or treat’ (n 252) 14. On the open procedure generally, see C H Bovis, *EU Public Procurement Law* (n 171) 229-30

⁵⁷⁷ Article 25. See also T Briggs, ‘The New Defence Procurement Directive’ (n 564) 135

⁵⁷⁸ See Recital 47. For general commentary on the negotiated procedure and its use relative to the restricted procedure, see Heuninckx, ‘Trick or Treat’ (n 252) 14-15; Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’ (n 125) 18

⁵⁷⁹ See Article 26; Article 30 Public Sector Directive. On the negotiated procedure with publication under the Public Sector Directive, see C H Bovis, *EU Public Procurement Law* (n 171) 231-36

⁵⁸⁰ see Heuninckx, ‘Trick or Treat’ (n 252) 14

⁵⁸¹ *ibid*

would, in any event, accord with the objective to open the market to EU wide competition.⁵⁸² As will be discussed in Chapter 9, U.S. law does not formally preclude the use of open tendering for defence contracts.

Further, similar to the Public Sector Directive, certain contracts may, in some cases, be awarded on the basis of the competitive dialogue or the negotiated procedure without publication of a contract notice.⁵⁸³ The competitive dialogue procedure may be used for particularly complex contracts⁵⁸⁴ if the contracting authority considers that using the restricted procedure or the negotiated procedure with publication will not allow the award of the contract.⁵⁸⁵ U.S. commentary has expressed surprise at what is considered to be a slight reluctance to allow use of the competitive dialogue in light of the fact that the equivalent use of competitive negotiations in the U.S. is considered to be the norm in advanced weapons systems.⁵⁸⁶

The negotiated procedure without publication may be used in certain very specific circumstances, when the use of the negotiated procedure with publication is impossible or entirely inappropriate.⁵⁸⁷ As will be discussed in Chapter 10, certain

⁵⁸² See Trybus, 'The tailor-made EU Defence and Security Procurement Directive' (n 125) 20

⁵⁸³ Article 25

⁵⁸⁴ The definition of "particularly complex contract" is the same as that of the Public Sector Directive. See Article 1(21) Defence Procurement Directive and Article 1(11)(c) Public Sector Directive and the procedure is the same under the two Directives. See, respectively, Article 27 and Article 29

⁵⁸⁵ Article 27 Defence Procurement Directive contains the relevant provisions on the competitive dialogue. For commentary on this provision, see Heuninckx, 'Trick or Treat' (n 252) 15-16. Article 29 Public Sector Directive contains the relevant provisions on the competitive dialogue. For a general commentary on the competitive dialogue procedure, see C H Bovis, *EU Public Procurement Law* (n 171) 236-41

⁵⁸⁶ C Yukins, *The European Defense Procurement Directive: An American Perspective* (n 311) 4

⁵⁸⁷ Article 28 Defence Procurement Directive contains the relevant provisions on the negotiated procedure without publication. See also and Recital 50. For commentary on this provision, see Heuninckx, 'Trick or Treat' (n 252) 16-17; Trybus, 'The tailor-made EU Defence and Security Procurement Directive' (n 125) 19. Article 31 Public Sector Directive contains the relevant provisions on the negotiated procedure without publication. For a general commentary on the negotiated procedure without publication, see C H Bovis, *EU Public Procurement Law* (n 171) 255. See also the discussion of the Agusta helicopters litigation in Chapter 2 of this thesis, Section 4.3

circumstances correspond with those legitimating non-competitive procurement under U.S. law.

Specific provision is also made for the publication of contract notices,⁵⁸⁸ time limits,⁵⁸⁹ information contained in invitations to tender, negotiate or participate in a dialogue,⁵⁹⁰ and information for candidates and tenderers.⁵⁹¹ Title II also specifies rules on communication,⁵⁹² and conduct of the procedure, including criteria for qualitative selection⁵⁹³ and contract award,⁵⁹⁴ as well as use of electronic auctions.⁵⁹⁵

Finally, Title III provides for detailed additional rules on subcontracting.⁵⁹⁶ Their inclusion is, in part, intended as a strategic attempt to open up supply chains to competition as well as to mitigate the potential for recourse to the practice of “offsets”, discussed in Chapter 7.⁵⁹⁷

Title IV sets out the scope, availability and requirements of review procedures.⁵⁹⁸

⁵⁸⁸ Article 30. Article 32 governs the form and manner of publication of contract notices. The equivalent provisions in the Public Sector Directive can be found in Articles 35 and 36. For generally commentary, see C H Bovis, *EU Public Procurement Law* (n 171) 113-118

⁵⁸⁹ Article 33. The equivalent provisions in the Public Sector Directive can be found in Article 38. For general commentary, see C H Bovis, *EU Public Procurement Law* (n 171) 119-120

⁵⁹⁰ Article 34. The equivalent provision in the Public Sector Directive can be found in Article 40

⁵⁹¹ Article 35. The equivalent provision in the Public Sector Directive can be found in Article 41

⁵⁹² Article 36. The equivalent provision in the Public Sector Directive can be found in Article 42

⁵⁹³ Articles 39-46. Certain of these requirements will be examined in this Chapter. The equivalent provision in the Public Sector Directive can be found in Articles 45-52. For general commentary, see C H Bovis, *EU Public Procurement Law* (n 171) 129-156

⁵⁹⁴ Article 47. Certain of these requirements will be examined in this Chapter. The equivalent provision in the Public Sector Directive can be found in Article 53. For general commentary, see C H Bovis, *EU Public Procurement Law* (n 171) 273-288

⁵⁹⁵ Article 48. The equivalent provision in the Public Sector Directive can be found in Article 54. For general commentary see C H Bovis, *EU Public Procurement Law* (n 171) 265-267

⁵⁹⁶ Articles 50-54. For commentary on the subcontracting provisions, see Heuninckx, ‘Trick or Treat’ (n 252) 19-21. The equivalent provision in the Public Sector Directive can be found in Article 60

⁵⁹⁷ For a further discussion of subcontracting under the Defence Procurement Directive in light of U.S. legal commentary, see Chapter 9, Section 5.1

⁵⁹⁸ Recital 72 and Articles 55-64. For commentary on these provisions, see Heuninckx, ‘Trick or Treat’ (n 252) 136; M Trybus, ‘The hidden Remedies Directive’ (n 564). The equivalent review and remedies provisions for

Finally, Title V contains miscellaneous provisions on statistical obligations, executory powers and final provisions.⁵⁹⁹

3. Defining Security of Supply

Before examining U.S. claims concerning the potential discriminatory application of the Directive's security of supply provisions, it is first necessary to put the assessment of security of supply in context.

Prior to the adoption of the Defence Procurement Directive, it had been argued that one of the disadvantages of the Public Sector Directive with regard to the public award of defence contracts had been the lack of specific provisions to ensure security of supply.⁶⁰⁰ In *R v. Secretary of State for Home Department Ex p Evans Medical*⁶⁰¹ and *EVN AG and Wienstrom AG*,⁶⁰² the ECJ had determined that "reliability of supplies" is one of (or can number amongst) the award criteria which may be taken into account in order to determine the most economically advantageous tender.⁶⁰³ However, these judgments did not specify what

public sector procurement are to be found in a separate Directive. See Council Directive 89/665/EEC of 21 December 1989 on the coordination of the laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts [1989] OJ L 395/33 as amended by Directive 2007/66/EC [2007] OJ L335/31

⁵⁹⁹ Articles 65-75. The equivalent provisions in the Public Sector Directive can be found in Articles 75-84

⁶⁰⁰ See Commission, 'Communication on the results of the consultation launched by the Green Paper on Defence Procurement and on the future Commission initiatives COM' (n 233). For a general commentary, see A Georgopoulos, 'Commission's Communication on the Results of the Consultation Process on European Defence Procurement' (n 233)

⁶⁰¹ C-324/93 *R v Secretary of State for Home Department Ex p Evans Medical* (n 286). For general commentary, see S Arrowsmith, *Public and Utilities Procurement* (n 119) 334-5, para 6.92; Trybus, *European Union Law and Defence Integration* (n 47) 216-9

⁶⁰² Case C-448/01 *EVN AG and Wienstrom AG* [2003] ECR I-4527

⁶⁰³ C-324/93 *Evans Medical*, para 44-45; Case C-448/01 *EVN AG and Wienstrom AG*, para 70

requirements may or may not be defined for security of supply.⁶⁰⁴ As a result of legal uncertainty, Member States appear to have exercised considerable discretion on this issue.⁶⁰⁵ It has been suggested that insistence on security of supply has provided a means to justify awards exclusively to national companies.⁶⁰⁶ In particular, commentators point to a “short-sighted” need to enforce security of supply as one of the most likely causes of the current EDEM fragmentation.⁶⁰⁷ There have only ever been very limited instances where security of supply has posed an issue between EU Member States.⁶⁰⁸ It should be observed that a NATO study has levelled the same criticism at the U.S.⁶⁰⁹

As this Chapter will discuss, the Defence Procurement Directive provides for the assessment of security of supply at various phases of a procedure. In doing so, the provisions should not be seen as conferring additional freedom to contracting authorities but rather subjecting security of supply assessments to more transparent, principled and verifiable determination.⁶¹⁰ Under the Defence Procurement Directive, security of supply requirements are used as a basis for: selecting suitable tenderers and candidates; examining whether the tenders meet the mandatory security of supply requirements set by the contracting authority; and evaluating, on the basis of specific contract award criteria, which tender offers the best performance in terms of

⁶⁰⁴ Heuninckx, ‘Trick or treat’ (n 252) 23

⁶⁰⁵ *ibid*

⁶⁰⁶ Heuninckx, ‘Trick or treat’ (n 252) 23 and citations at fn 132

⁶⁰⁷ Heuninckx ‘Trick or treat’ (n 252) 23 and citations at fn 134

⁶⁰⁸ A notable but isolated example concerned Belgium’s refusal to supply the U.K. during the first Gulf War

⁶⁰⁹ See NIAG SG-114 Consultancy Advice Study, ‘Trans-Atlantic Defense Industrial Cooperation, Final Report’ (n 458) 13 which states: “NATO allies regularly exercise certain exclusionary policies of “national preference” through various legislative or regulatory authorities, often invoking the principle of “security of supply” to direct procurements to host industries and block foreign suppliers. Although NATO is founded on the bedrock principle of collective defense, “logistics” has tended to remain a national responsibility, and there is a marked absence of effective security of supply arrangements between NATO allies. In the United States, “security of supply” arguments have underpinned the maintaining of, and in some cases extension of, items controlled by the “Buy America” Act and the “Berry Act” [...]” The Buy American Act is examined in Chapter 10, Section 2.1

⁶¹⁰ See Heuninckx ‘Trick or Treat’ (n 252) 23

security of supply.⁶¹¹ Contracting authorities must specify their security of supply requirements in the contract documentation. These requirements may typically take the form of conditions for the performance of a contract.⁶¹² They can also be used in the award procedure as selection criteria or award criteria.⁶¹³

3.1. Security of Supply as a Concept

Whilst the Defence Procurement Directive considers “security of supply” to be particularly important,⁶¹⁴ it does not in fact define this term. The Guidance Note states that this “broad concept” covers a wide range of different industrial, technological, legal and political aspects and can generally be defined as:

[...] a guarantee of supply of goods and services sufficient for a Member State to discharge its defence and security commitments in accordance with its foreign and security policy requirements [...] This includes the ability of Member states to use their armed forces with appropriate national control and, if necessary, without third party constraints.”⁶¹⁵

As a multi-faceted concept, it is difficult to subject security of supply to precise definition. However, three specific aspects have been usefully identified in academic

⁶¹¹ See Guidance Note, Security of Supply, 4, point 12

⁶¹² Recital 41 and 42 and Article 20

⁶¹³ Articles 23, 39, 42. See Guidance Note, Security of Supply, 2, para 6

⁶¹⁴ Guidance Note, Security of Supply, 1, point 1, para 1, fn2 citing Recitals 8 and 9 (although, in fact, Recital 8 makes no reference to security of supply). See also Recitals 42 and 44. Its importance is perhaps also evidenced by the fact that the Guidance Note on Security of Supply is the most comprehensive of the Guidance Notes, comprising 22 pages

⁶¹⁵ Guidance Note, Security of Supply, 1, point 1, para.1 (footnote omitted)

commentary.⁶¹⁶ The first is longer-term or strategic security of supply i.e. the stability and continuity of the supply chain over the life of military equipment.⁶¹⁷ The second is the geographical aspect of operational security of supply i.e. the ability of the supply chain to provide for the armed forces in theatres of operations outside home territory.⁶¹⁸ The third is the short-term or time aspect of operational security of supply i.e. the ability of the supply chain to cope with surges in requirements in times of crisis.⁶¹⁹

According to the Guidance Note, with regard to the practical considerations of contracting authorities in determining whether a tender meets security of supply requirements, a number of variables must be factored into account. These include, *inter alia*, the supplier's dependence on its own industrial capacities to ensure timely delivery and the supplier's dependence on national authorisations to transfer equipment and services across borders to the purchasing or requesting State.⁶²⁰ The Guidance Note observes that this issue is rendered even more complex when the prime contractor's supply chain is organised internationally, in particular, that suppliers established in the EU but which use sub-systems and components from non-EU sources may be obliged to comply with export restrictions imposed by third countries.⁶²¹ This issue will be discussed in more detail in Section 7 below. The Guidance Note states that this means that security of supply will not just be an industrial, but also a political issue which is, by definition, difficult to resolve in the

⁶¹⁶ B Heuinckx, 'Towards a Coherent European Defence Procurement Regime?' (n 85) 14; Heuinckx, 'Trick or treat' (n 252) 23

⁶¹⁷ Heuinckx, 'Trick or treat' (n 252) 22. See also Guidance Note, Security of Supply, 1, point 1, para 2

⁶¹⁸ Heuinckx, 'Trick or treat' (n 252) 23

⁶¹⁹ *ibid*

⁶²⁰ Guidance Note, Security of Supply, 1, point 2. As the Guidance Note observes, this is the case not only for the initial purchase, but also for all follow-on supplies and services which occur until the end of the life cycle of a product

⁶²¹ Guidance Note, Security of Supply, 1, point 2

Directive itself.⁶²²

3.2. Security of Supply as a Legal Construct

The Defence Procurement Directive does not define the material content of security of supply requirements, providing only a general indication of the areas that such requirements might cover.⁶²³ For the most part, the Directive describes information and commitments which may be required of tenderers.⁶²⁴ According to the Guidance Note, this provides contracting authorities with the necessary degree of flexibility to define and adapt their security of supply requirements to the specific circumstances and supply risks of each intended procurement.⁶²⁵

The EU legislator's decision to opt for generic information and commitment provisions at this stage is understandable. As an unprecedented legal development, the EU legislator may observe a period of monitoring in order to see how the provisions are applied and interpreted through EU case law. However, in the longer term, the EU legislator may have to give serious consideration as to how the Directive can better ensure that security of supply determinations are based on a candid determination of need. U.S. legal commentary has identified that the EU is confronted with a choice about how to define security of supply requirements and which can, to some extent, draw on U.S. experience.

⁶²² Guidance Note, Security of Supply, 2, point 3

⁶²³ Guidance Note, Security of Supply, 3, point 6, para 2. Recital 44 is the closest to providing specific examples. Recital 44 states: "[s]ecurity of supply can imply a great variety of requirements, including, for example, internal rules between subsidiaries and the parent company with respect to intellectual property rights, or the provision of critical service, maintenance and overhaul capacities to ensure support for purchased equipment throughout its life-cycle."

⁶²⁴ Guidance Note, Security of Supply, 2-3, point 6, para 2

⁶²⁵ Guidance Note, Security of Supply, 2-3, point 6, para 3

For instance, U.S. law prescribes a number of restrictions on specialty metals which can be required for use in defence procurement.⁶²⁶ U.S. law has established the U.S. DoD Strategic Materials Protection Board to monitor “materials critical to national security”.⁶²⁷ A controversial issue has concerned the legal question of how to define the term “materials critical to national security.” In 2008, the Board published a report which defined “materials critical to national security” as strategic material for which: (1) the DoD dominates the market; (2) the Department’s full and active involvement and support are necessary to sustain and shape the strategic direction of the market; and (3) there is significant and unacceptable risk of supply disruption due to vulnerable U.S. or qualified non-U.S. suppliers.”⁶²⁸ This approach was apparently based on the assumption that the U.S should impose a domestic preference for strategic materials only where the DoD does, in fact, play a substantial role in the market and, where the Department does not dominate the market, an attempt to ensure security of supply through a domestic preference may not prove effective.⁶²⁹ U.S. legal commentary had identified that, for foreign trade purposes, this narrow definition is an important bulwark against misuse of the “security of supply” principle to discriminate in international trade.⁶³⁰

However, the Defense Fiscal Authorization Act for 2011 redirected the Strategic Materials Protection Board in two respects.⁶³¹ First, the new statute amended the Board’s mission to call for the Board to develop a strategy to “ensure a secure supply

⁶²⁶ For a discussion of domestic source restrictions generally, see Chapter 11, Section 2.1

⁶²⁷ 10 U.S.C. 187

⁶²⁸ See Report of Meeting: Department of Defense Strategic Materials Protection Board, Held on Dec. 12, 2008 <www.acq.osd.mil/ip/docs/report_from_2nd_mtg_of_smpb_12-2008.pdf> accessed 20 September 2013

⁶²⁹ C R Yukins, ‘Barriers to International Trade in Procurement After the Economic Crisis, Part II: Opening International Procurement Markets: Unfinished Business’ (n 459) Int’l 2-24

⁶³⁰ C R Yukins and K E Ittig, ‘Feature Comment: The Defense Authorization Act for FY 2011 – A Bounded Step Forward for Acquisition Reform’ (2011) 53(2) The Government Contractor, 4

⁶³¹ Ike Skelton National Defense Authorization Act for Fiscal Year 2011 Pub. L. 111-383, § 829

of materials”, rather than a strategy “to ensure the domestic availability of materials” under the former provision. This suggested that non-domestic sources could also be considered.⁶³² Secondly, at the same time, however, the statute amended the definition of “materials critical to national security” to mean materials: (A) upon which the production or sustainment of military equipment is dependent; and (B) the supply of which could be restricted by actions or events outside the control of the Government of the United States.⁶³³ It has been contended that this definition is too broad on the basis it could conceivably cover everything from steel to rubber bands in light of the fact that both are material on which military equipment “depends” and the supply of which could be restricted.⁶³⁴ Therefore, under this new definition, the DoD’s assessment of the need to protect specialty metals will be driven by general concerns regarding “vulnerability” of supply as opposed to an assessment of the DoD’s market position with regard to those materials.⁶³⁵

In response to suggestions that the Directive’s security of supply provisions could provide a ground for discrimination, U.S. legal commentary asks what course the EU should take; more specifically, it questions whether the EU should allow “loosely” for domestic preferences for the purposes of security of supply under the Directive, or, whether it should follow the DoD’s earlier lead and require candid security of supply assessments.⁶³⁶ It has been suggested that so that U.S. exporters do not suffer “new discrimination” in Europe, it will be important that the U.S. set a good example, that U.S. policy follow a considered path, such as that initially suggested by the Board,

⁶³² Yukins and Ittig, ‘A Bounded Step Forward for Acquisition Reform’ (n 630) 3

⁶³³ *ibid*

⁶³⁴ *ibid*

⁶³⁵ Yukins, ‘Barriers to International Trade in Procurement After the Economic Crisis, Part II’ (n 459) Int’l 2-24

⁶³⁶ *ibid*

and that the U.S. not abuse the principle of security of supply.⁶³⁷ It should be observed that EU commentary has similarly argued that in light of the dramatic change in the geopolitical situation of Europe after the Cold War alongside increased European integration, the concept of security of supply within Europe clearly requires (re)evaluation.⁶³⁸

This discussion provides a useful early indication in this thesis of the necessity for comparative assessment of regulatory approaches to security of supply. At the very least, the above asks whether the conceptual basis of security of supply within Europe and the U.S. requires re-evaluation. Further, it may be questioned whether the Directive could or should subject security of supply assessments to more economically oriented assessments.⁶³⁹

4. International Traffic in Arms Regulations

A recurrent issue in transatlantic defence trade discourse concerns U.S. law applicable to the export of defence-related articles. As the following Sections will demonstrate, the U.S. International Traffic in Arms Regulations⁶⁴⁰ (“ITAR”) have been cited by official EU publications as providing a rationale for legislative intervention and as relevant to the interpretation of the Directive’s security of supply provisions.

⁶³⁷ Yukins and Ittig, ‘A Bounded Step Forward for Acquisition Reform’ (n 630) 4

⁶³⁸ Heuninckx, ‘Trick or treat’ (n 252) 23

⁶³⁹ It is of course accepted that the U.S. example above concerns the scenario of generally maintaining capability as opposed to an individual procurement decision. It necessarily follows that while a market based assessment is appropriate in the former case, an exclusive market-oriented focus is not necessarily appropriate for application to the kind of scenario in which a contracting authority needs to ensure (as far as possible) that what it procures will be delivered. Notwithstanding, this constitutes just one instance in which the comparative experiences of EU and U.S. practice may provide a basis for thinking more critically about regulatory approaches to discrete issues such as security of supply

⁶⁴⁰ Arms Export Control Act of 1976, Title II of Pub. L. 94-329, 90 Stat. 729 (codified at 22 U.S.C. 2778)

Further, U.S. legal commentary has placed particular emphasis on the possibility for ITAR compliance to affect security of supply assessments such as to discriminate against U.S. contractors. To this extent, it is necessary to firstly briefly outline the applicable U.S. legal framework on export-controlled content.⁶⁴¹

The U.S. Military List (“USML”)⁶⁴² provides categories of listed defence items, the export of which is controlled.⁶⁴³ Although the U.S. President is charged to exercise this authority, it has been delegated to the U.S. Secretary of State.⁶⁴⁴ The U.S. Department of State administers the regime through the Directorate of Defense Trade Controls (“DDTC”).⁶⁴⁵ The Arms Export Control Act (“AECA”) provides for the promulgation of implementing regulations which include ITAR.⁶⁴⁶

ITAR regulates, *inter alia*, the “export”⁶⁴⁷ of “defense articles”,⁶⁴⁸ “defense services”⁶⁴⁹ and “technical data”⁶⁵⁰ relating to defence articles and defence services. For the purposes of ITAR, an “export” includes more than simply the sending or taking of a defence article outside the U.S.⁶⁵¹ ITAR also regulates the transfer of controlled data or technology to foreign persons irrespective of their location.⁶⁵² This includes: transferring registration, control or ownership to a foreign person whether in

⁶⁴¹ For a definitive practitioner guide to ITAR, see A Irwin, E Krauland and J Hayes, *International Traffic in Arms Regulations Handbook* (West 2008). For a useful introduction to U.S. export control laws, see J R Liebman and K J Lombardo, ‘A Guide to Export Controls for the Non-Specialist’ (2006) 28 *Loy LA Int’l & Comp L Rev*, 497

⁶⁴² 22 CFR §121.1

⁶⁴³ 22 U.S.C. 2778

⁶⁴⁴ Executive Order 11,958, 42 Fed. Reg. 4,311 (Jan. 18 1977), as amended

⁶⁴⁵ 22 CFR § 120.1

⁶⁴⁶ 22 CFR 120-130

⁶⁴⁷ 22 C.F.R. §120.17

⁶⁴⁸ 22 C.F.R. §120.6

⁶⁴⁹ 22 C.F.R. §120.9

⁶⁵⁰ 22 C.F.R. §120.10

⁶⁵¹ § 22 C.F.R. §120.17

⁶⁵² *ibid*

the U.S. or abroad;⁶⁵³ disclosing or transferring in the U.S. any defence article to an entity of a foreign government;⁶⁵⁴ disclosure or transfer of technical data to a foreign person whether in the U.S. or abroad;⁶⁵⁵ and performing defence services in the U.S. or abroad on behalf, or for the benefit of, a foreign person.⁶⁵⁶ A prime example of the extra-territorial reach of ITAR is its application to items of U.S. origin even if a foreign person is in possession of the item or where the item has been incorporated for use in another product.⁶⁵⁷ To this extent, ITAR covers, *inter alia*, exports, transfers and re-exports. It therefore follows that ITAR controls may limit the possibility to fully utilise the general and global licensing regimes of the ICT Directive to transfer ITAR controlled products within the EU without extensive prior authorisations. The ICT Directive is discussed in Section 6.1 below.

In addition to the above controls, before engaging in munitions manufacturing brokering, importing, exporting or furnishing defence articles or defence services, it is necessary to register with the Department of State.⁶⁵⁸ Further, licenses are also required to provide defence services or to enter into technical assistance or manufacturing license agreements, even if no article or technical data is exported.⁶⁵⁹ Therefore, generally, no defence article, defence service or technical data may be

⁶⁵³ § 22 CFR 120.17(a)(2)

⁶⁵⁴ § 22 CFR 120.17(a)(3)

⁶⁵⁵ § 22 CFR 120.17(a)(4)

⁶⁵⁶ § 22 CFR 120.17(a)(5)

⁶⁵⁷ § 123.9

⁶⁵⁸ 22 C.F.R. § 122.1(a)

⁶⁵⁹ 22 C.F.R. §§ 123.15; 123.16. Since obtaining a license from the Department of State requires considerable resources and substantial time and effort, the company must allow adequate lead time between the date the company accepts an order for goods and the date upon which the company is to deliver the goods. See J R Liebman and K J Lombardo, 'A Guide to Export Controls for the Non-Specialist' (n 634) 504

exported or re-exported without prior approval (e.g through a licence) from the U.S. Department of State.⁶⁶⁰

For a number of years, a consistent debate between industry and the U.S. Government has concerned potential reform of the U.S. export control regime, in particular, ITAR.⁶⁶¹

As will be discussed below, specific criticisms concern the excessive controls placed on export, re-export and transfer of defence articles and the delays and risks incurred as a result for contractors.

Relevant to the present analysis, the impact of ITAR on transatlantic defence trade has been given specific priority in two recent U.S. and EU studies, both of which identify the significance of ITAR as an obstacle to liberalised transatlantic defence trade, aspects of which will be considered in later sections of this Chapter.⁶⁶²

5. Exclusion of Tenderers Through Qualitative Selection

It is recalled that whilst there are a number of references to security of supply in the

⁶⁶⁰ J R Liebman and K J Lombardo, 'A Guide to Export Controls for the Non-Specialist' (n 641) 504 citing at fn 40 P S Rhoads, *The International Traffic in Arms Regulations: Compliance and Enforcement in the Directorate of Defense Trade Controls U.S. Department of State*, reprinted in COPING WITH U.S. EXPORT CONTROLS 2003; EXPORT CONTROLS & SANCTIONS: WHAT LAWYERS NEED TO KNOW (Practising Law Institute 2003) 495-96

⁶⁶¹ See *Fortresses and Icebergs* (Vol II) (n 12) 693 which identifies that there were more than 60 reports by various private and governmental groups on export controls in the period 1997-2007

⁶⁶² The first is the U.S. *Fortresses and Icebergs* study. The second is DG Enterprise and Industry, Aerospace Industries, GMES, Security & Defence (Commissioned study), 'The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries', Final Report, December 2009, No ENTR 08/040 <http://ec.europa.eu/enterprise/sectors/defence/files/final_report_trans_en.pdf> accessed 20 September 2013

Defence Procurement Directive, U.S. commentary has focused primarily on Article 23 which stipulates security of supply requirements. The content of this provision will be examined in Sections 6 and 7. As will be discussed, Article 23 is intended to form the basis for the imposition of contract performance conditions and award criteria. It follows that there has been little focus on whether the Directive could potentially facilitate the exclusion of third countries as early as qualitative selection.

Articles 38 to 46 Defence Procurement Directive govern the criteria for qualitative selection.⁶⁶³ In restricted procedures, negotiated procedures with publication of a contract notice and competitive dialogues, qualitative selection ordinarily occurs at the point at which candidates are selected for the purposes of inviting tenders.⁶⁶⁴ Whilst the Defence Procurement Directive contains a number of grounds for excluding candidates and tenderers, Articles 39(2) (d) and (e) contain two exhaustive exclusion criteria related to security of supply.⁶⁶⁵ The first is where an economic operator has been guilty of ‘grave professional misconduct’ e.g. such as breach of obligations regarding security of information or supply during a previous contract.⁶⁶⁶ The second is where an economic operator has been found, on the basis of any means of evidence, including protected data sources, not to possess the “reliability

⁶⁶³ Article 38 concerns verification of the suitability and choice of participants and award of contracts. Article 39 concerns the personal situation of the candidate or tenderer. Article 40 concerns the candidate’s suitability to pursue the professional activity. Article 41 concerns the economic operator’s economic and financial standing. Article 42 concerns technical and/or professional ability. Articles 43 and 44 concern quality and environmental management standards. Article 45 concerns additional documentation and information. Article 46 concerns official lists of approved economic operators and relevant certification. For a general commentary on the provisions on qualitative selection, see Trybus, ‘The tailor-made EU Defence and Security Procurement Directive (n 125) 23-4; Heuinckx, ‘Trick or treat’ (n 252) 18-19

⁶⁶⁴ Guidance Note, Security of Information, 2, point 6

⁶⁶⁵ Therefore, it would not be possible for Member States or contracting authorities to exclude a candidate or tenderer on the basis of other criteria relating to their professional qualities. See *Case C-213/07 Michaniki AE v. Ethniko Symvoulío Radiotileorasis and Ypourgos Epikrateias* [2008] ECR I-9999 cited by the Guidance Note, Security of Supply, 7, para 21

⁶⁶⁶ Article 39(d). See Guidance, Security of Supply, 7, point 19. For a discussion of this exclusion, see Heuinckx, ‘Trick or treat’ (n 252) 28

necessary to exclude risks to the security of the Member State”.⁶⁶⁷ According to Recital 65, such risks could derive from certain features of the products supplied by the candidate, or from the shareholding structure of the candidate.⁶⁶⁸

With regard to the first basis for exclusion, given that a finding of “grave professional misconduct” pertains to the individual conduct of the tenderer, this does not adversely affect U.S. contractors to a greater extent than EU operators. However, the second exclusion is more problematic. The Guidance Note on Security of Information, for instance, recognizes that “reliability” is a “vague concept” which confers both a considerable degree of flexibility in its assessment but also a “special responsibility to handle it with care.”⁶⁶⁹ On its own terms, there is no credible basis for suggesting that U.S. tenderers or EU tenderers reliant on U.S. sources will be more likely to fail any “reliability” assessment (howsoever determined). However, the reference to “risks to security” in Recital 65 is less certain. Recital 65 identifies “risks” deriving from “certain features of the products supplied by the candidate”, or from the “shareholding structure of the candidate”. The basis for this statement is not clear.

As will be discussed in more detail in Section 7, the Guidance emphasizes that it is particularly important to distinguish selection criteria clearly from award criteria.⁶⁷⁰

More specifically, at the selection stage, what matters is the standing, qualifications and professional capacity of the candidate or tenderer; the assessment must not

⁶⁶⁷ Article 39(2)(e) is said to address the link between security of supply and the reliability of the candidate or tenderer. See also Recital 67 and the Guidance Note, Security of Supply, 7, point 20

⁶⁶⁸ Guidance Note, Security of Supply, 7, point 20. It should be observed that references to features of the products supplied by the candidate and the shareholding structure of the candidate do not feature in the dedicated security of supply provision in Article 23

⁶⁶⁹ Guidance Note, Security of Information, 6, point 13, para 2

⁶⁷⁰ Guidance Note, Security of Supply, 5-6 point 15 citing at fn 9 C-532/06 *Emm. G. Lianakis AE v Dimos Alexandroupolis* [2008] E.C.R. I -251. For a discussion of this case, see A Georgopoulos, ‘Greek jurisprudence: Lianakis v Dimos Alexandroupolis, No.1794/2008 of the Council of State (Simvoulion tis Epikrateias)’ (2009) 3 PPLR, 98

concern the characteristics of specific equipment which they may offer.⁶⁷¹ Yet, Recital 65 makes reference to “features of the product supplied”. Therefore, it is not clear whether such a feature could include the fact that a product may be subject to ITAR, for example.

Further, the reference to “shareholding structure” is not specified. It is not clear whether the degree to which a third country may exercise control could become relevant e.g. through nationality requirements for directors, percentage shareholding, voting requirements and prior authorizations from the home State in relation to key investments, for example.

In addition, the evidential threshold appears to be low, merely requiring any means of evidence. In considering the contracting authority’s “special responsibility”, the Guidance Note states that the contracting authority must be prepared to demonstrate, if necessary, in special review procedures that there are “objective and verifiable elements indicating a lack of reliability that causes risks to the security of the State”.⁶⁷² To this extent, whilst any means of evidence appears to be admissible, it must be sufficiently material to justify the determination made. However, the extent of the necessary causal relation between reliability and risk is not specified. For example, a risk may result in a determination of “unreliability” even though the risk is only remote.

⁶⁷¹ Guidance Note, Security of Supply, 5, point 15

⁶⁷² The Guidance Note, Security of Supply states at 7, point 20, para.3 that: “In any case, point (e) does not give unlimited discretion to contracting authorities/entities. Any exclusion of a candidate or tenderer must be based on risks to the security of the Member State. The contracting authority/entity must be prepared to demonstrate, if necessary in special review procedures, that there are objective and verifiable elements indicating a lack of reliability that causes risks to the security of the State.”

Ultimately, it is submitted that whilst interpretative nuances of these generic provisions could possibly suggest a basis for excluding tenderers or candidates which rely on U.S. sources, there is no credible reason beyond the fact that a contractor may have to comply with U.S. export controls that would place a U.S. contractor or EU contractor reliant on U.S. sources at a comparative disadvantage. As will be discussed below, the proper basis for assessing “risks” of this kind is in accordance with Articles 23(a) and (b) which constitute specific requirements under the dedicated security of supply provision. Further, as will be discussed, there is also an overriding question regarding the extent to which issues such as ITAR are, in reality, likely to affect tenders involving U.S. sources.

Notwithstanding, as will also be discussed in Section 7.1 below, Article 39(2)(e) is not the only provision on qualitative selection which takes account of security of supply considerations pertaining to third countries. To this extent, the risk of exclusion through qualitative selection cannot be entirely eliminated.

6. Discrimination Through Application of Award Criteria

Contracting authorities decide whether to award a contract to the lowest priced or most economic economically advantageous tender.⁶⁷³ Given the typical complexity of defence contracts, award decisions will generally be determined on a most economically advantageous tender basis.⁶⁷⁴ The contracting authority is free to

⁶⁷³ Article 47

⁶⁷⁴ Guidance Note, Security of Supply, 17 point 47. According to Article 47(1)(a), various criteria linked to the subject matter of the contract can be taken into consideration when assessing the most economically

choose its award criteria in reaching this determination provided that those criteria are linked to the subject matter of the contract, do not give unrestricted freedom of choice for the award,⁶⁷⁵ allow the information provided by tenderers to be effectively verified⁶⁷⁶ and must comply with principles of EU law.⁶⁷⁷ Article 47(1)(a) now makes explicit the possibility to use the fulfilment of security of supply requirements as an award criterion as distinct from “reliability of supplies” as identified in the ECJ’s previous judgments. Although, as indicated above, “reliability” is a concept which is still being utilised in the language of the Guidance Notes and academic commentary.⁶⁷⁸

As will be discussed in Sections 6.3 - 6.5 below, the main provisions identified as a concern by U.S. commentators in this regard are Articles 23(a) and (b) which provide the basis for contract performance conditions and award criteria. Article 23(a) provides that a contracting authority may require that the tender contain:

certification or documentation demonstrating to the satisfaction of the contracting authority/entity that it will be able to honour its obligations regarding the export, transfer and transit of goods associated with the

advantageous tender. These include for example: quality, price, technical merit, functional characteristics, environmental characteristics, running costs, lifecycle costs, cost-effectiveness, after-sales service and technical assistance, delivery date and delivery period or period of completion, security of supply, interoperability and operational characteristics. See also Recital 71. For a general discussion of the most economically advantageous tender criteria under the Defence Procurement Directive, see Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’ (n 125) 23-25

⁶⁷⁵ Guidance Note, Security of Supply, 17, para 49 citing Case C-513/99, *Concordia Bus Finlandia Oy Ab v. Helsingin Kaupunki et HKL-Bussiliikenne*, [2002] ECR 7213, para 61

⁶⁷⁶ Guidance Note, Security of Supply, 17-18, para 49 citing C-448/01, *EVN AG, Wienstrom GmbH and Republik Österreich* [2003] ECR I-14527, para 52

⁶⁷⁷ Guidance Note, Security of Supply, 18, para 49 citing Case C-513/99, *Concordia Bus* (n 675), para 63

⁶⁷⁸ C-324/93 *R v. Secretary of State for Home Department Ex p Evans Medical* (n 286) 44-45; Case C-448/01 *EVN AG and Wienstrom AG* (n 596), para 70. See Heuninckx, ‘Trick or treat’ (n 252) 23; M Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’ (n 125) 25

contract, including any supporting documentation received from the Member State(s) concerned.

Article 23(b) provides that a contracting authority may require that the tender contain:

the indication of any restriction on the contracting authority/entity regarding disclosure, transfer or use of the products and services or any result of those products and services, which would result from export control arrangements.

The Guidance Note on Security of supply observes that Article 23(a) is complemented by Article 23(b) in the regard that the requirements contained within Article 23(a) concern security of supply risks which derive from the possible refusal, withdrawal or delay of relevant export and transfer authorisations whereas Article 23(b) concerns any restrictions regarding disclosure, transfer or use of defence material (or any result thereof) which would result from export control or security arrangements.⁶⁷⁹

This Section will subject U.S. commentators' claims to further analysis. However, it should be observed that these claims are largely predicated on the potential cumulative impact of the Defence Procurement and ICT Directives on security of supply assessments. As a matter of context, it is therefore necessary in the following

⁶⁷⁹ According to the Guidance Note, 12, point 36, para 2: “[c]ontracting authorities/entities can combine the two instruments: under Article 23(a), they may require the tenderer to demonstrate that he will in all likelihood obtain the necessary export, transfer and transit licences with conditions that enable him to fulfil his mandatory contractual obligations. In addition, they can require, under Article 23(b), a list of all other restrictions, so that they can deal with them during the negotiation phase and/or take them into account during the award phase (provided the issue is covered by appropriate contract award criteria).”

two Sections to briefly outline the ICT Directive regime as well as the general basis for U.S. claims before examining those claims in more detail.

6.1. Intra-Community Transfers Directive

Articles 34 and 35 TFEU prohibit quantitative restrictions (and measures of equivalent effect) on imports and exports of goods. Restrictions on the internal movement of defence goods within the EU are no exception. In its 2003 Communication, 'European Defence – Industrial and Market Issues, Towards an EU Defence Equipment Policy', the Commission identified the internal transfer of defence-related products as an area in need of specific action.⁶⁸⁰ Until recently, each Member State regulated the intra-EU transfer of defence products in accordance with national licensing procedures.⁶⁸¹

A detailed 2005 EU commissioned study revealed a number of common obstacles to the effective licensing and transfer of defence goods. In particular, Member States formally treated intra-EU transfers and exports outside the EU without distinction out of a general concern to control their end-use or final destination especially to third

⁶⁸⁰ Commission, 'European Defence – Industrial and Market Issues' (n 231) 3. Prior to the adoption of the ICT Directive, there had been limited efforts by certain EU Member States to simplify licensing arrangements in the context of the Lol FA. These included: simplified export licensing arrangements concerning transfers made in the course of joint development and production programmes; the development of lists of permitted export destinations for jointly produced military goods; and the introduction of the Global Project Licence. The latter was designed to remove the need for specific authorisations to destinations permitted by the licence in order to simplify the arrangements for licensing military goods and technologies between the Lol FA partners participating in collaborative projects. However, the Lol proposals were never fully executed in practice and have yielded limited results. See Commission, 'Commission Staff Working Document, Accompanying document to the Proposal for a Directive of the European Parliament and of the Council on simplifying terms and conditions of transfers of defence-related products within the Community, Impact Assessment (Impact Assessment) SEC (2007), 1593, 9 and 18
<<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52007SC1594:EN:NOT>> accessed 20

September 2013

⁶⁸¹ For a useful summary of the applicable national laws and regulations for 25 EU Member States and three EEA States, see Unisys, 'Intra-Community Transfers of Defence Products' (n 122) Table C, 163-167

countries.⁶⁸² According to EU statistics, whilst an estimated 11,500 transfer licenses are issued annually, not a single request has been formally denied since 2003.⁶⁸³ Therefore, it has been suggested that the mere theoretical risk of refusal has meant that Member States generally prefer to source sensitive military equipment from a national producer.⁶⁸⁴ It has been reported that the need for compliance with lengthy approval procedures e.g. licences, certification, delivery verifications and end-user certifications has resulted in delays and inefficiency.⁶⁸⁵

It is recalled that in 2009 the EU adopted the ICT Directive in order to simplify the terms and conditions pertaining to the intra-Community transfer of defence-related products.⁶⁸⁶ Member States had until 30 June 2011 to transpose the Directive into national law; however, the Directive was not due to take effect until 30 June 2012.⁶⁸⁷ According to the Commission Report on transposition of the Directive, at the date of effect, not all Member States had confirmed transposition.⁶⁸⁸

The ICT Directive introduces a new licensing and certification regime which is designed to reduce disproportionate pre-transfer controls through more extensive licensing authorizations whilst ensuring effective control through a certification

⁶⁸² It has been observed that in practice the scrutiny level for export applications within the EU (or destined to NATO countries) is no doubt lower than for exports to third countries; however, the requirements for submitting an application are formally the same regardless of the country of destination. See Commission, 'European Defence – Industrial and Market Issues' (n 231) 13 and 14

⁶⁸³ Impact Assessment (n 680) 4

⁶⁸⁴ Ibid, 4-5

⁶⁸⁵ See Unisys, 'Intra-Community Transfers of Defence Products' (n 122) 59-64 and 145

⁶⁸⁶ Directive 2009/43/EC of the European Parliament and of the Council of 6 May 2009 simplifying terms and conditions of transfers of defence-related products within the Community [2009] OJ L 146/1 (n 21)

⁶⁸⁷ Article 18

⁶⁸⁸ See Commission, 'Report from the Commission to the European Parliament and the Council on transposition of Directive 2009/43/EC simplifying terms and conditions for transfer of defence-related products within the EU' COM (2012), 359 final, 5

system and post-transfer monitoring. The ICT Directive mandates the use of three types of licence: the general, global and individual licence.⁶⁸⁹

The general licence is the preferred option and is mandatory in certain cases.⁶⁹⁰ A general licence is a specific authorization granted by a Member State to a supplier established on its territory to perform transfers of defence-related products to recipients located in another Member State.⁶⁹¹ Member States are required to publish general transfer licences. It follows that unlike for individual or global licences, a certified undertaking will not be required to specifically request its use.

According to the ICT Directive, Member States should grant a global licence where a general licence cannot be published.⁶⁹² In contrast to a general licence, a global licence is only granted upon request by an undertaking for a period of three years, with a possibility of renewal.⁶⁹³ The main advantage of global licences is said to be the fact that they are not specific to a precise shipment and thus can be used several times to covers similar transfers.⁶⁹⁴

⁶⁸⁹ For the reasons underlying the specific policy and legislative choices for opting for a combination of all three licences as opposed to general licences or global licences only, see Impact Assessment (n 680) Impact Assessment, 34-36

⁶⁹⁰ The ICT Directive identifies four instances in which the publication of a general licence is mandatory. The first is where the recipient is part of a Member States' armed forces or a contracting authority in the field of defence, purchasing for the exclusive use of the armed forces (Article 5(2)(a)). The second is where the recipient is an undertaking certified in accordance with the Directive (Article 5(2)(b)). Article 9 concerns the certification of recipients of defence-related products. This second instance recognizes that common certification criteria should reduce the need for excessive procedural controls and lead to greater optimisation of supply chains and economies of scale through greater cooperation and integration of undertakings (Recital 23). The third is where the transfer is made for the purposes of demonstration, evaluation or exhibition (Article 5(2)(c)). The final instance is where the transfer is made for the purposes of maintenance and repair, if the recipient is the originating supplier (Article 5(2)(d))

⁶⁹¹ Article 5(1)

⁶⁹² Recital 26

⁶⁹³ Recital 26 and Article 6(2) paragraph 2

⁶⁹⁴ Impact Assessment (n 680) 35-6

Finally, in an attempt to circumscribe their use in practice, the Directive only permits use of individual licenses in exceptional circumstances.⁶⁹⁵ An individual licence is a specific authorization granted at the request of an individual supplier, permitting one transfer of a specified quantity of specified defence-related products to be transmitted in one or several shipments to one recipient only.⁶⁹⁶ Under existing national laws, the individual licence has been the most common but restrictive form of licence.⁶⁹⁷

As indicated, the ICT Directive also establishes common criteria for the certification of recipients of defence products under a general licence.⁶⁹⁸ DG Enterprise displays all certified companies on a certified register.⁶⁹⁹ To date, although the number of certified companies is relatively small, it should be observed that a number of companies are of U.S. origin.⁷⁰⁰

It is beyond the scope of this thesis to examine the extent to which the ICT Directive constitutes an effective transfer regime. However, its relevance to the present analysis is that the ICT Directive is, at least, intended to facilitate the progressive harmonization of national licensing and certification procedures, in turn, making it

⁶⁹⁵ According to the ICT Directive, the licence can only be granted in the following exceptional and exhaustive circumstances: (1) the request is limited to one transfer ((Article 7(a)); (2) it is necessary for the protection of the Member State's essential security interests or on grounds of public policy ((Article 7(b)); (3) it is necessary for compliance with Member States' international obligations and commitments (Article 7(c)) ; or (4) a Member State has serious reason to believe that the supplier will not be able to comply with all the terms and conditions necessary to grant it a global licence (Article 7(d))

⁶⁹⁶ Article 7

⁶⁹⁷ Impact Assessment (n 680) 26 and 34

⁶⁹⁸ Article 9. The Commission has recently issued a Recommendation designed to ensure convergent application of the certification requirements. See Commission Recommendation of 11 January 2011 on the certification of defence undertakings under Article 9 of Directive 2009/43/EC of the European Parliament and of the Council simplifying terms and conditions of transfers of defence-related products within the Community [2011] OJ L 11/62

⁶⁹⁹ DG Enterprise and Industry, CERTIDER, Certified Enterprises Register. See: <<http://ec.europa.eu/enterprise/sectors/defence/certider/index.cfm?fuseaction=undertakings.detail&id=172&count ry=DE&ref=UND%5FDE%5F0003>> accessed 20 September 2013

⁷⁰⁰ Examples include Raytheon Deutschland GmbH and Northrop Grumman LITEG GmbH. See: <<http://ec.europa.eu/enterprise/sectors/defence/certider/index.cfm?fuseaction=undertakings.detail&id=172&count ry=DE&ref=UND%5FDE%5F0003>> accessed 20 September 2013

easier for suppliers to demonstrate their ability to satisfy security of supply requirements in a contract award procedure.⁷⁰¹ The intended effect is to facilitate greater procedural efficiency in the transfer of defence-related products, saving costs and time. Both Directives should therefore be in the mindset of the procurement officer when assessing tenders in a contract award procedure. As will be discussed below, an important issue concerns the extent to which the availability of the ICT regime likely to be a discriminating factor in defence contract awards.

U.S. observers have questioned whether the Defence Procurement Directive and the ICT Directive could have the combined effect of discriminating against U.S. contractors, an issue to which this Chapter now turns.

6.2. General Bases of the “Discrimination” Claim

It is recalled that the U.S. ITAR regime has come under particular criticism in the U.S.. Prior to the adoption of the Defence Procurement Directive, the Fortresses and Icebergs Study contended that, in general, the nature of ITAR licences are such that parties cannot reasonably provide strong assurances especially regarding re-exports and that, as a result, this will affect security of supply assessments made under Article 23(a).⁷⁰² As a result, the Fortresses and Icebergs Study has suggested that European firms may be better situated in the regard that the combined operation of

⁷⁰¹ Impact Assessment (n 680) 21

⁷⁰² *Fortresses and Icebergs*: (Vol. I) (n 12) 222. For instance, it has been observed that a licence to export a subsystem does not necessarily mean, for example, that the final produced system would be licensable to all destinations

the Defence Procurement and ICT Directives could potentially discriminate against U.S. firms.⁷⁰³ It is worth reciting in full the scenario identified by the Study as follows:

[...] For example, imagine a national procurement where one bidder is a European supplier with a supply chain wholly within the EU operating under export licences issued under the EC Transfer Directive (e.g. the global⁷⁰⁴ licences). A second bidder might also be a European supplier but its supply chain might include U.S. firms that would need ITAR authorizations of various types to participate in the programme and for re-export of resulting systems in some cases. Needless to say, a national authority might very well grade the bidder with the EU supply chain as more “secure” because of the reliance on the new EC Transfers Directive, and the bidder with the U.S. subcontractors more insecure because of the uncertainty of obtaining ITAR authorizations (which typically will not be in place at the time that the bid is submitted).⁷⁰⁵

Therefore, it has been argued that the security of supply provisions could put U.S. companies at a “comparative disadvantage” based on ITAR which “could be judged negatively with regard to security of supply”.⁷⁰⁶

However, it is necessary to question certain of these basic premises and which will inform the remainder of the analysis of this Chapter.

⁷⁰³ *ibid*

⁷⁰⁴ It is not clear whether the Study actually intended to refer to general licences here

⁷⁰⁵ *ibid*, 222-3

⁷⁰⁶ See D J Berteau, Senior Adviser and Director, Defense Industrial Initiatives, CSIS, Statement before the Subcommittee on Terrorism, Nonproliferation and Trade of the House Committee on Foreign Affairs “A STRATEGIC AND ECONOMIC REVIEW OF AEROSPACE EXPORTS”, 9 December 2009, 3 <http://csis.org/files/ts_091209_berteau.pdf> accessed 20 September 2013

6.2.1. Complexity of Bidder and Bidding Scenarios

Whilst the above example is no doubt for illustrative purposes only, it is submitted that caution must be exercised against relying too heavily on overly simplistic representations of bidder and bidding scenarios as typical scenarios in transatlantic defence procurement. For instance, whilst it is difficult to determine the number of contractors that are likely to operate under such circumstances, the above scenario is predicated on the scenario of a European bidder relying exclusively on European sources and global licences. This is likely to represent only limited classes of bidder and defence material and, most probably, only the majority of lower tiers of the market which do not provide final weapons systems.⁷⁰⁷ Further, the above suggests that the primary beneficiaries of a liberalised licensing regime under the ICT Directive will be European. Whilst this is inevitable the case, the ICT Directive enables legal or natural persons established in the EU to transfer defence-related products in accordance with the ICT regime.⁷⁰⁸ As indicated in Section 6.1 above, a number of EU subsidiaries of U.S. defence companies have been certified for use of licences under the ICT regime.

With regard to bidding arrangements, it is recalled from Chapter 4 that there may often be more than two bidders and/or more complex bidding arrangements involved e.g. teaming arrangements.⁷⁰⁹ On the one hand, the presence of both EU and third

⁷⁰⁷ As the Impact Assessment (n 680) observes at 34: “[i]t has been objected that facilitated intra-EU transfers could bump against ITAR restrictions, thereby damping the facilitation potential. However, ITAR rules essentially concern final weapons systems that account for a slight minority of intra-EU transfers (the probability that a transferred good includes a US ITAR-flagged component grows with the number of components and technologies that it integrates, and is thus higher for complete weapon systems). Conversely, transfers of components are little affected by ITAR rules (unless the component itself stems from an US supplier).”

⁷⁰⁸ Article 3(3) ICT Directive

⁷⁰⁹ See Chapter 4, Section 4.4

country operators on a bid may be perceived to constitute a security of supply risk in the assessment. On the other hand, this dual presence may equally mitigate such concern.

6.2.2. Extent of ITAR's "Obvious Restrictive Impact"

The above scenario also presumes that ITAR will affect security of supply assessments. To an extent, certain assumptions about the impact of ITAR are understandable, if not wholly justified. For instance, concerns regarding third country, in particular, U.S. restrictions on the export and transfer of defence material have been an important consideration underlying the adoption of the ICT Directive. The so-called "Impact Assessment" accompanying the proposal for an ICT Directive identified ITAR as the most prominent example of the "indirect impact" of restrictions imposed by third countries on intra-EU transfers of defence material.⁷¹⁰ In particular, the Impact Assessment referred to the "lengthy and burdensome ITAR approval procedure" and that its intrinsic extraterritorial nature has an "obvious restrictive impact" for EU integrators both on market access to third countries and on intra-EU transfers insofar as prior U.S. agreement has to be sought for intra-EU transfers containing ITAR components.⁷¹¹ The document also identified that the expected benefits of the ICT Directive to a fully functional EDEM from a demand side perspective is that greater security of supply on EU-defence related products *would* favour European goods compared to goods sourced from third countries.⁷¹²

⁷¹⁰ Impact Assessment (n 680) 17

⁷¹¹ *ibid*

⁷¹² *Ibid* 21. Emphasis added

In addition, the Impact Assessment also purported to assess the “foreign trade impact” of an EU initiative facilitating Intra-EU transfers.⁷¹³ It indicated that it would provide European integrators with a further incentive to work with EU rather than third country suppliers because of the purported improved guarantee on security of supply that will result when European integrators source components in the EU.⁷¹⁴ According to the document, this would be consistent with current efforts of some EU defence companies to promote “ITAR-free” initiatives in order to elude the complexity and restrictive impacts of U.S. ITAR rules, and thereby enlarge their access potential on third markets.⁷¹⁵ Further, that this is also mirrored in the EU governments’ new momentum looking for greater autonomy.⁷¹⁶

The Chapter will return to the discussion of so-called “ITAR free solutions” after an analysis of the Defence Procurement Directive’s provisions. At this stage, it is important to debunk certain of the statements contained in the Impact Assessment. Firstly, the dedicated 2005 study on intra-EU transfers identified in Section 6.1 above did not give any detailed consideration to the impact of ITAR on the internal movement of defence material within the EU.⁷¹⁷ The extent of any “obvious restrictive impact” has not therefore been fully discerned. Secondly, as will be discussed below, it is by no means clear that the ICT Directive will be a decisive factor in security of supply assessments. Nor is it clear that it will enable greater assurances of security

⁷¹³ *ibid* 33

⁷¹⁴ *ibid*

⁷¹⁵ *ibid*

⁷¹⁶ *ibid*, citing at fn32 EDA, ‘A Strategy for the European Defence Technological and Industrial Base, Brussels’, 14 May 2007, 2: “[t]his EDTIB must also be more closely integrated with the wider, non-defence European technological and industrial base, with less European dependence on non-European sources for key defence technologies.” See also the specific reference to the US at 5. Although, it should be observed that according to the *Fortresses and Icebergs Study Vol I* (n 13) 231 during the course of interviews for the Study, EDA and EC officials expressed the position that the EU is not acting against ITAR. Rather, in their view, ITAR forms its own barriers

⁷¹⁷ Unisys, ‘Intra-Community Transfers of Defence Products’ (n 122)

of supply or, in fact, improve security of supply. Finally, it is also not clear what is the precise basis is for asserting that European goods will be favoured above those sources from third countries as a result of the ICT Directive.

Therefore, as the remaining Sections of this Chapter will demonstrate, it is important to recognize the extent to which ITAR has increasingly permeated the legislative policies underlying the adoption of EU defence trade legislation. However, absent a clear empirical basis substantiating the effects of ITAR in practice, it is quite another to assume that it similarly impacts on contracting authorities and contractors in the ways, and to the extent, suggested.

6.3. Uncertainty of Obtaining ITAR Authorisation to Export

It is recalled that a major issue raised by U.S. commentary concerns uncertainty of obtaining relevant ITAR authorisations and its potential effect on the security of supply assessment under Article 23(a). However, Article 23(a) merely stipulates an evidential requirement demonstrating a tenderer's ability "to honour obligations regarding export and transfer of goods associated with the contract". At the outset, it is submitted that the inherent generality and discretion imported by such provisions is a risk to all non-domestic operators. To this extent, much will depend on the individual circumstances of each case.

There appears to be no evidence to verify how many applications are made each year to export, transfer and re-export specific types of ITAR controlled products in

satisfaction of public defence contracts awarded within the EU.⁷¹⁸ It is also not possible to identify the exact numbers or percentages of authorizations refused, delayed or withdrawn each year. In light of these evidential limitations, it is only possible to draw on existing studies which provide some anecdotal evidence regarding expressed attitudes towards ITAR in practice and which must, necessarily, be treated with caution in deriving any general conclusions.

6.3.1. Experiences of ITAR within the EU

The Fortresses and Icebergs Study has examined the experiences of a number of EU Member States with regard to the operation of ITAR from both Western and Eastern European Member States. One issue identified by the Study appears to concern the risk of licensing denials. According to the Study, France was the only country to specifically identify the risk of licensing denials as creating a general state of unpredictability.⁷¹⁹ However, it is not clear whether it is merely the risk, or the additional fact, of any denials or both which has raised concern.⁷²⁰

Another issue which the Study identified concerns lengthy delays in obtaining export approvals. According to the Study, Germany, Sweden and the UK all identified lengthy delays. More specifically, the experience of German market participants was

⁷¹⁸ For example, it is not clear whether formal records of licensing decisions (including refusal and requests) are kept and periodically monitored and reviewed

⁷¹⁹ *Fortresses and Icebergs* (Vol. II) (n 12) 353

⁷²⁰ This distinction is particularly important. It is recalled from Section 6.1 above that whilst there had been no formal denials of transfer licences prior to the adoption of the ICT Directive, it was reported that the mere risk of denials was considered alone sufficient to encourage Member States to source defence material domestically. See Impact Assessment (n 680) 4-5

that even when Technical Assistance Agreements (“TAA”)⁷²¹ are issued in accordance with ITAR, the delays imposed by the process make it difficult to rely upon U.S. companies as suppliers on time-critical projects.⁷²² Sweden also reported that it simply takes too long to obtain required licenses and agreements, whether TAA’s, Manufacturing License Agreements (“MLA”)⁷²³ or DSP-5 Export Licenses.⁷²⁴ In addition, the Study identified that a significant issue for U.S. defence firms seeking to access the UK market is the growing level of frustration and concern with ITAR.⁷²⁵ In particular, the Study highlighted technology release and procedural issues with respect to the Joint Strike Fighter (“JSF”) programme.⁷²⁶ The Study reports that the UK has more broadly faced mounting issues of delays and uncertainties posed by U.S. export licensing and their adverse implications for development and delivery schedules.⁷²⁷

⁷²¹ A TAA can exempt the communication of technical data to a foreign partner. 22 CFR §120.22 defines a “technical assistance agreement” as: “[a]n agreement (e.g., contract) for the performance of a defense service(s) or the disclosure of technical data, as opposed to an agreement granting a right or license to manufacture defense articles. Assembly of defense articles is included under this section, provided production rights or manufacturing know-how are not conveyed [...]” For more detail in this regard, see 22 CFR Pt 124. See also ‘The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries’ (n 662) 48

⁷²² *Fortresses and Icebergs*: (Vol. II) (n 12) 369

⁷²³ 22 CFR §120.21 defines a “manufacturing license agreement” as: “[a]n agreement (e.g., contract) whereby a U.S. person grants a foreign person an authorization to manufacture defense articles abroad and which involves or contemplates: (a) The export of technical data (as defined in § 120.10) or defense articles or the performance of a defense service; or (b) The use by the foreign person of technical data or defense articles previously exported by the U.S. person. For more detail in this regard, see 22 CFR Pt 124

⁷²⁴ A DSP-5 licence is a licence for the permanent export of an item. The licence takes the shorthand name of the application form which is required to be submitted. See 22 CFR §123.1(a)(1)

⁷²⁵ *Fortresses and Icebergs*: (Vol. II) (n 12) 623

⁷²⁶ *ibid* 573 and citations at fns 516 – 518. See also more generally, D M Moore, S Young, P Ito, K Burgess, P Antill, ‘U.S. Export Controls and Technology Transfer Requirements – A United Kingdom Perspective’ (2010) 3 *International Journal of Defense Acquisition Management* 23. The JSF programme is a development and acquisition programme that is intended to replace a range of existing fighter aircraft and develop the next generation of serviceable aircraft for the US, U.K., Canada, Australia and the Netherlands. For more details, see <<http://www.jsf.mil/program/index.htm>> accessed 20 September 2013

⁷²⁷ *Fortresses and Icebergs*: (Vol. II) (n 12) 623-4 which states: ““UK and EU trust in the U.S. slid way down”, according to one UK government official interviewed for this study. As he noted, “the nations or firms spend millions or even billions of dollars on a program but cannot be guaranteed an export license. How can we say we have security of supply with the U.S.?” Like elsewhere in Europe, UK firms and government representatives report that waiting for U.S. export licensing is creating unacceptable risk in their product and system development and delivery schedules.”

6.3.2. EU Experiences of ITAR within the U.S.

At the time of the adoption of the Defence Procurement and ICT Directives, the EU published a commissioned study entitled ‘The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries.’⁷²⁸ The Study focused primarily on U.S. technology control policy and practice and the experiences of EU companies seeking access to the U.S. market.⁷²⁹ To this extent, the Study is less useful for discerning the impact of ITAR on contracting authorities in the EU. It nevertheless provides a European perspective on the administration of the ITAR system. According to the Study, the latest audits from the U.S. Government Accountability Office (“GAO”) repeatedly indicated that the DDTC has not met its objectives in terms of processing licences.⁷³⁰ Further issues identified included a lack of accurate record keeping of what had been licensed and why, leading to repetition of approval procedures.⁷³¹ These findings appear to be corroborated by the Fortresses and Icebergs Study which identifies a licensing culture at the U.S. Department of State that encourages firms to apply for narrower licenses in order to get approvals rather than “return without action” determinations.⁷³² One consequence of a narrow scope license is an increased volume of new license applications to cover exports of articles, technical data and services outside the original narrow scope.⁷³³

In addition to the above, the Studies have identified a number of additional criticisms

⁷²⁸ ‘The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries’ (n 662)

⁷²⁹ In this regard, see *ibid*, Part 4 (on the U.S. export control regime) and Part 5 (on European strategies and “models” for accessing the U.S. market)

⁷³⁰ *ibid* 55

⁷³¹ *ibid*

⁷³² *Fortresses and Icebergs*: (Vol. II) (n 12) 693

⁷³³ *ibid*

regarding ITAR. The following are merely illustrative and include *inter alia*: the breadth of ITAR regulation in terms of technology and information covered;⁷³⁴ lack of transparency in ITAR determinations which has been described as opaque and arbitrary;⁷³⁵ the risks to European industry with regard to commingled technology from Europe and the U.S.;⁷³⁶ the ability to maintain correspondence with U.S. government contacts;⁷³⁷ and the control of performance parameters going forward which result in certain items becoming ITAR controlled that were previously uncontrolled.⁷³⁸

6.3.3. The “Trade-Off”: ITAR Management

Whilst the above has highlighted general criticisms of ITAR, as indicated, it is important to discern more precisely the extent to which ITAR is likely to affect the decision-making of contracting authorities in their assessment of security of supply, in particular, with regard to the ability of tenderers to honour their export and transfer obligations. The Fortresses and Icebergs Study has identified that ITAR restrictions are a significant issue for both the German government customer and German companies doing business with U.S. companies.⁷³⁹ The Study reported that German officials readily conceded that European procurement authorities could use the

⁷³⁴ see ‘The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries’ (n 662) 48

⁷³⁵ *Fortresses and Icebergs*: (Vol. II) (n 12) 369; see also ‘The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries’ (n 662) 48 which observes that it offers very little visibility and induces extreme caution on the part of U.S. industry

⁷³⁶ ‘The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries’ (n 662) 51. It has been suggested that European industry is generally hesitant to bring technology to the U.S. because of the risk of losing control over it if it is modified or commingled with ITAR-controlled US technology

⁷³⁷ *Fortresses and Icebergs*: (Vol. II) (n 12) 559, identifying that Swedish companies have found it difficult to maintain an open dialogue with their U.S. government contact, whether it is someone at DDTC or DoD

⁷³⁸ *ibid*

⁷³⁹ *ibid* 356

Directive's security of supply provisions to discriminate against bidders relying on ITAR controlled technology.⁷⁴⁰ The Study also identified that Swedish companies confirmed that ITAR restrictions are a factor in choosing suppliers.⁷⁴¹

However, again, caution must be exercised against drawing any generalised conclusions. Whilst the above refer to issues identified by both contracting authorities and companies, the Studies do not clearly differentiate between the effects of ITAR on the choices of contracting authorities and the choices of prime contractors selecting subcontractors in fulfillment of the main contract. It cannot be presumed that these correspond such that a negative impact of ITAR on a contractor will negatively impact a contracting authority's overall determination.

Further, it follows that it is not clear the precise circumstances in which ITAR would likely be a significant factor in any choice of supplier either by a contracting authority or a prime contractor in the selection of a subcontractor, nor how contracting authorities may use the Directive's provisions to discriminate.

In light of the above, it is submitted that, at present, there is a risk that the distinction between ITAR as a general management issue (in most cases) and ITAR as "security of supply" risk is elided. For example, U.S. legal commentary has asserted that managing a product with U.S. components will become more complicated and more expensive and will present more security of supply concerns than an equivalent

⁷⁴⁰ Ibid 397

⁷⁴¹ Ibid 559

product outside the U.S. export control regime.⁷⁴² Yet, as will be discussed below, there are clear instances in which it is possible to manage ITAR as part of the procurement process (e.g. through conditions imposed on contract start date) without it significantly affecting the basis of assessment of the tender itself. Here, management (which may include an assessment of risk) is separated from a qualitatively distinct assessment of “security” of supply as a risk. It is further submitted that the conflation between management and risk and security of supply and risk is exacerbated by the terms used in the Defence Procurement Directive itself. As indicated in the introduction to this Section, issues of “reliability” appear to be considered synonymous with issues of “security” of supply. Whilst the two notions are not necessarily mutually exclusive, it may be questioned whether issues such as delay and inconvenience are matters which only affect “reliability” and should not, in and of themselves, generally provide a basis for rendering a bid “insecure” on grounds of “security of supply”, unless there is some additional operative factor.

In addition, it should not be overlooked that companies which are also experienced in submitting bids in both the U.S. and EU will have ITAR management strategies in place.

6.4. Prior Authorisations to Export and Transfer

It is recalled that a further issue identified in the Fortresses and Icebergs Study concerns the likelihood that ITAR authorisations will not typically be in place at the

⁷⁴² See N Tushe, ‘U.S. Export Controls: Do they Undermine the Competitiveness of U.S. Companies in the Transatlantic Defence Market?’ (2011-2012) 41 Pub Cont LJ 57,69 who goes on to state that: “It is little wonder, then, that there is a growing belief that Europeans may increasingly avoid U.S. involvement in defense work whenever possible”

point at which a bid is submitted.⁷⁴³ Again, existing studies provide no real indication of the extent to which contracting authorities consider prior authorizations to export or transfer items to be a decisive factor in their decision-making.

The Guidance Note observes that at the moment when the tender is prepared, the authorisation to transfer the equipment which is to be supplied will (usually) not yet have been granted.⁷⁴⁴ However, it also states that the “situation will change” in light of the ICT Directive because no prior individual authorization requests will be necessary for those products subject to a general licence.⁷⁴⁵ To this extent, U.S. officials have considered that general licences provide a “trump card” that will provide an incentive to “buy European”.⁷⁴⁶

Again, caution must be exercised. Firstly, it is recalled that EU subsidiaries of U.S. companies are eligible to be certified to use general licences under the ICT regime. Secondly, the significance of general licences must not be overstated. It is recalled from Section 6.1 that the ICT Directive limits the mandatory use of general licences to certain defined circumstances.⁷⁴⁷ Further, whilst the intention of the ICT Directive is to limit recourse to individual licensing, the fact of its retention as well as its wording may provide for a more extensive use than envisaged.⁷⁴⁸ Importantly,

⁷⁴³ *Fortresses and Icebergs*: (Vol. II) (n 12) 223

⁷⁴⁴ Guidance Note, Security of Supply, 10, point 30

⁷⁴⁵ *ibid*

⁷⁴⁶ See I Maelcamp, Commercial Specialist, U.S. Mission to the European Union, ‘Recent EU developments in Defense Procurement & Reform of Arms Transfer Licenses’, Presentation to the North Alabama International Trade Association, May 19, 2011. <<http://www.naita.org/docs/Isabelle%20Maelcamp%20NATO%20Pres%20May%202011.pdf>> accessed 20 September 2013

⁷⁴⁷ See Article 5(2)(a)-(2) identified above (n 690)

⁷⁴⁸ For instance, Article 7(b) restricts its use to the instance in which it is necessary for the protection of the essential security interests of the Member State. See also Guidance Note, Security of Supply, 2, point 3. This incorporates the wording of Article 346 TFEU and may legitimate a similarly restrictive interpretation (on which see Chapter 2 of this thesis). However, Article 7(b) also enables the use of individual licences on “grounds of

therefore, the fact that the ICT Directive does not create a “licence-free zone” should be emphasized.⁷⁴⁹ Thirdly, as the Guidance Note indicates, for tenders involving transfers and/or products not covered by a general licence, contracting authorities will only be able to require a tenderer to provide elements indicating that they will be able to obtain the required licences if the contract is awarded to them.⁷⁵⁰ To this extent, an EU tenderer will only be able to provide a relevant assurance as opposed to any guarantee.

In addition to these arguments, it is recalled that it should be cautioned not to place excessive emphasis on ITAR as necessarily constituting a “security of supply” risk, especially where that risk merely pertains to the fact that ITAR authorizations may not typically be in place at the point of tender. For instance, the Guidance Note states that for equipment not covered by a general licence under the ICT Directive, in order to ensure that contractors correctly process licences expeditiously, contracting authorities may require tenderers to provide evidence showing their planning and resources for obtaining any necessary transfer and/or export licences.⁷⁵¹ Moreover, they can insert into the contract documents conditions which will improve and expedite the export licensing process.⁷⁵² The Guidance Note states that this could include a requirement for the contractor to notify all licensing requirements or other transfer restrictions applicable to the products to be delivered and to any parts, sub-

public policy”, where it is necessary to comply with international obligations and commitments of Member States and where a Member State has serious reason to believe that the supplier will not be able to comply with all the terms and conditions necessary to grant it a global transfer licence. The reference to “serious reason” could require strict justification in accordance with the general ECJ jurisprudence identified in Chapter 2. However, the Directive does itself not specify an exhaustive or illustrative list of possible circumstances that may constitute a “serious reason”, thereby importing a degree of subjectivity

⁷⁴⁹ Guidance Note, Security of Supply, 2, point 3

⁷⁵⁰ Guidance Note, Security of Supply, 10, point 30

⁷⁵¹ *ibid*

⁷⁵² Guidance Note, Security of Supply, 11, point 31

systems thereof, in particular if these have to be provided from third countries.⁷⁵³ As indicated in Section 6.3.3 above, these appear to constitute issues pertaining to ITAR management only.

As expected, there are examples of published contract notices for procurements undertaken in accordance with the Defence Procurement Directive which stipulate early disclosure of ITAR implications as well as the ability of any selected contractor to comply with ITAR at the contract start date.⁷⁵⁴

6.5. Restrictions On Disclosure, Transfer and Use

U.S. commentary has not differentiated any possible effects for third countries which may result from the separate application of Articles 23(a) and (b).⁷⁵⁵ It is recalled that the Guidance Note differentiates Article 23(a) and (b) on the basis that the former pertains to a requirement to demonstrate that the contractor will “in all likelihood” obtain the necessary export, transfer and transit licences with conditions that enable it to fulfil mandatory contractual obligations whilst the latter pertains to a requirement to list all *other* restrictions to which an exported item is subject so that they can be dealt with during the negotiation phase, and or as part of the evaluation in the award phase.⁷⁵⁶

⁷⁵³ Other conditions include requirements to: notify the contracting authority of export-controlled content; institute timely action to obtain export licences; liaise fully with the contracting authority and/or other relevant authorities on the export licensing process to ensure that all requirements are met and ensure that contractual requirements are passed down to any subcontractor who may have to apply for export/transfer licences. See Guidance Note, Security of Supply, 11, point 31

⁷⁵⁴ See for example, Chinook Engine Support Arrangement, Contract Notice published in the OJEU (2011/S 62-101005) <<http://www.government-online.net/chinook-engine-support-arrangement/>> accessed 20 September 2013

⁷⁵⁵ As consistently observed throughout this thesis, the technical imprecision of many of the Directive’s provisions leaves them susceptible to interpretational overlap and raise issues of legal certainty

⁷⁵⁶ Guidance Note, Security of Supply, 12, point 36, para.2

The Guidance Note states that Article 23(b) concerns, in particular, so-called “black boxes” or anti-tamper devices which it describes as components and sub-systems which cannot be accessed or modified by the customer.⁷⁵⁷ With specific regard to the U.S., the Guidance Note expressly refers to the fact that Article 23(b) also concerns items covered by export control regimes or special end-use monitoring such as ITAR, identifying the requirement to obtain specific authorisation from the US for export to other countries, including transfers between Member States.⁷⁵⁸ Both black box restrictions and special end use monitoring have one common feature, namely a concern to prevent further unauthorized re-exportation and/or use of material.

The Fortresses and Icebergs Study has identified the use of “black boxes” and other “ring-fence” or management systems as limiting the ability of Member States to operate freely with their military systems and that these are limitations which these countries are reluctant to accept.⁷⁵⁹ According to the Study, the UK, as well as France and Italy, expressed strong concerns about this issue, in particular regarding their overall effect on autonomy and flexibility (operational sovereignty), in particular with regard to sales to foreign partners.⁷⁶⁰

Similarly, the Study identified re-transfers and re-exports as a significant issue. Germany indicated specific risks to third country exports arising from ITAR.⁷⁶¹ Germany also identified issues related to such matters as end-use certificates

⁷⁵⁷ Guidance Note, Security of Supply, 12, point 35, para 1

⁷⁵⁸ *ibid*

⁷⁵⁹ *Fortresses and Icebergs: (Vol. I) (n 12) 113*

⁷⁶⁰ *ibid* 353

⁷⁶¹ *ibid* 356. However, these risks were not specified in the Study

needed for re-transfers.⁷⁶² This issue was also specifically reported by Sweden. According to the Study, because Swedish systems have often contained a high percentage of U.S.-origin parts and components, re-export restrictions imposed by the ITAR is a constant issue confronting the Swedish Inspectorate of Swedish Products and Swedish defence firms.⁷⁶³ The Study reported that the requirement to obtain re-export authorization from the U.S. Department of State's DDTC prior to the transfer or sale of a Swedish product containing U.S.-origin components to a third party is "an irritation that is not only inconvenient, but inevitably leads to delays."⁷⁶⁴ It was reported that, to this extent, ITAR restrictions serve as a trade barrier for U.S. companies, particularly lower tier companies that are not selling sophisticated systems or subsystems.⁷⁶⁵

Beyond the existing available evidence of general concerns expressed, it is not clear to what extent such restrictions or further conditions on use are decisive in contract awards in practice. Again, the Guidance Note expressly emphasizes effective planning in this regard. In particular, the Guidance identifies the importance of early disclosure as fundamental not only to ensuring that the contracting authority's/entity's security of supply requirements can be met, but also to maintaining the possibility to award in competition contracts for downstream equipment support.⁷⁶⁶ Whilst it is difficult to discern whether early disclosure could override inherent reservations on the part of contracting authorities regarding their autonomy to use products, nevertheless, as indicated by the practice outlined above, early disclosure may, at

⁷⁶² *ibid* 397

⁷⁶³ *ibid* 558

⁷⁶⁴ *ibid* 558-9

⁷⁶⁵ *ibid*. The Study does not, however, elaborate as to why this would have a more substantial impact on lower tier suppliers. This may be due to the ability of those providing more sophisticated systems and subsystems to absorb the costs or better manage ITAR issues

⁷⁶⁶ Guidance Note, Security of Supply, 12, point 35, para 2

the least, enable adequate planning in order to take account of, or mitigate to the extent possible and practicable, any ITAR restrictions. This also seems to be consistent with the fact that the Guidance Note states that all the tenderer has to do in order to satisfy the condition in Article 23(b) is to provide complete and sufficiently detailed information about such restrictions (if any).⁷⁶⁷ It could be suggested that if such issues were perceived to be potentially decisive, more than an informational requirement may have been specified.⁷⁶⁸

More generally, it should be added that EU officials and commentators have identified the potential role which the ICT Directive could have in mitigating the extent to which the U.S. deems it necessary to place restrictions on re-exports. A principal motivation that continues to drive ITAR (and militate against reform) concerns the ability of EU Member States to safeguard against re-export risks of illicit technology transfer and which is said to be considered by U.S. authorities to be a pre-requisite for any softening of ITAR.⁷⁶⁹ The U.S. continues to harbour concerns that the degree of liberalization intended by the ICT Directive will further increase such risks.

It has been argued by EU officials that the certification provisions of the ICT Directive could contribute to providing the U.S. with greater assurance against the risk of illicit technology transfer in the event of collaboration with European companies, thus

⁷⁶⁷ Guidance Note, Security of Supply, 12, point 36, para 1

⁷⁶⁸ Although, as will be discussed in Section 7.1 below, the Guidance has placed emphasis on the potential for such informational provisions to provide a legitimate basis for exclusion of tenderers at the qualitative selection stage. Therefore, any weight to be attached to a particular requirement should not necessarily be presumed

⁷⁶⁹ H Ingels, 'The intra-EU defence trade directive: positive goals' in A JK Bailes and S Depauw (ed) 'The EU defence market: balancing effectiveness with responsibility', Conference Report, Flemish Peace Institute, Brussels, 15 September 2011, 64
<<http://www.sipri.org/research/armaments/transfers/controlling/research/armaments/transfers/publications/other/publ/other%20publications/conference-report-eu-defence-market-flemish-peace-institute>> accessed 20 September 2013.

enhancing mutual trust.⁷⁷⁰ For example, the ICT Directive requires Member States to determine all the terms and conditions of transfer licences including limitations on the export of defence-related products to third countries and may request end-use assurances including end user certificates.⁷⁷¹

Similarly, in evidence given to the UK Parliament, U.S. concerns about possible risks in relation to re-exports arising as a result of the ICT Directive have been acknowledged.⁷⁷² However, it has also been stated that if Europeans want the US to take part and take more “ambitious steps in dismantling barriers to transatlantic defence cooperation”, existing trust issues must be addressed.⁷⁷³ It has been suggested that the best way to reassure the U.S. about the inadequate technical standards of export controls within some European countries is for EU governments to implement thoroughly the ICT Directive, as a result of which the U.S. will feel more confident about exploring possible synergies.⁷⁷⁴

In light of the above, whilst it is difficult to validate the extent to which subsequent restrictions on use of defence products are decisive in practice, a critical issue which must be addressed concerns perceived and actual risks of re-exportation. Longer term export reform initiatives may alter U.S. practices in relation to re-exports which,

⁷⁷⁰ *ibid*

⁷⁷¹ Article 4(6). Although, it should be recognized that the ICT Directive has been criticized on grounds that it does not provide for any systematic means whereby receiving Member States are routinely informed about relevant re-export conditions (i.e. it is up to the certified recipient company to comply with, and alert its government to, any export restrictions associated with the original transfer licence). It has been suggested that this could create a significant risk of unauthorised export in cases where companies either wilfully or inadvertently neglect to inform their authorities of any re-export restrictions that apply to particular defence-related products. See See C Taylor, ‘EC Defence Equipment Directives, Standard Note SN.IA/4640’, 3 June 2011, 1-22, 20 citing at n49 written evidence given by the U.K. Working Group on Arms to the Commission on Arms Export Controls, *Scrutiny of Arms Export Controls 2009*, HC 178, Session 2008-09

⁷⁷² C Taylor, ‘EC Defence Equipment Directives, Standard Note SN.IA/4640, 3 June 2011, citing at 21, fn 51 C O’ Donnell *A Transatlantic defence market, forever elusive?* Centre for European Reform Policy Brief, July 2010’

⁷⁷³ *ibid*

⁷⁷⁴ *ibid*

in turn, may reduce the attributed significance of restrictions on re-export as a basis for assessing security of supply under the Defence Procurement Directive.

6.6. “ITAR-Free”: Cost of Freedom

Both the Fortresses and Icebergs and EU Nature and Impacts of Barriers to Trade Studies identify the development of so-called “ITAR-free” initiatives which are said to have been undertaken by U.S. and EU companies and endorsed by certain EU Member States.⁷⁷⁵ Whilst there is no official EU ITAR free policy or initiative, the Fortresses and Icebergs study identifies national policies and informal guidance encouraging avoidance of ITAR as well as tangible evidence in this regard, in particular, the use and procurement of “design arounds” or “design outs”.⁷⁷⁶ Further, the Study specifically identifies that German industrial and Government representatives suggested that the security of supply and global licence provisions of the Defence Directives had the potential to “jump-start” an ITAR-free initiative within Europe that would amount, in fact, to a European preference in defence procurement.⁷⁷⁷ U.S. legal commentary has identified a number of instances which apparently provide “compelling” and “systemic” evidence of U.S. disadvantage”, in light of which EU Member States’ ability to use the Defence Procurement Directive to discriminate against U.S. suppliers is a cause for concern.⁷⁷⁸

Whilst it is important to give due credence to very serious statements made in

⁷⁷⁵ As The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries Study (n 662) observes at 53, the concept was turned into a kind of “buzz word” and used for a political purpose. See also *Fortresses and Icebergs*: (Vol. I) (n 12) 113-117

⁷⁷⁶ *Fortresses and Icebergs*: (Vol. I) (n 12) 114

⁷⁷⁷ *Fortresses and Icebergs*: (Vol. II) (n12) 369-70

⁷⁷⁸ Tushe, ‘U.S. Export Controls: Do they Undermine the Competitiveness of U.S. Companies in the Transatlantic Defence Market?’ (n 742)

relation to ITAR concerns, it is also important to understand the observable limits of this phenomenon. The same U.S. legal commentary itself identifies that it is very difficult to quantify the impact of export controls on U.S. companies.⁷⁷⁹ Further, the Fortresses and Icebergs Study identifies anecdotal evidence which suggests caution on the part of EU Member States in adopting ITAR free initiatives.⁷⁸⁰ For instance, Germany has not gone so far as to make ITAR-free an element of German procurement policy for a number of reasons.⁷⁸¹ One stated reason is that it is impractical at the present time because it could cost more and take longer to develop ITAR free solutions.⁷⁸² Another stated reason is that the result could be less capability in relation to the investment.⁷⁸³ Similarly, Sweden reported that ITAR issues will not prohibit the Swedish government from purchasing advanced U.S. equipment because ultimately advanced technology and capabilities decide which systems will be purchased.⁷⁸⁴ In particular, it stated that in most cases, U.S. suppliers will continue to be the supplier of choice for systems and subsystems because in the final analysis Sweden will purchase the best product available.⁷⁸⁵ Further, as the Nature and Impacts of Barriers to Trade with the U.S. Study observes, it is at least possible to argue that it would not be reasonable to believe that Europe has the capacity or the political will and objective to replace U.S. technology to a significant extent.⁷⁸⁶

⁷⁷⁹ *ibid* 69 at fn97 and citations therein

⁷⁸⁰ Whilst Tushe (n 742) relies extensively on references to the Fortress and Icebergs Study throughout, the findings of the Fortresses and Icebergs Study on this issue are not included

⁷⁸¹ *Fortresses and Icebergs: (Vol. II)* (n 12) 369-70

⁷⁸² *ibid* 397

⁷⁸³ *ibid*

⁷⁸⁴ *ibid* 559. Interestingly, Tushe (n 742) at 68 specifically refers to Sweden as an example of a country for which ITAR re-export restrictions are considered a vital issue. Yet, the article does not include these other views expressed by Sweden

⁷⁸⁵ *Fortresses and Icebergs: (Vol. II)* (n 12) *ibid*

⁷⁸⁶ 'The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries' (n 662) 53

Further, in principle, there can be no objection to instances in which a contracting authority chooses an ITAR-free product where there is an ITAR equivalent if, in the trade-off, the-ITAR free solution provides a better security of supply assurance, even if at reduced capability, for example. It may simply constitute a genuine economic expedient to select European solutions in this instance.⁷⁸⁷

In summary, it is clear that ITAR increasingly factors into the underlying policy debates, rationales and even Guidance supporting EU legislation. Whilst the preceding Sections have sought to offer a rational assessment of the Defence Procurement Directive's possible interaction with ITAR in light of experiences prior to the Directive, the Defence Directives signal a change in the EU regulatory environment the likely effects of which in light of the continued operation of ITAR is, admittedly, uncertain. Whilst inconvenience may be tolerated at present, it may become less tolerable and may result in ITAR becoming an increasingly relevant factor which discriminates between (as opposed to against) tenders on grounds of security of supply.

These concerns are, at least to some extent, also recognized within the U.S. As the Nature and Impacts of Barriers to Trade with the U.S. Study observes, generally speaking, both the underlying policy and the processes regarding the U.S. export control regime are in "disarray" in that "the very balance between protecting sensitive technology and promoting legitimate commerce is often judged to be out of kilter".⁷⁸⁸

⁷⁸⁷ *Fortresses and Icebergs*: (Vol. II) (n 12) 401 expressing the views of a senior Italian Government official Similarly 'The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries' (n 655) states at 53 that European entities are not making a political statement about ITAR but are simply motivated by logical business practices on a case-by-case basis

⁷⁸⁸ 'The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries' (n 662) 58; *Fortresses and Icebergs*: Vol. II (n 13) 694-7

In 2010, the Obama Administration announced the Export Control Reform Initiative following an interagency review of the export control system and which found that the current export control system was overly complicated, redundant, and in trying to protect too much, diminishes U.S. efforts to focus on the most critical national security priorities.⁷⁸⁹ The Initiative aims to consolidate four aspects by developing a single control list, a single licensing agency, a single information technology system and a single main enforcement agency.⁷⁹⁰ The extent to which these reforms could result in a reduction in export controls that will affect European choices will remain to be seen.

As will be discussed in Part III, despite initial political resistance in the U.S., the U.S. and U.K. have ratified a U.K.-U.S. defence trade treaty permitting a licence waiver for certain technologies, thereby attempting to reduce the restrictive effects of ITAR and which has been proposed as a model for the adoption of a “transatlantic general licence” applicable to all EU Member States.⁷⁹¹

7. Security of Supply in the Supply Chain

The preceding Section focused on the assessment of security of supply with regard, principally, to the issue of export, transfer and use of goods. By contrast, this Section

⁷⁸⁹ For more information on the background to the initiative, see <http://export.gov/ecr/eg_main_047329.asp> accessed 20 September 2013

⁷⁹⁰ The White House, Office of the Press Secretary, ‘President Obama Lays the Foundation for a New Export Control System to Strengthen National Security and the Competitiveness of Key U.S. Manufacturing and Technology Sectors’ (August 30 2010) Press Release <<http://www.whitehouse.gov/the-press-office/2010/08/30/president-obama-lays-foundation-a-new-export-control-system-strengthen-n>> accessed 20 September 2013

⁷⁹¹ Treaty Between The Government of The United States of America and The Government of The United Kingdom of Great Britain and Northern Ireland Concerning Defense Trade Cooperation, June 21, 2007

brings into focus the observations of Chapter 4 regarding the potential for EU law to impact on third countries indirectly through an assessment of an EU economic operator's supply chain. U.S. legal commentary has not examined this aspect. However, as will be discussed, the Defence Procurement Directive and Guidance contain a number of additional references to third countries. This Section examines the assessment of the supply chain at the qualitative selection and award stages.

7.1. Exclusion Through Qualitative Selection: Indication of Location

It is recalled that Section 5 examined certain grounds for excluding candidates or tenderers at the qualitative selection stage.⁷⁹² Another basis on which candidates or tenderers may be excluded is on grounds of their technical and professional capacity.⁷⁹³ Article 42(1) describes different means by which operators may provide evidence of their technical abilities and which can, in turn, be used by contracting authorities as a basis for establishing their selection criteria.⁷⁹⁴

One form of evidence identified by Article 42(1)(h) refers to:

[...] a description of the tools, material, technical equipment, staff numbers and know-how and/or sources of supply — with an indication of the geographical location when it is outside the territory of the Union — which the economic operator has at its disposal to perform the contract, cope with any additional needs required by the contracting authority/entity as a

⁷⁹² See Article 39(2)

⁷⁹³ For general commentary on these requirements under the Public Sector Directive, see C H Bovis, *EU Public Procurement Law* (n 171) 133-140

⁷⁹⁴ Guidance Note, Security of Supply, 8, point 22, para. 2. As the Guidance observes, according to Article 38, contracting authorities/entities are permitted to use selection criteria in two ways: (a) to require candidates to meet minimum capacity levels (provided those levels are related and proportionate to the subject matter of the contract) and (b) as the basis for their ranking if they decide to limit the number of suitable candidates they invite to tender

result of a crisis or carry out the maintenance, modernisation or adaptation of the supplies covered by the contract.

The above appears to refer to ostensibly objective factors with the exception of “sources of supply”. In this regard, it is worth reciting the Guidance in relevant part:

[...] The explicit reference to the *‘indication of the geographical location when it is outside the territory of the Union’* implies that location in third countries can be relevant for the assessment of a candidate’s or tenderer’s capability to perform the contract. A contracting authority/entity can therefore exclude a candidate or tenderer from the procedure if it considers that the geographical location of non-EU sources could compromise their ability to comply with its requirements, in particular those related to Security of Supply. In addition, if a successful tenderer is obliged to award subcontracts in accordance with the rules set out in Title III of the Directive, any sub-contractor can be excluded on the same grounds. However, any such decision has to be based on the individual circumstances of each procurement case and must be proportionate and related to the subject matter of the contract.⁷⁹⁵

It is observed that there is no definitive CJEU judgment on factors pertaining to the assessment of the location of a contractor/subcontractor.⁷⁹⁶ Nevertheless, it is necessary to question the emphasis placed by the Guidance on distinguishing

⁷⁹⁵ Guidance Note, Security of Supply, 8-9, point 24, para 2

⁷⁹⁶ For a limited instance in which the Court has considered such factors and which is, in any event, distinguishable from the present scenario, see Case C-315/01 *Gesellschaft für Abfallentsorgungs-Technik GmbH v Österreichische Autobahnen und Schnellstraßen AG* [2003] ECR I-6351

sources of supply (in particular from third countries) from the other considerations listed in Article 42(1)(h). Firstly, whilst the UK DSPCR, for example, directly transposes Article 42(1)(h) in this respect,⁷⁹⁷ the UK Guidance on supplier selection does not identify sources of supply as a relevant form of evidence and makes no reference to geographical indication of the location of the supply chain when it is outside the EU.⁷⁹⁸ Therefore, to the extent that there is any emphasis at all, it may be variable between Member States. Secondly, Article 42(1)(h) merely emphasises the need for an “indication” of sources of supply. Whilst the above Guidance appears to suggest that this indication could provide a basis for exclusion, it is recalled from Section 6.5 the similar reference to an indication in Article 23(b), namely that all that a tenderer has to do to fulfil that condition is to provide complete and sufficiently detailed information. In light of the above, it is suggested that the Guidance Note places an emphasis on the provision that is not necessarily mandated by its wording.

This issue is rendered even more uncertain by the fact that Article 42(1)(h) is not the only reference to the location of sources of supply contained in the Directive. As will be discussed in Section 7.2 below, Article 23(c) provides that a contracting authority may require certification or documentation demonstrating that the organisation and location of the tenderer’s supply chain will allow it to comply with the contracting authority’s security of supply requirements.

⁷⁹⁷ See Regulation 25(2)(j) DSPCR

⁷⁹⁸ The only relevant reference to third countries relates to Article 41(c) Defence Procurement Directive which refers to: “a description of the technical facilities and measures used by the economic operator to ensure quality and the undertaking’s study and research facilities, as well as internal rules regarding intellectual property [.]” See also Recital 44 to the Directive. In this regard, the UK Guidance states that this requirement is to inform the procurer if the supplier’s internal rules require the transfer of IPR to another party e.g. a parent or sister company located in another Member State or outside the EU and that this may have an impact on a supplier’s capability to meet security of supply requirements. See Defence and Security Public Contracts Regulations 2011, Ch. 14, Supplier Selection, 6-7
<https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/27664/dspcr_c14_supplier_selecti_on_apr12.pdf> accessed 20 September 2013

It is also recalled from Section 5 that the Guidance Note expressly states that it is particularly important to distinguish selection criteria clearly from award criteria.⁷⁹⁹

The basis for this distinction is sound in theory and has been endorsed by the ECJ.⁸⁰⁰ However, reinforcing the earlier observation in Section 5, this relation between Article 42(1)(h) and Article 23(c) arguably raises the issue of whether the distinction between capability to perform the contract and characteristics of the product itself can be retained such as to act as a safeguard against the early exclusion of tenderers with third country elements.

The Guidance Note has not provided any useful indication of the type of enquiry that may be undertaken when determining whether to exclude a candidate or tenderers on the grounds of capability to perform the contract, and more specifically, on the basis that geographical location of non-EU sources may compromise their ability to comply with security of supply requirements. In contrast, as will be discussed in Section 7.2 below, the Guidance Note has discussed the issue of geographical location and its relevance to security of supply under Article 23(c). Suffice to state that it cannot be excluded that contracting authorities may take into account a host of more subjective factors under Article 42(1)(h) which are not exclusively related to capability.

Again, the above observations are based on nuanced legal interpretations. There are a number of possible arguments which may militate against the likelihood of early exclusion of economic operators on the basis of third country supply chain

⁷⁹⁹ Guidance Note, Security of Supply, 5-6

⁸⁰⁰ Guidance Note, Security of Supply, 5-6. As the Guidance Note itself observes: “[e]specially in the case of off-the-shelf procurement, contracting authorities/entities may often already have an idea of the products that could fulfil their requirements. However, at this stage of the procedure the assessment does not concern the products, works or services to be procured, but the tenderer’s or candidate’s ability to perform the contract in question.”

considerations in practice. Firstly, as discussed above, it is possible that an indication of sources of supply may be just that, indicative, rather than decisive. Secondly, it is recalled that any decision by a contracting authority to exclude a candidate or tenderer must be: (i) based on the individual circumstances of the case; (ii) proportionate and (iii) related to the subject matter of the contract.⁸⁰¹ Whilst it is not clear to what extent factors such as ITAR, for example, could be included in the assessment under Article 42(1)(h), U.S. commentary has not identified the possibility for such a requirement to discriminate against U.S. contractors.

7.2. Location and Organisation of the Supply Chain

The location and organisation of a tenderer's supply chain can form the basis of a contract performance condition or award criterion. It is recalled that Article 23(c) provides that a contracting authority may require:

certification or documentation demonstrating that the organisation and location of the tenderer's supply chain will allow it to comply with the requirements of the contracting authority/entity concerning security of supply set out in the contract documents, and a commitment to ensure that possible changes in its supply chain during the execution of the contract will not affect adversely compliance with these requirements [...].

Unlike Article 42(1)(h), Article 23(c) does not make any reference to geographical location of sources of supply when outside the EU. According to the Guidance Note,

⁸⁰¹ Guidance Note, Security of Supply, 6, point 16

the organisation of the tenderer's supply chain covers all the resources and activities necessary to deliver the supplies, services, or works.⁸⁰² The analysis of the supply chain has to be based on objective, performance-oriented considerations.⁸⁰³ In this regard, contracting authorities may require evidence that the supply chain is "reliable" and "stable".⁸⁰⁴ Further, the Guidance states that contracting authorities may wish tenderers to identify key components or potential single points of failure so that measures can be adopted to manage these risks.⁸⁰⁵ However, the Guidance further elaborates as follows and which is worth reciting in full:

[...] In this context, it is particularly important to avoid any discrimination on grounds of nationality when assessing the 'location'⁸⁰⁶ of the tenderer's supply chain. For all production sites and facilities established in the EU, geography may play a role but only in terms of distances and delivery times not in terms of national territory. Security of supply requirements therefore have to be based exclusively on objective, performance-oriented considerations. They may concern, for example, time-limits and conditions for the availability of spare parts, other materials or maintenance services. The tenderer would then have to submit elements demonstrating that the location and organisation of his supply chain allows him to make the

⁸⁰² Guidance Note, Security of Supply, 13, point 37

⁸⁰³ *ibid*

⁸⁰⁴ *ibid*

⁸⁰⁵ *ibid*

⁸⁰⁶ It is unclear why location is placed in inverted commas. It may suggest a degree of underlying conceptual uncertainty regarding precisely what is to be considered as part of this assessment. As indicated above, the Guidance merely states that "geography may play a role but only in terms of distances and delivery times not in terms of national territory". It is not clear what is meant by "in terms of national territory". The reference implicitly suggests that "national territory" could incorporate a range of factors other than ostensibly objective performance oriented considerations, in particular, subjective determinations about broader (unspecified) risks pertaining to the relevant locality or localities (and even any risk arising from any relation between localities if more than one locality comprises a tenderer's supply chain) and which could, otherwise, be used as a basis for discriminatory assessment

necessary deliveries and/or provide the requested services within the required timeframe under the terms and conditions defined in the contract documents [...]⁸⁰⁷

Importantly, the Guidance Note appears to suggest that this emphasis on avoiding nationality discrimination and use of ostensibly objective performance oriented considerations does not necessarily apply to third country supply chains. Again, similar to the Guidance on Article 42(1)(h), the Guidance clearly seeks to differentiate non-EU sources of supply. For instance, the Guidance states:

The situation is somewhat different with respect to supply chains which are (partly) established in or depend on third countries. To safeguard security interests, the contracting authority/entity may require the tenderer to use only reliable sub-contractors from allied countries, for example, or to avoid subcontractors which have to comply with specific export control regimes in third countries. Such conditions, however, must be appropriate and proportionate.”⁸⁰⁸

This emphasis on third countries is even more stark in light of the fact that, unlike Article 42(1)(h), Article 23(c) contains no reference to non-EU sources. It is necessary to discuss this aspect in more detail.

⁸⁰⁷ Guidance Note, Security of Supply, 13, point 38, para 1

⁸⁰⁸ Guidance Note, Security of Supply, 13, para 38, para 1

7.2.1. Partial Establishment and Dependence on Third Countries

The Guidance is not clear on what is meant by supply chains which are “partly established” in or “depend” on third countries. As indicated in Chapter 4, Section 4, there are a variety of ways in which an economic operator may relate to a third country e.g. through ownership, affiliation etc. Further, it is not clear how “dependence” is qualitatively and quantitatively determined. To this extent, it is difficult to know how these aspects could be accurately and objectively assessed. For instance, given the general prevalence of concerns about foreign ownership in the defence sector, in particular, in relation to the need for operational sovereignty and autonomy, it is not clear whether such an assessment might enable subjective decision-making based on factors which do not, in fact, affect the tenderer’s ability to supply the product. Again, it is not clear to what extent such factors are likely to be decisive in practice.

7.2.2. Reliable Sub-Contractors from Allied Countries

As indicated, the Guidance Note also refers to a possible requirement of the tenderer to use only “reliable sub-contractors” from “allied countries” or “avoid subcontractors which have to comply with specific export control regimes in third countries”.⁸⁰⁹ Again, it should be observed that the UK Guidance, for example, makes no reference to the possibility to impose conditions of this kind.⁸¹⁰ There is also a fundamental uncertainty as to precisely when such a requirement would be incorporated.

⁸⁰⁹ Guidance Note, Security of Supply, 13, para 38, para 1

⁸¹⁰ See Defence and Security Public Contracts Regulations 2011, Chapter 13 – Subcontracting under the DSPCR

In terms of the substance of any such requirement, there is an inherent difficulty in the reference to the use of “reliable subcontractors from allied countries”. Firstly, as indicated in preceding Sections, whilst “reliability” is referred to at a number of points in the Directive, “reliability” is not defined and may import highly subjective determinations.⁸¹¹ Secondly, the notion of an “allied country” is not clear. Most Member States would likely agree that a State party to NATO constitutes an “allied country”. However, a further question arises as to whether allied countries should be confined to NATO countries. Certain Member States may also prioritise neighbouring or regional alliances above NATO. There is also a possibility for alliances and their strengths to vary over time. As indicated in Chapter 2, Member States have different defence solutions based on different threat scenarios and security interests, which may be highly relevant to procurement acquisitions.⁸¹²

It may also be questioned whether such a requirement is consistent with one of the core rationales underlying the Directive’s subcontracting provisions, namely to drive competition into the supply chain of prime contractors.⁸¹³ The provisions of Articles 21 and Title III are an exhaustive description of the possible ways in which a contracting authority can oblige a successful tenderer to subcontract a certain share of the contract to third parties and/or to intervene in the way successful tenderers select their subcontractors.⁸¹⁴ This responds to a particular concern regarding

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/27663/dsprc_c13_mandating_subcontracting_3rd_parties_apr12.pdf accessed 20 September 2013

⁸¹¹ See for instance, Recitals 65 and 67 and Article 39(2)(e)

⁸¹² See Aalto, ‘Interpretations of Article 296’ (n 81) 34. See Chapter 2, Section 5.2

⁸¹³ Guidance Note, Subcontracting, 1, para 2. For a discussion of the subcontracting provisions, see Trybus, ‘The tailor-made EU Defence and Security Procurement Directive (n 125) 27-29

⁸¹⁴ Guidance Note, Subcontracting, 2, para.6 which states that this results from the restrictive wording of the relevant provisions such as, for example, Article 21(4)) and also from the principle expressed in Article 21(1) that

systemic practices of contracting authorities to dictate the award of subcontracts to local industries.⁸¹⁵ For instance, one of the subcontracting provisions of the Directive enables a contracting authority to allow a successful tenderer to determine which share and which parts of the main contract to subcontract, and the potential subcontractors with whom it wishes to subcontract, subject only to a possible verification of its selection criteria.⁸¹⁶ Whilst the Directive provides that contracting authorities may place some limitations on successful tenderers, the Guidance Note on Subcontracting confirms the importance of the principle of non-discrimination, in particular that a contracting authority may not require the successful tenderer to award subcontracts to specific subcontractors or to subcontractors of a specific nationality.⁸¹⁷ Therefore, the possibility for a contracting authority to require a tenderer to use only reliable sub-contractors from allied countries not only constitutes an incursion on a successful tenderer's discretion in this regard but also nationality alone could provide a basis for discriminating in favour of the use of a sub-contractor on grounds that it is from an "allied" country.

There is also a more general sense of inconsistency of approach under EU law to the issue of the relevance of alliances in contract award procedures. It is recalled from Chapter 2, Section 5.3 that in its Interpretative Communication on Article 296 TEC, the Commission downplays the relevance of alliance commitments when seeking to invoke Article 346 TFEU.⁸¹⁸ Yet the Guidance suggests that it is permissible to rely

"the successful tenderer shall be free to select its subcontractors for all subcontracts that are not covered by the requirement referred to in paragraphs 3 and 4 of that Article"

⁸¹⁵ Guidance Note, Subcontracting, 1, para 3

⁸¹⁶ In accordance with Article 21(5). See Article 21(1) and (2). See also Guidance Note, Subcontracting, 3, 11

⁸¹⁷ Article 21(1). See also Guidance Note, Subcontracting, 2, para 4

⁸¹⁸ 'Interpretative Communication on the Application of Article 296 of the Treaty in the field of defence procurement' (n 234) 9

on the same as a basis for awarding a contract under the Directive and limiting that award to specific subcontractors.

Again, it is important to question the likely significance of the above in practice. The reality is that U.S. contractors would likely satisfy such conditions. However, the apparent flexibility to choose third country subcontractors from allied countries must be juxtaposed against a possible requirement to avoid subcontractors subject to specific third country export control regimes, to which this Chapter now turns.

7.2.3. Avoidance of Sub-Contractors Subject to Third Country Export Controls

It is not clear whether the reference to “specific third country export control regimes” is a reference to ITAR, which, it is recalled, is so referenced elsewhere in the Guidance.⁸¹⁹ Again, a number of observations can be made in this regard.

It is recalled that any such conditions must be appropriate and proportionate. On the wording of the Guidance, it is not clear whether the simple fact that a third country has to “comply” with a specific export control regime would be considered sufficient to avoid such subcontractors. Whilst it is possible that contracting authorities could take into account subjective and extraneous factors unrelated to the subject matter of the contract, the possibility for an alternative subcontractor to provide a comparable ITAR free solution might be a consideration. However, reinforcing the earlier observations above, the Guidance is not mandatory. Further, any such requirement is inconsistent with the flexibility otherwise accorded to EU tenderers under the

⁸¹⁹ See Guidance Note, Security of Supply, 12, point 35, para 1

subcontracting provisions. Most importantly, as indicated in Section 6, it must be questioned to what extent ITAR would likely be a decisive factor that would force a contracting authority to require avoidance of U.S. subcontractors.

Were such a measure to be challenged, it is not clear whether or not a Member State would be able to invoke Article 346 TFEU to justify any decision to require an award to a particular subcontractor(s) or avoid use of a third country subcontractor(s). The Guidance Note appears to simply suggest, without more, that the above conditions can be taken to “safeguard security interests”.⁸²⁰

More generally, it may be questioned whether the Guidance fully reflects or appreciates the commercial realities of defence contracting in presuming that tenderers are able to readily make alternative subcontracting choices. It cannot be presumed that a contractor can simply switch to alternative suppliers.⁸²¹ A civil contractor operating in the public sector may be able to rely more easily on alternative suppliers it uses in private sector contracts. However, this may not be possible for defence contractors providing defence material exclusively under public contracts. Defence contractors may have invested heavily in developing a particular supply network e.g. establishing a permanent base in the country of supply, incurring significant costs in obtaining relevant licensing, transfer, export, security and intellectual property agreements, all of which are designed to maintain regular supply and repeat business with a limited number of trusted suppliers and which may be

⁸²⁰ Guidance Note, Security of Supply, 12, point 38, para 2

⁸²¹ See e.g. the UK Defence and Security Public Contracts Regulations 2011, Chapter 13, Subcontracting under the DSPCR (n 810) which states at 4, para 23: “[...] you should consider carefully any action that may alter the successful tenderer’s proposed supply chain and satisfy yourself that action you take is objective and justified. You should also consider the effect on the tender and the timescales for performance recognising that the successful tenderer may have based its tender on a presumption of sourcing work from particular suppliers.”

prejudiced in future if a tenderer is required to use an alternative source. In addition, switching to another supplier may result in increased costs passed on to the prime contractor or Government consumer.⁸²² Long term, strategic relationships across supply networks is therefore a necessary and significant consideration.⁸²³

It is important to recognize that the references in the Guidance do not feature in the terms of Article 23(c) itself. Therefore, contracting authorities should be free to undertake any assessment exclusively according to performance oriented considerations without reference to determinations made on the basis of non-EU sources of supply. However, the above observations expose the extent to which it is possible to differentiate EU and third country supply in a way that results in considerable legal and practical uncertainty. Again, U.S. commentary has not identified Article 23(c) as creating a possibility for discrimination against U.S. contractors.

7.3. Additional Needs in a Crisis

A final set of provisions which have been considered by U.S. commentators are Articles 23(d) and (e) and which provide, respectively, that a contracting authority may require:

[...] a commitment from the tenderer to establish and/or maintain the capacity required to meet additional needs required by the contracting

⁸²² As the UK Defence and Security Public Contracts Regulations 2011, Ch. 13, Subcontracting under the DSPCR (n 810) observes at 6, para 31: “[a]ny attempt by the procurer to alter the tenderer’s subcontract network (or supply chain) may lead to an increase in cost and introduce delays. It may also increase the procurer’s liability.”

⁸²³ Ibid, which observes at 3, para 16 that procurers must consider whether to ask the tenderer at the start of the procedure to provide information on long term strategic relationships in place across potential supply networks that may affect or extend beyond the requirement in question

authority/entity as a result of a crisis, according to terms and conditions to be agreed;

[...] any supporting documentation received from the tenderer's national authorities regarding the fulfillment of additional needs required by the contracting authority/entity as a result of a crisis [.]

From a purely practical perspective, U.S. commentary has argued that these provisions could pose challenges for the U.S. Government because these matters are normally left to case-by-case determination and that the U.S. would probably be unwilling to commit long in advance to ensuring supply in writing.⁸²⁴ Before examining the U.S. claim in more detail, it should be observed that EU commentators have similarly argued that contracting authorities within the EU may be reluctant to provide such documentation.⁸²⁵

7.3.1. Security of Supply “Guarantees” Through Existing Arrangements

U.S. commentary has placed particular emphasis on the purported ability of Member States to provide stronger guarantees of security of supply based on the fact that EU Member States have concluded an international agreement on security of supply

⁸²⁴ *Fortresses and Icebergs*: (Vol. I) (n 12) 223. The Study also identifies a similar issue with regard to Article 23(h) which provides that a contracting authority may require: “[...] a commitment from the tenderer to provide the contracting authority/entity, according to terms and conditions to be agreed, with all specific means necessary for the production of spare parts, components, assemblies and special testing equipment, including technical drawings, licenses and instructions for use, in the event that it is no longer able to provide these supplies.” For guidance on Article 23(h), see Guidance Note, Security of Supply, 16, point 45

⁸²⁵ Heuninckx, ‘Trick or treat’ (n 252) 24 citing at 140 M Bowsher, ‘How to Meet the Security of Supply Criteria and Avoid the Disqualification of your Bid’, presentation at the C5 EU Defence and Security Procurement Conference, Brussels, November 17, 2009

under the Letter of Intent initiative.⁸²⁶ The Guidance Note places a similar emphasis stating that assurances under Articles 23(d) and (e) could typically be based on the Letter of Intent initiative⁸²⁷ and EDA security of supply arrangements.⁸²⁸ In particular, the Guidance identifies that such arrangements could establish prioritisation systems which enable the execution of the requesting State's order before the supplying State can meet its other orders, or alternatively, include "general commitments" to make best efforts to satisfy urgent needs of partners.⁸²⁹

The Letter of Intent Framework Agreement ("Loi-FA") calls, *inter alia*, for the establishment of measures to achieve security of supply, none of which should result in unfair trade practices or discrimination.⁸³⁰ Importantly, Parties must not hinder the supply of defence articles and services to other Parties, and must seek to further simplify and harmonise existing rules and exchange procedures.⁸³¹ Provision is made for Parties to retain key strategic activities, assets and installations on national territory for "national security reasons".⁸³² Reconstitution of facilities, however, must

⁸²⁶ *Fortresses and Icebergs*: (Vol. I) (n12) 223

⁸²⁷ See the Letter of Intent between 6 Defence Ministers on Measures to facilitate the Restructuring of the European Defence Industry signed in London, 6 July 1998. Six Working Groups were established to assess the restructuring of European industries, the findings of which led to a legally binding Framework Agreement ("Loi-FA"). See Framework Agreement between The French Republic, The Federal Republic of Germany, The Italian Republic, The Kingdom of Spain, The Kingdom of Sweden and The United Kingdom of Great Britain and Northern Ireland Concerning Measures to Facilitate the Restructuring and Operation of the European Defence Industry signed during the Farnborough Air Show on 27 July 2000. The Framework Agreement entered into force on 2 October 2003. The objective of the Loi-FA is to facilitate restructuring of the European defence industrial base. The Framework Agreement focuses on the following key areas: (1) security of supply; (2) export procedures; (3) security of classified information; (4) defence related research and technology; (5) treatment of technical information, and (6) harmonization of military requirements. For a discussion of the Loi, see *Fortresses and Icebergs*: (Vol I) (n 12) 185-6

⁸²⁸ Guidance Note, Security of Supply, 14, point 42. See EDA Steering Board Decision No. 2006/17 on Framework Arrangement for Security of Supply Between Subscribing Member States (sMS) in Circumstances of Operational Urgency

⁸²⁹ *ibid*

⁸³⁰ Loi FA (n 827), Articles 4 and 5

⁸³¹ *ibid*, Articles 6.1 and 6.2

⁸³² *ibid* Article 8.1. and 8.2

be a “method of last resort”.⁸³³ In cases of emergency requests, the Parties must immediately consult together to enable priority in ordering, supply reallocation, or modification of existing equipment for a new role.⁸³⁴ The requested Party will ensure timely delivery, and consult with a view to providing, if required, items from its own stocks.⁸³⁵ However, it is important not to place excessive emphasis on the Lol FA. The Lol FA is not applicable between all EU Member States. Further, its initiatives have not been significantly developed.

In 2007, the EDA approved a framework arrangement on security of supply in circumstances of operational urgency.⁸³⁶ According to this arrangement, subscribing Member States (“sMS”) agreed that they will do everything possible, consistent with national law and international obligations to assist and expedite each others’ contracted defence requirements, particularly in circumstances of pressing operational urgency, and to work to increase the level of mutual confidence amongst themselves, in particular, by improving the predictability of their policies.⁸³⁷ If, in times of emergency, crisis or armed conflict, a sMS requests defence goods or services from other sMS, they will engage in immediate consultation with the aim of ensuring that the need is met as expeditiously as possible.⁸³⁸ In addition to taking all possible steps to expedite its administrative processes, each sMS will also, if so requested, engage with suppliers on its territory to help ensure that an appropriate priority is given to the needs of the requesting sMS, and will consider, “urgently and

⁸³³ *ibid*

⁸³⁴ Articles 10.2(a) and (b). By contrast, Article 10.1 provides that the Parties agree that prioritisation of supplies in peace time will be according to schedules negotiated under normal commercial practices

⁸³⁵ *ibid*, Articles 10.2(a), (b), (c) and 11.1

⁸³⁶ EDA Steering Board Decision on a Framework Arrangement for Security of Supply (n 828)

⁸³⁷ *ibid* 1

⁸³⁸ *ibid*. 1-2

sympathetically” any request for provision of defence goods from its own stocks, mainly on a re-imburement basis.⁸³⁹

However, this document is just over 1 page in length. The provisions are generic and compliance is dependent on the good faith of the SMS. Even though they clearly constitute an attempt to foster EU-wide security of supply, it remains to be seen how they will be implemented.⁸⁴⁰ Moreover, these provisions only concern “short-term” security of supply in case of urgent operational need. It has been argued that this is relatively uncontroversial, as any SMS would ordinarily recognise in principle that they should provide support in these cases.⁸⁴¹ However, a key issue with this form of security of supply concerns practical priorities: if such instance arises, many, if not all, SMS are likely to be involved in urgent operations simultaneously, therefore imposing conflicting demands on the defence industry.⁸⁴² It has been observed that no generic arrangement can satisfactorily resolve the allocation of scarce resources to multiple customers.⁸⁴³

More recently, in 2011, the EDA launched a designated Portal on Security of Supply.⁸⁴⁴ The Portal is designed to publish Member State policies, procedures and priorities connected to security of supply. However, at the time of writing, Member

⁸³⁹ *ibid*

⁸⁴⁰ See Heuninckx, ‘Towards a coherent European defence procurement regime?’ (n 85) who observes at 14 that it is unclear, for instance, how this commitment would be applied, if at all, in situations where some SMS participate in an operation that other SMS oppose (e.g. the second Iraq war)

⁸⁴¹ *ibid*

⁸⁴² *ibid*. See also Heuninckx, ‘Trick or treat’ (n 252) who states at 24: “[e]ven from a strategic security of supply point of view, it is unclear what could be done if the supply chain would be disturbed by an embargo, which is something that is not only possible when the contractor is from a non-European State, but also something that EU Member States could enforce against each other on the basis of art.346 TFEU. In case of a conflict or an embargo, it is likely that the contractor could claim *force majeure*, and any security of supply provision would become ineffective.”

⁸⁴³ *ibid*

⁸⁴⁴ The portal is operational and can be found at <<http://www.eda.europa.eu/sosweb/>> accessed 20 September 2013

States have only provided very basic, partial or no information.⁸⁴⁵ Entries by certain Member States provide a clear indication that security of supply continues to present a significant issue even between EU Member States. In particular, France has indicated that whilst the ICT Directive is a step in the right direction towards improving security of supply, to reach the goal of transnational long-term security of supply, a harmonised quality of control of foreign investment in the defence industry appears as a prerequisite.⁸⁴⁶ In any event, the Portal also identifies that in addition to any existing NATO/NAMSA arrangements which include security of supply elements, certain Member States have concluded bilateral security of supply arrangements with the U.S. and include Italy⁸⁴⁷ and Sweden.⁸⁴⁸ Further, as will be discussed in Part II, the RDPs concluded between the U.S. and certain EU Member States also include specific provision on security of supply. Thus, to the extent that any meaningful emphasis can be placed on security of supply arrangements, the U.S. is able to demonstrate broadly equivalent assurances.

7.3.2. Control Exercised by Contractors over Security of Supply

A pertinent but recurring observation of this Chapter is the fundamental fact that there are demonstrable limits to a tenderer's ability to provide any guarantee in satisfaction of any security of supply obligation. This inherent limitation substantially

⁸⁴⁵ Member States which have not yet provided any published information are: Bulgaria, Cyprus, Estonia, Greece, Hungary, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Romania, Slovenia and Sweden

⁸⁴⁶ France states categorically that no member state will ever accept mutual dependencies if defence companies located in another Member State it relies upon are not adequately protected from foreign take over that could jeopardise its security of supply. See <<http://www.eda.europa.eu/sosweb/France.aspx>> accessed 20 September 2013

⁸⁴⁷ Memorandum of Understanding between the Ministry of Defence of Italy and the Department of Defense of the United States of America for Meeting National Defense Requirements – Security of Supply, 2006

⁸⁴⁸ Memorandum of Understanding between the Government of the United States of America and the Government of the Kingdom of Sweden Relating to the Principles Governing Mutual Cooperation in the Defence Procurement Area 2003

qualifies any comparative advantage which is said to accrue to EU economic operators.

Firstly, it has been argued that it is questionable how practically enforceable the security of supply provisions of the Defence Procurement Directive could be because they only represent the intent of the tenderer at the time of tender, and more importantly, only on the basis of available evidence.⁸⁴⁹ Prior to the adoption of the Defence Directives it had been argued that certain security of supply requirements are simply beyond the economic operator's sphere of control (whether European or third country) because of external factors such as the refusal of an export licence from the government of the country of origin, for example.⁸⁵⁰ On this view, the only suppliers which arguably can guarantee security of supply are domestic suppliers.⁸⁵¹ For this reason, it had been argued that parameters such as security of supply could not form a basis of assessment under the most economically advantageous tender principle under a revised Public Sector Directive.⁸⁵²

7.3.3. Limitations of the ICT Directive

The preceding sections have cautioned against overstating the possible impact of the ICT Directive with regard to third countries. In addition to the limitations already identified, as the Guidance Note itself acknowledges, requirements under Articles 23(d) and (e) are limited by licensing obligations of suppliers from other Member

⁸⁴⁹ Heuninckx, 'Trick or treat' (n 252) 24

⁸⁵⁰ Georgopoulos, 'European Defence Procurement Integration: Proposals for Action within the European Union' (n 75) 101

⁸⁵¹ *ibid*, 102

⁸⁵² *ibid*

States.⁸⁵³ In particular, a tenderer may not be required to obtain a commitment from a Member State that would prejudice its freedom to apply its national export, transfer or transit licensing criteria in accordance with relevant international or EU law.⁸⁵⁴

It has been argued that whilst the ICT Directive represents a first step towards ensuring greater security of supply, the only instrument that would help ensure security of supply within the EU sufficient to substantiate such assurances would be a binding commitment of EU Member States not to prevent the transfer of defence and security supplies and services within the EU under any circumstances.⁸⁵⁵ As indicated above, the existing Lol-FA and EDA initiatives are not sufficient in this regard.

In light of the above, it is suggested that U.S. is not placed at a comparative disadvantage with regard to the commitments under Article 23(d) and (e).

8. Conclusions

This Chapter has sought to provide a balanced analysis of U.S. claims concerning the latent discriminatory potential of the Directive's security of supply provisions. It is recalled that U.S. legal commentary has warned of the potential need for a more critical approach to the definition of security of supply requirements. Any comparison would need to take account of fundamental similarities and differences in the

⁸⁵³ Guidance Note, Security of Supply, 15, point 42, para 2

⁸⁵⁴ Article 23, para 3 and Guidance Note, Security of Supply, 15, point 42, para 2

⁸⁵⁵ Heuninckx, 'Trick or treat' (n 252) 25

conceptualization of security of supply, the core interests which may be protected by such notions and their function, all of which impact on their definition. Security of supply is a key consideration in instruments regulating defence procurement. To this extent, it is important to emphasise the overriding point that, irrespective of claims regarding the discriminatory potential of security of supply provisions, there is a basis for constructive transatlantic engagement on fundamental issues of definition, scope and function.

With regard to claims concerning the Directive's potential to discriminate against the U.S., this Chapter has identified the possible bases on which the Directive could be utilized to exclude third countries at the point of qualitative selection, in particular, in consideration of the organization and location of an economic operator's supply chain. However, a rational assessment of Articles 39(2)(e) and 42(1)(h) questioned the extent to which the provisions are likely to discriminate against U.S. contractors, in particular, U.S. subcontractors.

Further, focusing specifically on U.S. claims in relation to Articles 23(a), (b), (d) and (e), the preceding analysis has sought to place the Directive's provisions in their wider context. Firstly, it has acknowledged the role which ITAR has played even to the extent of purportedly informing the basis for the adoption of the ICT Directive. However, the reality is that the Defence Procurement Directive's provisions on security of supply are limited. U.S. claims have to draw on the alleged cumulative impact of the Defence Procurement and ICT Directives in order to substantiate the notion that EU bids will likely be rendered more "secure". This Chapter has questioned a number of underlying assumptions regarding the ICT Directive and

other security of supply arrangements in this regard. It has also sought to provide a balanced assessment of the extent to which ITAR is likely to constitute a discriminatory, as opposed to discriminating, factor in EU defence procurement based on the findings of existing studies. The reality is that on either view, it is not clear to what extent ITAR is, or will likely become, a decisive factor in contract awards.

The Chapter has even gone beyond U.S. claims and addressed the discriminatory potential of other references to third countries. However, these references are arguably more significant for the fact that they reveal a state of uncertainty on the EU legislator's part regarding appropriate regulatory approaches to third countries in the field of defence procurement.

The reality is that it is important to differentiate the nuances of legal interpretation (which are themselves based on interpretative Guidance Notes which are not legally binding interpretations of EU law) from the effect of legal institutions in practice. The above analysis would be fundamentally inaccurate were it to fail to recognize the limitations of precisely what is known about how such legal requirements are likely to be utilized by contracting authorities to engineer a particular outcome or their effects on economic operators. This absence is compounded when the limited empirical evidence available is used by official sources as a predictor of behaviour in an unprecedented regulatory climate. This creates a risk of drawing specific conclusions based on generalised and incomplete understandings of perceived trends.

Fundamentally, the most accurate observation to make is the simplest: the provisions of the Defence Procurement Directive are not such that would necessarily lead contracting authorities to place greater or lesser emphasis on U.S. sources in their procurement decisions than they had prior to the Directive's adoption.

However, U.S. claims about the Directive's potentially discriminatory application cannot simply be ignored. As indicated, an important question is whether, irrespective of the Directive's ostensible neutrality with regard to third countries, the Directive takes adequate account of third country considerations necessary to ensure legal certainty, in particular, given the realities of an increasingly globalised defence procurement practice. Whilst official publications emphasise the absence of direct impact on third countries, the Directive cannot operate in a vacuum. It should not be overlooked that the Directive contains specific references to third countries which are clearly intended to enable a formal *prima facie* distinction to be drawn between EU and third country economic operators. This Chapter has raised questions about the legitimacy and propriety of these references and the extent to which any differences are justifiably emphasized as well as their potential effects.

Ultimately, the Directive is intended to be an instrument of EU defence procurement liberalization as opposed to one of transatlantic defence procurement liberalisation. However, the former is integral to the latter. The Directive also operates alongside historically preceding bilateral transatlantic defence procurement relations between the U.S. and individual Member States. To this extent, consistent with the observations of the preceding Chapters, there is a need to concurrently monitor the

Directive's application to economic operators where decision-making includes third country considerations.

This thesis now turns to examine the technical specifications provisions under the Defence Procurement Directive.

6

Technical Standards and Specifications

1. Introduction

Standards and specifications can act as barriers in public procurement contracts in a number of ways. For instance, contracting authorities may use apparently differing systems of standards and specifications as an excuse for the disqualification of tenderers.⁸⁵⁶ Standardisation and specification requirements can also be restrictively defined in order to exclude products or services of a particular origin, or to limit the field of competition amongst tenderers.⁸⁵⁷

As this Chapter will discuss, the Defence Procurement Directive contains specific provisions on technical specifications which broadly correspond with those contained in the Public Sector Directive. However, U.S. commentary has identified that whilst on their face these provisions do not mandate discrimination against U.S. contractors, there is a risk that they could become an intended or unintended “disguised market access barrier”.⁸⁵⁸ This Chapter begins with a discussion of technical standards and specifications within the broader scheme of defence standardisation initiatives. It then proceeds to examine U.S. claims in detail.

⁸⁵⁶ See C H Bovis, *EU Public Procurement Law* (n 171) 124-5

⁸⁵⁷ *ibid* 125

⁸⁵⁸ *Fortresses and Icebergs: (Vol I)* (n 12) 225

2. Background and Recent Initiatives

It is important to clarify at the outset the difference between technical “standards” and “technical specifications”. A standard may be defined as a technical specification approved by a recognised standardisation body for repeated or continuous application.⁸⁵⁹ A “technical specification” is a document defining the required characteristics of a product or service, such as quality, performance, use, production method and procedure.⁸⁶⁰ Therefore, it is possible for a contracting authority to draw up a technical specification which relies on a particular standard as an indicator of quality or performance.

2.1. European Standardization Organisations

Regulation 1025/2012 provides the legal basis for standardization within the EU.⁸⁶¹

There are three main civil standardization organizations in operation at the EU level.

The first is the European Committee for Standardisation (“CEN”).⁸⁶² The second is

⁸⁵⁹ Annex II(2) Defence Procurement Directive defines a “Standard” as: “a technical specification approved by a recognised standardisation body for repeated or continuous application, compliance with which is not compulsory, from one of the following categories: — international standard: a standard adopted by an international standards organisation and made available to the general public, — European standard: a standard adopted by a European standardisation body and made available to the general public, — national standard: a standard adopted by a national standards organisation and made available to the general public [...]”

⁸⁶⁰ A more comprehensive definition is provided in Annex III to the Defence Procurement Directive. Annex III(1)(a) and (b) differentiate between technical specifications in the case of works contracts and supply and service contracts, respectively. With regard to supply contracts, “technical specification” is defined as: “a specification in a document defining the required characteristics of a product or service, such as quality and environmental performance levels, design for all requirements (including accessibility for people with disabilities), and conformity-assessment, performance, use of the product, its safety or dimensions, including requirements relevant to the product as regards the name under which the product is sold, terminology, symbols, testing and test methods, packaging, marking and labeling, user instructions, production methods and procedures, as well as conformity assessment procedures[...]”.

⁸⁶¹ Regulation (EU) No 1025/2012 of the European Parliament and of the Council of 25 October 2012 of 25 October 2012 on European standardisation, amending Council Directives 89/686/EEC and 93/15/EEC and Directives 94/9/EC, 94/25/EC, 95/16/EC, 97/23/EC, 98/34/EC, 2004/22/EC, 2007/23/EC, 2009/23/EC and 2009/105/EC of the European Parliament and of the Council and repealing Council Decision 87/95/EEC and Decision No 1673/2006/EC of the European Parliament and of the Council, L 316/12

⁸⁶² Information on CEN is available at: <<https://www.cen.eu/cen/pages/default.aspx>> accessed 20 September 2013

the European Committee for Electrotechnical Standardisation (“CENELEC”).⁸⁶³ The third is the European Telecommunications Standards Institute (“ETSI”).⁸⁶⁴ Most standards are prepared at the request of industry. The European Commission can also request the standards bodies to prepare standards. With the move towards the greater use of civil standards in defence procurement, stakeholders now seek to influence the initiation and development of civil standards.⁸⁶⁵ With specific regard to defence standardisation, in 2007, the EDA established the European Defence Standardization System (“EDSIS”).⁸⁶⁶ EDSIS’ primary function is to enable EDA pMS and industry to advertise defence material standards which are currently in development or modification.⁸⁶⁷ Its stated objective is to contribute to the reduction in dependency on use of national defence standards.⁸⁶⁸

2.2. North Atlantic Treaty Organisation Standards

NATO also creates military standards in support of its missions. These standards are ordinarily known as standardization agreements (“STANAGs”) and Allied Publications (“APs”) but also include designations such as Multinational Publications (“MPs”). These are produced in three domains: (1) “operations”; (2) “materiel” and (3)

⁸⁶³ Information on CENELEC is available at: <<http://www.cenelec.eu>> accessed 20 September 2013

⁸⁶⁴ Information on ETSI is available at: <<http://www.etsi.org/standards>> September 2013

⁸⁶⁵ EDA (Commissioned) ‘Study into the Role of European Industry in the Development and Application of Standards’, July 2009, EDA ref. 08-ARM-003, 58
<http://www.eda.europa.eu/docs/documents/Study_into_the_Role_of_European_Industry_in_the_development_and_Application_of_Standards.pdf> accessed 20 September 2013

⁸⁶⁶ Information on EDSIS can be found at: <<http://www.eda.europa.eu/edsisweb/Default.aspx>> accessed 20 September 2013.

⁸⁶⁷ Information on EDSIS’ main functions can be found at: <<http://www.eda.europa.eu/edsisweb/Introduction.aspx>> accessed 20 September 2013

⁸⁶⁸ For a discussion of EDSIS within the wider development of EDA standardization initiatives see, EDA, ‘All at sea? Standardization explained’ European Defence Standardization Journal, Autumn 2007, available for download at: <http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=0CDEQFjAB&url=http%3A%2F%2Fwww.eda.europa.eu%2Fedsisweb%2FFileView.aspx%3Fid%3D157&ei=GhM_Up7nBlaW0QW0h4DoDA&usq=AFQjCNEJZiiwaytzX-74SrKRwl9u51t9PQ&bvm=bv.52434380.d.d2k> accessed 20 September 2013

publications in support of administrative matters of the Alliance.⁸⁶⁹ The production of NATO standards is guided by principles specified in the NATO Policy for Standardization.⁸⁷⁰ Approximately 1700 STANAGs and 500 APs are listed in a dedicated database, the “NATO Standardisation Documents Database”, an information technology tool that is administered by the NATO Standardization Agency (“NSA”).⁸⁷¹

2.3. Use of Technical Standards and Specifications in Practice

The issue of co-ordinated standardisation has consistently been identified alongside procurement and Intra-EU transfers as a priority for the development of an EU defence market.⁸⁷² Yet, whilst official EU publications have sought to particularise issues confronting procurement and transfers of defence material in practice, there has only been a limited focus on the discrete effects of defence standards. The Impact Assessment accompanying the proposal to the Defence Procurement Directive provides a limited insight in this regard. A particular issue identified has concerned the general availability and proliferation of standards which project managers face when selecting and setting out technical specifications in contract documents.⁸⁷³ As will be discussed below, these standards can include, *inter alia*, national civil standards, national civil standards which incorporate European

⁸⁶⁹ For more information see P-L Bertrand, J0-L Laqua and C Urbanovsky, ‘Shifting the NATO Standardization Documents Development Paradigm or Revising the AAP-03’, 13 in European Defence Standardization Journal, Issue 2, 2009. Available for download from http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CCgQFjAA&url=http%3A%2F%2Fwww.eda.europa.eu%2Fedsisweb%2FfileView.aspx%3Fid%3D161&ei=5hE_Up33O6fO0QWv8YG4Cg&usg=AFQjCNFeLV0aSIRV2sVTBoOOropKBAC89w accessed 20 September 2013

⁸⁷⁰ *ibid*

⁸⁷¹ *ibid*

⁸⁷² See for example, Commission, ‘European Defence – Industrial and Market Issues, Towards an EU Defence Equipment Policy’ (n 231) 3

⁸⁷³ Impact Assessment, ‘Annex to the Proposal for a Defence and Security Procurement Directive’ (n 123) 20

standards, international civil standards, national defence standards and international defence standards. A prominent example of the latter includes the NATO “STANAG” identified above which define minimal common requirements in order to guarantee interoperability between armed forces.⁸⁷⁴ As a result, Member States have often developed hierarchies of standards which vary from one Member State to another.⁸⁷⁵ According to the Impact Assessment, in defence procurement, European civil standards are generally the first choice followed by a defence standard which is generally mentioned only when no equivalent civil standard exists.⁸⁷⁶ However, the Impact Assessment also identifies that other Member States consider defence standards to have priority.⁸⁷⁷

EU commissioned studies have provided a more detailed insight into their use in practice. According to an EDA commissioned Study into the Role of European Industry in the Development and Application of Standards, issues identified included, *inter alia*, the use of inappropriate standards, referencing obsolete standards, and the use of defence standards where civil standards would provide better procurement management and value for money.⁸⁷⁸ Whilst the Study indicated a lack of industry willingness to elaborate on problems encountered with standards during invitations to tender and negotiations, it found on the basis of the limited evidence available, that industry does not experience direct problems with standards in the tender and pre-

⁸⁷⁴ Ibid

⁸⁷⁵ Ibid

⁸⁷⁶ Ibid. 21. According to the Impact Assessment, some take up the hierarchy set up in EC law, even when applying Article 296 TEC

⁸⁷⁷ Ibid

⁸⁷⁸ ‘Study into the Role of European Industry in the Development and Application of Standards’ (n 865) 91. This study was preceded by a significant study commissioned by the European Commission (EC DG III – Enterprise) in 1998 entitled ‘On the Standardisation Systems in the Defence Industries in the European Union (EU) Member States and the USA’ led by the University of Sussex and often referred to as the “Sussex Study”

contractual phases; rather the principal issue concerns the selection process of the right standards for a specific procurement venture.⁸⁷⁹

In response to general issues regarding the proliferation of standards, the EU has sought to centralize standardization efforts. In its 2003 Communication, the Commission identified the development of a European Defence Standardisation Handbook containing common references to standards and standard-like specifications commonly used to support defence procurement contracts as well as guidelines on the optimum selection of such standards.⁸⁸⁰ The Handbook was titled the 'European Handbook on Defence Procurement' ("EHDP") and took the form of a database. On its handover from the Commission to the EDA in 2011, the Handbook was renamed the European Defence Standards Reference System ("EDSTAR").⁸⁸¹ As a result, an increasingly coordinated European approach to standardization has emerged over the last decade. As will be discussed in Section 5 below, a primary focus is on ensuring compatibility and comparability with standardization processes in NATO.

3. Specifications under the Defence Procurement Directive

Article 18 Defence Procurement Directive contains the relevant provisions on technical specifications.⁸⁸² Article 18 broadly corresponds with the provision in the

⁸⁷⁹ 'Study into the Role of European Industry in the Development and Application of Standards' (n 865) 91-2

⁸⁸⁰ Commission, 'European Defence – Industrial and Market Issues, Towards an EU Defence Equipment Policy' (n 231) 13

⁸⁸¹ For more information, see < <http://www.eda.europa.eu/EDSTAR/home/history.aspx>> accessed 20 September 2013

⁸⁸² For a general discussion of technical specifications under the Defence Procurement Directive, see M Trybus, 'The tailor-made EU Defence and Security Procurement Directive', (n 125) 21-22

Public Sector Directive with minor additions that will be discussed below.⁸⁸³ This may explain why DG Internal Market and Services has not published a specific Guidance Note in contrast to other key aspects of the Directive.

The Directive provides that technical specifications must be set out in the contract documentation.⁸⁸⁴ Similar to the Public Sector Directive provisions, the technical specification provisions are prefaced by the broad obligation to ensure that they must afford equal access for tenderers and must not have the effect of creating “unjustified obstacles to the opening up of procurement to competition”.⁸⁸⁵

Article 18 requires that technical specifications must be drawn up using one of four prescribed methods.⁸⁸⁶

3.1. Method 1: Technical Specifications by Reference to an “Order of Preference”

The first option is to draw up technical specifications in order of preference to: (i) national civil standards transposing European standards;⁸⁸⁷ (ii) European technical approvals;⁸⁸⁸ (iii) common civil technical specifications;⁸⁸⁹ (iv) national civil standards

⁸⁸³ See Article 23 Public Sector Directive. For general commentary on the Public Sector Directive provisions, see Arrowsmith, *The Law of Public and Utilities Procurement* (n 119) Ch 17; S Arrowsmith and P Kunzlik, ‘EC Regulation of Public Procurement’ in Arrowsmith and Kunzlik (eds), *Social and Environmental Policies in EC Procurement Law: New Directives and New Directions* (CUP 2009) 59- 67; P A Trepte, *Public Procurement in the European Union* (OUP 2007) 272-292; C H Bovis, *EC Public Procurement: Case Law and Regulation* (OUP 2006) 397–399

⁸⁸⁴ Contract documentation includes contract notices, contract documents, descriptive documents or supporting documents. See Recital 39 and Article 18(1)

⁸⁸⁵ Article 18(2). See Article 23(2) Public Sector Directive

⁸⁸⁶ See Article 18(3)(a)-(d)

⁸⁸⁷ Annex III(2) defines a national standard as: “a standard adopted by a national standards organisation and made available to the general public [.]”

⁸⁸⁸ Annex III(4) defines a ‘European technical approval’ as: “a favourable technical assessment of the fitness for use of a product for a specific purpose, based on fulfillment of the essential requirements for building works, by means of the inherent characteristics of the product and the defined conditions of application and use. European technical approvals are issued by an approval body designated for this purpose by the Member State [.]”

transposing international standards;⁸⁹⁰ (v) other international civil standards; (vi) other technical reference systems⁸⁹¹ established by the European standardisation bodies, or, where these do not exist, other national civil standards, national technical approvals or national technical specifications relating to the design, calculation and execution of the works and use of the products; (vii) civil technical specifications stemming from industry and widely recognised by it⁸⁹² or (viii) the national 'defence standards'⁸⁹³ and defence materiel specifications similar to those standards.⁸⁹⁴

It is observed that the Defence Procurement Directive adds defence standards to the preference list. Prior to the adoption of the Directive, it was observed that it seemed that the Public Sector Directive did not offer a sufficient degree of flexibility in procurement because of its exclusive focus on civil standards.⁸⁹⁵ The significance of this addition will be discussed below.

⁸⁸⁹ Annex III(5) defines a 'Common technical specification' as: "a technical specification laid down in accordance with a procedure recognised by Member States which has been published in the Official Journal of the European Union [.]"

⁸⁹⁰ Annex III(2) defines an 'International standard' as: "a standard adopted by an international standards organisation and made available to the general public [.]"

⁸⁹¹ Annex III(6) defines a 'Technical reference' as: "any product produced by European standardisation bodies, other than official standards, according to procedures adapted to developments in market needs."

⁸⁹² This may include, for example, ASD-Stan (Aerospace Defence Standards), Institution of Engineering Technology (IET) standards, Institute of Electrical and Electronics Engineers (IEEE) standards

⁸⁹³ Annex III(3) defines a 'Defence standard' as: "a technical specification the observance of which is not compulsory and which is approved by a standardisation body specialising in the production of technical specifications for repeated or continuous application in the field of defence [.]"

⁸⁹⁴ Article 18(3)(a)

⁸⁹⁵ For instance, the Public Sector Directive replicated the definition contained in Council Directive 98/34/EC of 22 June 1998 laying down a procedure for the provision of information in the field of technical standards and regulations and of rules on Information Society services [1998] OJ L204/37, as amended which recognized only civil standards developed by the (civil) standardizing bodies listed in the Annex of Directive 98/34/EC. See Impact Assessment, 'Annex to the Proposal for a Defence and Security Procurement Directive' (n 123) 17, fn 30

3.2. Method 2: Technical Specifications by Reference to Performance/Function

The second option available under the Directive is to draw up technical specifications through performance or functional requirements.⁸⁹⁶

3.3. Method 3: Performance/Function with Reference to the Order of Preference

The third option allows for technical specifications to be drawn up in performance or functional terms (as in method 2) with reference to the specifications identified in the order of preference as a means of presuming conformity with such performance or functional requirements.⁸⁹⁷

3.4. Method 4: Order of Preference and Performance/Function for Certain Characteristics

The fourth option is to draw up technical specifications by reference to the specifications mentioned in the order of preference for certain characteristics, and by reference to the performance or functional requirements for other characteristics.⁸⁹⁸

4. Application of Specifications in Relation to Third Countries

U.S. observers have identified that the Directive's technical specifications provisions have raised concern among industry and non-European government stakeholders.⁸⁹⁹

⁸⁹⁶ Article 18(3)(b)

⁸⁹⁷ Article 18(3)(c)

⁸⁹⁸ Article 18(3)(d)

Specifically, it has been suggested that contractual requirements to meet specific technical standards could operate to discriminate against U.S. contractors.⁹⁰⁰ U.S. commentary has gone even further and claimed that any preference may discriminate against U.S. products built around non-European and non-international standards.⁹⁰¹ It is therefore necessary to examine these claims in more detail.

4.1. An “Order of Preference” Based on a “Hierarchy of Standards”

It is recalled that Article 18 provides for the possibility to draw up technical specifications “in order of preference”. U.S. commentary suggests that this creates a “hierarchy of standards” which appears to prioritise European approved standards and which could lead to an “intentional or unintentional disguised U.S. trade barrier”.⁹⁰²

However, a number of observations counter claims regarding the possible effect of any such “hierarchy”. Firstly, it presumes that Member States will develop uniform practices in the selection of European standards. Yet, it has been observed that whilst Member States have developed hierarchies in response to the proliferation of standards, there is still no common practice in the way that Member States set out specifications and resort to standards and that hierarchies vary significantly from one Member State to another.⁹⁰³ Secondly, one U.S. official has identified that a general

⁸⁹⁹ I Maelcamp, ‘EU Defense Procurement Directive: 27 Teams Under One League?’ Defense Standardization Program Journal, October/December 2011, 21
<http://www.dsp.dla.mil/APP_UIL/content/newsletters/journal/DSPJ-10-11.pdf> accessed 20 September 2013

⁹⁰⁰ *Fortresses and Icebergs*: (Vol I) (n 12) 225

⁹⁰¹ C Yukins, ‘The European Defense Procurement Directive: An American Perspective’ (n 311) 6

⁹⁰² *Fortresses and Icebergs*: (Vol I) (n 12) 225

⁹⁰³ Impact Assessment, ‘Annex to the Proposal for a Defence and Security Procurement Directive’ (n 123) 20; ‘Study into the Role of European Industry in the Development and Application of Standards’ (n 865) 42

“link” to origin is apparent in the order of preference and which may seem an apparent contradiction to the NATO Framework for Civil Standards.⁹⁰⁴ The latter emphasises the focus of the selection of civil standards according to availability, accessibility, effectiveness, relevance, market acceptance and technical excellence as opposed to their region of origin.⁹⁰⁵ However, as the same observer identifies, the order of preference under the Directive has not been specifically designed for the defence sector, having been derived from the Public Sector Directive which substantially uses the same language.⁹⁰⁶ To this extent, the Defence Procurement Directive does not intend to institute a qualitative change.⁹⁰⁷ Thirdly, as indicated above, a technical specification cannot refer to a specific origin with the effect of favouring or eliminating certain undertakings or certain products.⁹⁰⁸

Finally, it is possible to question the extent to which origin is, itself, a decisive factor in determining technical specifications. According to the EDA commissioned study on the Role of European Industry in the Development and Application of Standards, a particular criticism identified by industry is that most tenders and defence projects include too many standards from different origins.⁹⁰⁹ Therefore, it may be suggested that contracting authorities may often use standards indiscriminately irrespective of origin. The choice to adopt hierarchies may be a response to a proliferation of standards. However, this does not necessarily equate to a hierarchy predicated on origin but rather may simply be a result of practical necessity.

⁹⁰⁴ I Maelcamp, ‘EU Defense Procurement Directive: 27 Teams Under One League?’ (n 899) 24

⁹⁰⁵ *ibid*

⁹⁰⁶ *ibid.* See Article 23(a) Public Sector Directive

⁹⁰⁷ Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’ (n 125) 22

⁹⁰⁸ Article 18(8)

⁹⁰⁹ ‘Study into the Role of European Industry in the Development and Application of Standards’ (865) 91

On the issue of practicality, a broader question is whether, in fact, it is appropriate for the EU legislator to identify an order of preference that prioritises national civil standards transposing European standards. It had been argued two decades ago in relation to the Public Sector Directive provisions that in light of the absence of a common external policy in the public procurement Directives, the emphasis on European standardization is defensible; since the Directives only apply to tenders submitted by undertakings established within the EU, a preference for international standardization would be “rather surprising” in that it would almost amount to “an official declaration of lack of confidence in the work done by the European standardization bodies”.⁹¹⁰ However, it is observed that this is defensible only to the extent that the European standard would be technically more suited than any other standard.

4.2. Choice between Order of Preference or Performance or Function

Another basis on which it is possible to limit recourse to a hierarchy of standards based on origin is through the exercise of the option to draw up technical specifications according to performance or function. It is becoming an increasingly standard feature of defence procurement practice to determine specifications based on the use of functional or performance requirements.⁹¹¹ For instance, it may be difficult for new market entrants to acquire an understanding of, and access to, the range of available standards without extensive experience. In addition, unlike pre-determined specifications, performance and function-based requirements may be

⁹¹⁰ Eeckhout, *The European Internal Market and International Trade: A Legal Analysis* (n 477) 324

⁹¹¹ Interestingly, whilst the Directive does not specify a preferred method of drawing up specifications, Recital 38 identifies establishment of technical specifications on the basis of performance and functional requirements before it identifies reference to the use of standards

more transparent. According to the study on the Role of European Industry in the Development and Application of Standards, a number of EDA participating Member States have taken to the “doctrine” that requirements should be specified in performance terms rather than in a prescriptive manner.⁹¹² Indeed, the Study also observes that “romancing the performance based standard” has become a world-wide trend.⁹¹³

However, the same Study has also identified the limits of what is known about the use of performance and functional requirements and highlighted certain views that performance based contracting can, in some respects, be as problematic (if not more so) than simply identifying the standard or specification at the outset.⁹¹⁴ Further, researchers have yet to subject performance-based standards to close empirical scrutiny.⁹¹⁵ In addition, the Study has identified that the use of performance-based standards has remained less frequent than might be expected.⁹¹⁶ Most standards will specify particular behaviours, technologies, procedures or processes rather than setting a wider and more “esoteric” performance target which provides industry with the necessary flexibility to meet the designated objective.⁹¹⁷ To this extent, the Study

⁹¹² ‘Study into the Role of European Industry in the Development and Application of Standards’ (n 865) 109. Similarly, the EDA Code of Conduct on Defence Procurement, 3 has also emphasised the formulation of specifications according to function and performance, as far as possible

⁹¹³ ‘Study into the Role of European Industry in the Development and Application of Standards’ (n 865) 116

⁹¹⁴ *ibid* 109 and 119-125

⁹¹⁵ *ibid*

⁹¹⁶ *ibid*

⁹¹⁷ *ibid*. The Study states at 116-117: “[t]here may be good reasons why public and private regulators alike and at all levels – national, regional and international – do not rely more extensively on performance targets: [p]erformance-based standards depend on the ability of the responsible “organisations/agencies” to specify, measure, and monitor performance, but reliable and appropriate information about performance may sometimes be difficult if not impossible to obtain [...] When implemented in the wrong way, or under the wrong conditions, performance-based standards will function poorly, as will any regulatory instrument that is ineffectually deployed.” For a specific discussion of issues arising with regard to their use in the defence context, see the Study’s findings at 118-121

expresses caution that general claims about the advantages and disadvantages of performance based standards need to be assessed concretely.⁹¹⁸

Further, the Impact Assessment on the Defence Procurement Directive indicated that stakeholders consistently identified the technological intricacies of defence equipment which make it difficult for procurement authorities to ‘translate’ at the outset a functional requirement into a detailed specification as a reason for the need for flexible procedures.⁹¹⁹ It was suggested that the standard procedures of the Public Sector Directive (the open and restricted procedures) are based on an assumption that the contracting authority is able to specify from the outset all technical specifications.⁹²⁰ Both procedures require finalised technical specifications when the contract is advertised and prohibit negotiations.⁹²¹ However, the flexibility introduced by the procedures under the Defence Procurement Directive, in particular, default use of the negotiated procedure with publication may reduce the practical importance of technical specifications as a means to discriminate against tenders. Therefore, it must be acknowledged that there continues to be limited evidence regarding the extent to which the use of performance and functional requirements may be utilised to discriminate against foreign contractors.

4.3. National Defence Standards

As indicated, the Defence Procurement Directive provides for the possibility to select national defence standards and defence materiel specifications. It has been

⁹¹⁸ *ibid* 119

⁹¹⁹ Impact Assessment, ‘Annex to the Proposal for a Defence and Security Procurement Directive’ (n 123) 15

⁹²⁰ *ibid*, 16

⁹²¹ Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’, (n 125) 18

suggested that if such standards are set arbitrarily, they could potentially be used as non-tariff barriers to protect domestic producers.⁹²²

However, again it is possible to question the extent to which such standards are prevalent in defence procurement practice in preference to civil standards. It has been identified that there is an increasing emphasis on the use of civil standards in defence procurement within the EU.⁹²³ This is reflected in the order of preference. A similar emphasis has been placed on the use of international standards. As will be discussed in Chapter 9, Section 3.2, this trend is also apparent in the U.S with increasing recourse to the use of civil standards and performance and function-based specifications in preference to military standards and specifications.

Nevertheless, it will always be necessary for certain items to be developed according to defence standards and specifications. To this extent, it has been observed that defence standards are not and will not be redundant in future.⁹²⁴

Importantly, the Fortresses and Icebergs Study indicated that it did not identify any specific problems or discriminatory treatment faced by foreign defence firms with respect to technical standards, in contrast to the foreign defence firms entering the U.S. market.⁹²⁵

⁹²² *Fortresses and Icebergs*: (Vol I) (n 12) 118

⁹²³ According to the 'Study into the Role of European Industry in the Development and Application of Standards' (n 865) 83-84, depending on the sector of activity, the percentage use of civil standards can be as high as 90% for naval projects, approximately 75% in aeronautics and aerospace and about 70% in the land sector

⁹²⁴ *ibid*, 88

⁹²⁵ *ibid*, 119. For a discussion in this regard, see Chapter 9, Section 3.2

In light of the above, national defence standards are unlikely to constitute a significant basis for discriminating against U.S. contractors to any greater extent than they would discriminate against EU economic operators.

4.4. Equivalence and Interoperability

It is submitted that U.S. claims regarding the emphasis on “origin” should also be tempered on the basis of the priority accorded by the Directive to the possibility of relying on “equivalents”. Similar to the Public Sector Directive, the Defence Procurement Directive provides that every reference to one of the standards identified must be followed by the expression ‘or equivalent’.⁹²⁶ Again, similar to the Public Sector Directive, the Defence Procurement Directive also provides that technical specifications must not refer to a specific make or source, or a particular process, or to trade marks, patents, types or a specific origin or production with the effect of favouring or eliminating certain undertakings or certain products, unless justified by the subject-matter of the contract.⁹²⁷ Any such reference must only be permitted “on an exceptional basis” where a sufficiently precise and intelligible description of the subject-matter of the contract is not possible under any of the above stated methods. Any such reference must be accompanied by the words ‘or equivalent’.⁹²⁸

⁹²⁶ Article 18(3)(a). The equivalent provision can be found in Article 23(a) Public Sector Directive. This requirement was confirmed in Case 45/87, *Commission v Ireland (“Dundalk”)* [1988] ECR 4929. See also Case C-359/93, *Commission v Netherlands (“UNIX”)* [1995] ECR I-157

⁹²⁷ Article 18(8). The equivalent provision can be found in Article 23(8) Public Sector Directive. This requirement was confirmed in Case C-359/93, *Commission v Netherlands (“UNIX”)* [1995] ECR I-157

⁹²⁸ Article 18(8)

It is unlikely that a U.S. contractor will be unable to meet a relevant European or international standard for the relevant product(s) offered. In addition, it is important to observe that the Defence Procurement Directive itself acknowledges that equivalence can also be assessed in particular with regard to interoperability.⁹²⁹ The drawing up of technical specifications is without prejudice to the technical requirements to be met by the Member State under international standardisation agreements in order to guarantee the interoperability required by those agreements.⁹³⁰ To this extent, full accord should be given to common U.S. and EU interests in this regard.

4.5. Reciprocal Defence Procurement MoUs

Finally, the Fortresses and Icebergs Study has identified that the RDPs afford signatories some protection against arbitrary discrimination on the basis of regulatory standards.⁹³¹ An Annex to the RDP's provides specific procedures to ensure that defence articles and services meet mutual government quality assurances.⁹³² A purchasing government has the option to request that the other government independently test and provide a certification of conformity for defence articles produced by suppliers of the selling country. As will be discussed in Chapter 11, Section 4, it is generally unclear to what extent the RDP provisions are effectively

⁹²⁹ Recital 38

⁹³⁰ Article 18(3)

⁹³¹ *Fortresses and Icebergs*: (Vol II) (n 12) 626

⁹³² See for example, Memorandum of Understanding Between the Government of the United States and the Government of the United Kingdom of Great Britain and Northern Ireland Relating to the Principles Governing Cooperation in Research and Development, Production, Procurement And Logistics Support of Defense Capability, December 16 2004, Annex II <[http://www.acq.osd.mil/dpap/Docs/paic/MOU-United%20Kingdom%20\(Dec%202004\).pdf](http://www.acq.osd.mil/dpap/Docs/paic/MOU-United%20Kingdom%20(Dec%202004).pdf)> accessed 20 September 2013

utilized. Notwithstanding, this provides at least a means to enable certification and conformity and thus compatibility.

5. Developing EU Initiatives in the Field of Standardization

The preceding Sections indicate that it is difficult to form a coherent overall view of the extent to which the Directive's technical specifications provisions may discriminate against U.S. contractors. This raises a question as to whether what really motivates U.S. claims about potential discrimination is a more general concern about the increasing coordination of European standardization efforts and their compatibility with international standardization initiatives.

For instance, it was observed two decades ago in relation to an analysis of the technical specification provisions of the Public Sector Directive that, ultimately, any effect on third countries will be the result of the relationship between European and international standardization.⁹³³ More specifically, it was argued that to the extent that European standardization duly respects the work done within international standardization bodies, and that international standards are relied upon as much as possible, the negative effects on the competitive position of third country products will be limited.⁹³⁴ It was suggested that the "impact" of the preference given to European standardization in the public procurement Directives depends entirely upon the direction which European standardization policies take.⁹³⁵ In addition, the EDA

⁹³³ Eeckhout, *The European Internal Market and International Trade: A Legal Analysis* (n 477) 324

⁹³⁴ *ibid*

⁹³⁵ *ibid*

commissioned Study on the Role of European Industry in the Development and Application of Standards recognises the potential for incompatibility and advises on a movement towards integrating NATO STANAGs into the EHDP⁹³⁶ (now EDSTAR) as well as advocating working to analyse and screen U.S. military specifications and NATO derived standards for their potential usefulness within a European procurement database.⁹³⁷ To this extent, U.S. concerns may necessitate closer engagement with EU standardization bodies to ensure consistency and coherence in the scope of coverage of standards.

6. Conclusions

Consistent with the findings of Chapter 5, U.S. claims about the potential discriminatory application of the technical specifications provisions must be tempered on a number of grounds. Firstly, claims about a “hierarchy of standards” must be appropriately qualified. Secondly, this Chapter has acknowledged the increased prevalence accorded to the use of performance and functional requirements. Thirdly, the Directive contains important safeguards based on equivalence and interoperability. Finally, it has been suggested that the principal concern relates not to the Directive’s provisions on technical specifications but rather the general incompatibility of EU and international standardisation initiatives as these bodies develop their competences.

This Chapter concludes a substantive assessment of the main provisions of the Defence Procurement Directive identified by U.S. commentators as creating a

⁹³⁶ ‘Study into the Role of European Industry in the Development and Application of Standards’ (n 865) 90

⁹³⁷ *ibid* 137

potential for discrimination. However, it should be observed that Part II will also engage discussion of other key provisions of the Defence Procurement Directive within the context of an analysis of comparable provision under U.S. procurement law. This thesis now turns to an assessment of the intergovernmental dimension of EU defence procurement law.

“Offsetting” Supranationalism and Intergovernmentalism in EU Defence Procurement Law

1. Introduction

The preceding Chapters have demonstrated that U.S. claims regarding the Defence Procurement Directive’s potential to discriminate against U.S. contractors are largely predicated on, and bolstered by, a sense of the emerging coherence of the EU defence procurement and defence trade regimes. However, whilst two supranational Defence Directives are intended to bring internal market discipline, the Directives do not operate in a political or legal vacuum. It is recalled from Chapter 3 that the Defence Procurement Directive may exclude from its scope of application certain forms of procurement conducted on an intergovernmental basis. This would include collaborative procurement organisations such as OCCAR. However, in addition, the EDA, which, it is recalled from Chapter 3 may be the subject of an exclusion under the Defence Procurement Directive, also purports to exercise procurement competences by governing (as opposed to regulating) procurement which Member States have determined to fall outside the scope of the EU Treaties on the basis of Article 346 TFEU.

As indicated by the title, the final Chapter of this Part examines the EU's attempt to balance its supranational and intergovernmental features in the field of defence procurement. Through an examination of the most systemic feature of international defence procurement practice, namely "offsets", this Chapter reinforces the importance of EU institutional debates on the internal and external coherence of EU defence procurement governance to a transatlantic defence procurement analysis.⁹³⁸

This Chapter begins by setting out the key institutional features of the EDA including its procurement initiatives. The Chapter then outlines international, regional and national approaches to offset regulation as background context to the examination of the legal issues surrounding third country offset provision.

2. The European Defence Agency

Historically, defence procurement and cooperation within Europe has been conducted within the framework of intergovernmental initiatives.⁹³⁹ The Lol FA and OCCAR are characteristic in this regard. It is recalled from Chapter 5, Section 7.3.1 that the Lol FA is a legally binding treaty but does not specify detailed regulation. Similarly, it is recalled from Chapter 3, Section 4.4.1 that the OCCAR Convention is

⁹³⁸ Certain of the issues explored in this Chapter were the subject of a paper presented at the 5th Public Procurement Research Students Conference, University of Nottingham, 12-13 September 2011. See L R A Butler, 'Considering the External Implications of Internal European Defence Procurement Regulation: The Practice of Offsets'. On file with the author. I am grateful to members of the Public Procurement Research Group at the University of Nottingham and Dr. Aris Georgopoulos, in particular, for views expressed on the paper

⁹³⁹ Examples of which include the Western European Union ("WEU"), Western European Armaments Group ("WEAG") and Western European Armaments Organisation ("WEAO") whose functions have now ceased. The Western European Union was established by a Protocol (with Exchange of Letters) Modifying and completing the Brussels Treaty, signed 23 October 1954, 211 UNTS 342. For a general discussion of these initiatives, see A Georgopoulos, 'The European Armaments Policy: A *conditio sine qua non* for the European Security and Defence Policy?' (n 54) 206-8

designed to regulate the management of European collaborative procurements as opposed to regulating procurement within the market.⁹⁴⁰ However, it is also recalled that in 2004, the EDA was established.⁹⁴¹ Article 42(3) paragraph 2 TEU identifies the EDA as an agency “in the field of defence capabilities development, research, acquisition and armaments”.⁹⁴² One key EDA objective is to adopt effective, compatible procurement methods.⁹⁴³ Its characteristic intergovernmental features are reflected by its initial establishment under the Second Pillar of the TEU, supervision by the Council and the limited involvement of EU supranational institutions, namely the Commission, European Parliament and the CJEU. This configuration has been criticised on grounds that the EDA suffers from both a democratic and rule of law deficit.⁹⁴⁴

⁹⁴⁰ For an extensive discussion in this regard, see Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations in the European Union’ (n 272) 121-150 esp. 121-6

⁹⁴¹ Council Joint Action 2004/551/CFSP of July 12, 2004 on the establishment of the European Defence Agency [2004] O.J. L245/17. For a useful overview of the historical, political, legal, economic and industrial background to the EDA, see M Trybus, ‘The New European Defence Agency: A Contribution to A Common European Security and Defence Policy and A Challenge to the Community Acquis?’ (2006) 43 CML Rev, 667, 668-677; A Georgopoulos, ‘The new European Defence Agency: major development or fig leaf’ (2005) 2 PPLR 103; S N Ferraro, ‘The European Defence Agency: Facilitating Defense Reform or Forming Fortress Europe?’ (n 261) 570-578

⁹⁴² Article 42(3) TFEU provides as follows: “Member States shall undertake progressively to improve their military capabilities. The Agency in the field of defence capabilities development, research, acquisition and armaments (hereinafter referred to as ‘the European Defence Agency’) shall identify operational requirements, shall promote measures to satisfy those requirements, shall contribute to identifying and, where appropriate, implementing any measure needed to strengthen the industrial and technological base of the defence sector, shall participate in defining a European capabilities and armaments policy, and shall assist the Council in evaluating the improvement of military capabilities.” More specifically, Article 45(1) TEU provides as follows: “[t]he European Defence Agency referred to in Article 42(3), subject to the authority of the Council, shall have as its task to: (a) contribute to identifying the Member States’ military capability objectives and evaluating observance of the capability commitments given by the Member States; (b) promote harmonisation of operational needs and adoption of effective, compatible procurement methods; (c) propose multilateral projects to fulfill the objectives in terms of military capabilities, ensure coordination of the programmes implemented by the Member States and management of specific cooperation programmes; (d) support defence technology research, and coordinate and plan joint research activities and the study of technical solutions meeting future operational needs; (e) contribute to identifying and, if necessary, implementing any useful measure for strengthening the industrial and technological base of the defence sector and for improving the effectiveness of military expenditure

⁹⁴³ Ibid. For a discussion of the compatibility of the EDA’s procurement methods in this regard, see Heuninckx, ‘The Law of Collaborative Defence Procurement Through International Organisations’ (n 272) 182-204

⁹⁴⁴ See Trybus, ‘The New European Defence Agency’ (n 939) 686

2.1. Member State Participation in Collaborative Projects

All EU Member States except Denmark participate in the EDA. Due the fact that the EDA has legal personality, it is able to conclude contracts on behalf of participants and contributing member States in the case of specific *ad hoc* projects, as well as be a party to legal proceedings. The EDA is not expressly intended to replace, but rather to complement, its Members' defence procurement agencies.

Participation in EDA projects is organized into two categories. "Category A" participation concerns collaborative projects where participation of all EDA Member States is presumed.⁹⁴⁵ "Category B" concerns collaborative projects where participation of all EDA Member States is not presumed.⁹⁴⁶

2.2. EDA Relations with Third Countries

The EDA may enter into administrative arrangements with third States, organizations and entities.⁹⁴⁷ This requires that the EDA respect the EU's single institutional framework and decisional autonomy.⁹⁴⁸ Importantly, the Council must approve each arrangement concluded by its Steering Board by unanimity.⁹⁴⁹ Working relations between the EDA and relevant NATO bodies are envisaged,⁹⁵⁰ as well as possible

⁹⁴⁵ Article 20(1) Joint Action. Those not wishing to participate will inform the Chief Executive accordingly

⁹⁴⁶ Article 21(1) and (2) Joint Action. Here, Member States wishing to collaborate inform the Steering Board and other Member States can decide whether to participate

⁹⁴⁷ Article 25(1) Joint Action. Such arrangements will cover: (a) the principle of a relationship between the Agency and the third party; (b) provisions for consultation on subjects related to the Agency's work; (3) security matters

⁹⁴⁸ Article 25(1) paragraph 2 Joint Action

⁹⁴⁹ Ibid. This seeks to guarantee that the consent of all Member States is given as to whether an agreement with a third party is in conformity with the single institutional framework of the EU and their national interests

⁹⁵⁰ Article 25(3) Joint Action

participation with other organisations, entities⁹⁵¹ and third countries.⁹⁵² The EDA has a Consultative Committee open to participation by non-EU European NATO members on request.⁹⁵³ European legal commentary has suggested that such provision counters any possibility of the establishment of a “Fortress Europe”, foreseeing consultative and cooperative frameworks with the USA, Japan, Russia and China.⁹⁵⁴ Whilst the EDA could constitute a potentially vital and significant consultative institution, the full effectiveness of the EDA’s cooperative measures has not been fully discerned.

2.3. EDA Procurement Codes of Conduct

Initially, the EDA developed its Codes of Conduct in response to data which indicated that more than 50 per cent of defence procurement by EU governments was undertaken outside the EU Treaties pursuant to Article 346 TFEU.⁹⁵⁵ To date, the EDA has adopted four Codes of Conduct, three of which predate the adoption of the Defence Procurement Directive. The first is the Code of Conduct on Defence Procurement.⁹⁵⁶ The second is the Code of Best Practices in the Supply Chain.⁹⁵⁷

⁹⁵¹ Article 25(4) Joint Action

⁹⁵² Article 25(5) Joint Action. A plain reading of Article 25(2),(3),(4) and (5), suggests that a distinction is to be drawn between working relations with NATO on the one hand and other organisations, entities, and third countries on the other

⁹⁵³ Article 25(7) Joint Action

⁹⁵⁴ A Georgopoulos, ‘The new European Defence Agency: major development or fig leaf’ (n 941) 103, 111

⁹⁵⁵ EDA Steering Board Decision No.2005/03/EDA, June 2005 on European Defence Equipment Market. For a discussion in this regard, see Chapter 2, Section 3

⁹⁵⁶ EDA, The Code of Conduct on Defence Procurement of the EU Member States Participating in the European Defence Agency, 21 November 2005. For a discussion of the Code, see A Georgopoulos, ‘The European Defence Agency’s code of conduct for armament acquisitions: a case of paramnesia?’ (2006) 2 PPLR, 51; Heuinckx, ‘Towards a coherent European defence procurement regime?’ (n 85) 5-8; Ferraro, ‘The European Defence Agency: Facilitating Defense Reform or Forming Fortress Europe?’ (n 261) 597-603

⁹⁵⁷ EDA, The Code of Best Practice in the Supply Chain, 27 April 2006. For a discussion of the Code, see A Georgopoulos, ‘European Defence Agency: the new Code of Best Practice in the Supply Chain’ (2006) 5 PPLR, 145; B Heuinckx, ‘Towards a coherent European defence procurement regime?’(n 85) 8-9

The third is the Code of Conduct on Offsets.⁹⁵⁸ Most recently, the EDA published a Code of Conduct on Pooling and Sharing, although the latter concerns planning as opposed to procurement.⁹⁵⁹

The key features of the three procurement Codes are as follows. Firstly, the Codes are only intended to apply once a SMS has invoked Article 346 TFEU, although the Codes do not provide guidance on the circumstances in which Article 346 TFEU can be invoked. Secondly, the Codes are not legally binding and therefore rely for their enforcement on institutional peer pressure exerted between SMS. Thirdly, whilst the Codes have been symbolised as important political statements, the reality is that they are short (2-3 page) documents substantially comprised of generic statements encouraging best practice. Whilst any initiatives in the field of defence procurement are welcome, their practical effect is difficult to discern and should not be overstated.

Most importantly, the Code on Defence Procurement and the Code on Best Practice in the Supply Chain substantially exclude third countries from their personal scope. At the time of adoption, a number of commentators had apparently questioned whether the exclusion of the U.S. from the Code on Defence Procurement would promote EU protectionism.⁹⁶⁰ However, this criticism is predicated on the Codes' ability to exert a significant effect in practice and which has not been evidentially substantiated. In contrast, as will be discussed in Section 4 below, the EDA Offsets Code makes several references to third countries. Whilst similar caution should be

⁹⁵⁸ EDA, A Code of Conduct on Offsets Agreed by the EU Member States Participating in the European Defence Agency, 3 May 2011. For a discussion of the Code, see A Georgopoulos, 'Revisiting offset practices in European defence procurement: the European Defence Agency's Code of Conduct on Offsets' (2011) 1 PPLR, 29

⁹⁵⁹ EDA Code of Conduct on Pooling & Sharing, 19 November 2012

⁹⁶⁰ See C Taylor, 'European Security and Defence Policy: Developments Since 2003' International Affairs and Defence Section, Research Paper 06/32, 8 June 2006, House of Commons Library, 47 cited in Ferraro, 'The European Defence Agency: Facilitating Defense Reform or Forming Fortress Europe?' (n 261) 605, fn 323

expressed regarding the practical significance of the Offsets Code, the Code does stand apart from the Defence Procurement and Best Practice Codes. As will be discussed below, unlike the latter which are somewhat overshadowed by more detailed regulation in the Defence Procurement Directive, the absence of regulation of offsets under the Directive renders the Offset Code even more politically contentious.

At the time of writing, the EDA has approved an analysis of a possible intergovernmental arrangement to replace the Code of Conduct on Defence Procurement and has also commissioned a review of the Code of Best Practice in the Supply Chain.⁹⁶¹

2.4. Other Procurement-Related EDA Initiatives

It is recalled that the EDA has developed a host of other initiatives. Until recently, the EDA operated an Electronic Bulletin Board (“EBB”), a portal designated for government defence contract opportunities and industry subcontract opportunities.⁹⁶² However, the EBB was closed in 2013 and replaced by the EDA Defence Procurement Gateway.⁹⁶³ The EDA has also set up a reporting and monitoring system under an offsets portal which provides information on a range of matters including, *inter alia*, the legal basis of national offset laws and practices, the objectives of individual offset policies, the role of offsets in the procurement procedure, thresholds, offset requirement criteria, multipliers used and fulfilment

⁹⁶¹ For details, see: <<http://www.eda.europa.eu/procurement-gateway/information/eda-codes-arrangements>> accessed 20 September 2013

⁹⁶² For a discussion of the portal, see generally B Heuninckx, ‘The European Defence Agency Electronic Bulletin Board: a survey after two years’ (2009) 2 PPLR, 43

⁹⁶³ For details, see <<http://www.eda.europa.eu/procurement-gateway>> accessed 20 September 2013

periods.⁹⁶⁴ In addition, it is recalled from Chapter 6, Section 2.1 that EDSTAR has taken over the EHDP.

Other initiatives include a non-binding framework arrangement on security of supply in circumstances of operational urgency, discussed in Chapter 5, Section 7.3.1. The EDA Steering Board has also approved common minimum standards on industrial security.⁹⁶⁵ The EDA has also established a Capability Development Plan and European Armaments Cooperation Strategy, and has additional EDA initiatives in progress, including the development of a detailed European defence industrial base strategy.⁹⁶⁶

3. Offset Regulation

Before examining the Offset Code's provisions, it is first necessary to provide a brief outline of offset practices and the current legal issues surrounding their operation.⁹⁶⁷

It should be observed at the outset that a comprehensive analysis of offsets would necessitate several theses. This Chapter simply provides the legal context for a more detailed discussion of offset provision by third countries under EU law.

⁹⁶⁴ Details regarding the web portal can be found at <<http://www.eda.europa.eu/offsets/>> accessed 20 September 2013

⁹⁶⁵ EDA Steering Board Decision No. 2006/18 on "Security of Information between Subscribing Member States (sMS). For a discussion of this initiative, see B Heuninckx, 'Towards a coherent European defence procurement regime?' (n 85) 15-16

⁹⁶⁶ For a useful analysis of this plan see B Heuninckx 'The European Defence Agency Capability Development Plan and the European Armaments Cooperation Strategy' (2009) PPLR 4, 136

⁹⁶⁷ For a useful insight into offsets in practice, see S Verma, 'National Offsets in the Defence Sector: Next Steps for Improving Integrity & Effectiveness in Defence Offset Contracts' 24 June 2013, Presented to the Public Procurement: Global Revolution VI Conference, Nottingham <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2288312> accessed 20 September 2013; S Verma, 'Offset Contracts Under Defense Procurement Regulations in India: Evolution, Challenges, and Prospects (2009) Summer, NCMA Journal of Contract Management 17, <<http://www.ncmahq.org/files/articles/jcm09%20-%2017-32.pdf>> accessed 20 September 2013

3.1. International Offset Regulation

There is no uniform classification or definition of an “offset”. At the risk of oversimplification, an “offset” can be understood in one form as a compensation either offered by, or required of, a seller to compensate for the fact that the buyer has not awarded a contract to its domestic industry.⁹⁶⁸ Offsets can either be direct or indirect.⁹⁶⁹

The WTO GPA expressly prohibits offsets. Article XVI (1) GPA provides that:

Entities shall not, in the qualification and selection of suppliers, products or services, or in the evaluation of tenders and award of contracts, impose, seek or consider offsets.⁹⁷⁰

However, it has been argued that offsets could otherwise be justified pursuant to the essential security interests derogation contained in Article XXIII(1).⁹⁷¹ It has been suggested that this provision has led to a *de facto* categorical exemption of

⁹⁶⁸ Article XVI footnote 7 defines offsets in government procurement as: “measures used to encourage local development or improve the balance-of-payments accounts by means of domestic content, licensing of technology, investment requirements, counter-trade or similar requirements”

⁹⁶⁹ “Direct offsets” can generally be described as offset transactions that are directly related to the defence items or services imported by a State. These are usually in the form of co-production, subcontracting, training, production, licensed production, or possibly technology transfer or financing activities. By contrast, “indirect offsets” can generally be described as offset transactions that are not directly related to the defence items or services imported by a State. The kinds of offsets that are considered ‘indirect’ include purchases, investment, training, financing activities, marketing/exporting assistance, and technology transfer. Indirect offsets can be further subdivided into “defence (related) indirect offsets” and “non-defence (related) indirect offsets”. For a useful taxonomy, see EDA (Commissioned), ‘Study on the effects of offsets on the Development of a European Defence Industry and Market’, 12 July 2007, Executive Summary, Final Report of 06-DIM-022, 14-18

⁹⁷⁰ This is subject to a limited exception in Article XVI(2) GPA permitting the use of offsets for developing countries acceding to the WTO GPA. See WT/DS1 63/7, Document (00-4679), 6 November 2000

⁹⁷¹ For the relevant terms of Article XXIII(1), see Chapter 2, Section 2.1. U.S. legal commentary has also raised the question of whether indirect offsets should be required to qualify under this exception. See M J Nackman, ‘A Critical Examination of Offsets in International Defence Procurements: Policy Options for the United States’ (2011) 40(2) Pub Cont LJ, 511, 518, fn 44 and citations therein

armaments from the GPA and its prohibition of offsets.⁹⁷² Moreover, Article XXIII(1) GPA is not applicable in any event to parties which have already excluded armaments in their Annexes.⁹⁷³ Further, for those parties who have not already excluded armaments in their Annexes, it has been argued that offsets could potentially be justified on public interest grounds.⁹⁷⁴ Thus, for major defence contracting countries such as the U.S. and the EU, offsets can be excluded from the WTO GPA's scope of application. To date, there has only been one reported challenge relating to offsets.⁹⁷⁵

3.2. Offset Regulation under EU Law

Neither the EU Treaties nor the Defence Procurement Directive expressly prohibit or regulate offsets. In addition, there is no definitive CJEU judgment on offset practices. The fact that a specific Guidance Note on Offsets has been adopted is therefore indicative of the significance of offsets in practice.⁹⁷⁶ However, it has been suggested that as the Guidance Note is not legally binding, the EU legislator has missed an opportunity to expressly prohibit offsets within the legislation.⁹⁷⁷

⁹⁷² See 'Study on the effects of offsets on the Development of a European Defence Industry and Market' (n 969)

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⁹⁷³ See S Arrowsmith, *Government Procurement in the WTO* (n 77) 148

⁹⁷⁴ Article XX(7)(a). For a discussion in this regard, see C H Bovis, 'Public-Private Partnerships in the Defence Sector: How Offset Agreements interface between the private and public stakeholders' (2008) 4 Eur. Pub. Private Partnership L Rev 200, 210

⁹⁷⁵ See WT/DS163/1, Document (99-0676), 22 February 1999; WT/DS163/7 Document (004-4679, 6 November 2000, cited by Bovis, 'Public-Private Partnerships in the Defence Sector' (n 974) 205-206 and fns 23 and 24

⁹⁷⁶ The Guidance Note does not provide a working definition of offsets. However, the Guidance Note does identify examples of offset practices. As the Guidance Note, Offsets, 1, para 1 observes: "[i]n some cases, offsets are of a military nature and concern the subject-matter of the contract directly (for example, industrial participation of local companies in the production of the equipment procured). In other cases, they are indirect, but limited to the military sphere (for example, sub-contracts awarded by the supplier to local defence companies for other military products), or indirect and non- military (for example, the supplier's commitment to mobilise foreign investment in civil sectors of the buying country's economy or to purchase civil goods in that country)."

⁹⁷⁷ Trybus, 'The tailor-made EU Defence and Security Procurement Directive' (n 125) 27 who suggests that this is possibly because the resulting strong opposition from the offsets establishment in many Member States might have delayed or even derailed the Defence Directive as a whole

The Guidance serves two principal functions. Firstly, it emphasises the legal argument that offsets are *prima facie* incompatible with the EU Treaties and which therefore provides the justification as to why the Directive “cannot allow, tolerate or regulate them.”⁹⁷⁸ Prior to the Directive’s adoption, it had been argued that offsets represented clear violations of the core free movement regimes relating to goods, services and establishment as well as the general prohibition of discrimination on grounds of nationality.⁹⁷⁹ The Guidance Note confirms this view suggesting that offset practices could potentially violate a number of EU Treaty provisions.⁹⁸⁰ The Guidance Note also identifies certain provisions of the Defence Procurement Directive that would preclude the use of offset requirements as part of an award procedure.⁹⁸¹

Secondly, the Guidance Note states that security related justifications for offsets and offers are accommodated within the Directive’s security of supply and subcontracting provisions.⁹⁸² These provisions are considered to be “non-discriminatory alternatives” to offsets that will drive competition into the supply chain of successful tenderers.⁹⁸³ According to one EU legal commentator, subcontracting is seen as a “substitute” for offsets.⁹⁸⁴ Offsets can often take the form of subcontracting to ensure industrial participation of favoured contractors. To this extent, by enabling the use of

⁹⁷⁸ Guidance Note, Offsets, 1, para 2. Indeed, it has been suggested that perhaps neither the TFEU nor the Defence Directives mention offsets because it is so obvious that they make an open, transparent and competitive procurement procedure without discrimination very difficult or entirely impossible. See M Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’ (n 125) 26. See also B Heuninckx, ‘Trick or Treat?’ (n 252) 25 who states that offsets are not mentioned in the Defence Procurement Directive because of their illegality: “an EU legal instrument cannot possibly regulate a practice that is by definition in breach of EU law.”

⁹⁷⁹ ‘Study on the effects of offsets on the Development of a European Defence Industry and Market’ (n 969) 27

⁹⁸⁰ These include Articles 18, 34, 35 and 56-62 TFEU. See Guidance Note, Offsets, 2, paras 5-8.

⁹⁸¹ These include Articles 4, 20, 38 to 42 and Article 47. See Guidance Note, Offsets, 2, paras 9-17

⁹⁸² *ibid*

⁹⁸³ *ibid*

⁹⁸⁴ Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’ (n 125) 28

competitive procedures and visibility of subcontracting decisions, the objective is to facilitate EU-wide industrial participation by other means.

Therefore, according to the Guidance Note, the combined effect of the EU Treaties and the Defence Procurement Directive is that contracting authorities may not “require or induce by whatever means” tenderers to commit themselves to: (1) purchase goods or services from economic operators located in a specific Member State; (2) award sub-contracts to operators located in a specific Member State; (3) make investments in a specific Member State or (4) generate value on the territory of a specific Member State.⁹⁸⁵ Furthermore, tenderers may not be required to mobilise other undertakings to make such purchases, subcontracting or investments whether related to those undertakings or not.⁹⁸⁶ The predominant focus in the Guidance therefore is on offsets required of EU economic operators, although the references to “related” to “other undertakings” is not as specific.

Notwithstanding, whilst emphasising the *prima facie* illegality of offsets, the Guidance Note appears to acknowledge a legitimate application of Article 346 TFEU to justify offsets.⁹⁸⁷ The Guidance Note makes a number of important statements in relation to the potential use of Article 346 TFEU to justify offset requirements. First, because the measure must be necessary for security interests, economic or employment related interests are not accepted.⁹⁸⁸ Hence, (economic) return on investment made abroad

⁹⁸⁵ Guidance Note, Offsets, 5, point 19

⁹⁸⁶ Guidance Note, Offsets, 6, point 19, para 2

⁹⁸⁷ The Guidance Note Offsets, 6, point 21, para 2 observes that where a Member State intends to rely on Article 346 TFEU to require offset and related compensation practices, the Member State must be prepared to: (a) specify the essential security interest that makes the specific requirement necessary; (b) demonstrate that this requirement is an appropriate means to protect that interest, and (c) explain why it is not possible to achieve the same objective by less restrictive means

⁹⁸⁸ Guidance Note, Offsets, 7, point 22. For a discussion of the relation between security and economic interests, see Chapter 2, Section 5.1

is not sufficient to justify use of Article 346 TFEU.⁹⁸⁹ Second, because the justification must always concern the specific measure in question, a justified derogation from the Directive for a particular security reason does not also implicitly authorize, or automatically legitimate, use of an offset which must be justified separately.⁹⁹⁰ The Guidance Note states unequivocally that a Member State must be able to prove that the specific requirement is itself “indispensable” to protect its essential security interest.⁹⁹¹

An important remaining question, therefore, is whether it is possible to conceive of any circumstances in which offsets would be permissible. To date, official EU publications and commentary have not provided a detailed analysis of hypothetical instances in which an offset could theoretically be justified. However, whilst the suggestion has been that offsets are difficult to justify under Article 346 TFEU because they normally meet economic as opposed to security considerations, it has been observed that economic considerations will not always be at the centre of an offset agreement.⁹⁹² Further, in accordance with the discussion engaged in Chapter 2, Section 5.2, it is possible to conceive of an instance in which a Member State may seek to invoke Article 346 TFEU where its interests cannot be protected either within the EU or NATO.⁹⁹³ Irrespective of the issue of their (il)legality, it appears to be

⁹⁸⁹ *ibid*

⁹⁹⁰ Guidance Note, Offsets, 7, point 23

⁹⁹¹ Guidance Note, Offsets, 7, 23. It is interesting that the Guidance Note refers to “indispensable”. Strictly speaking, EU law imposes no such requirement, the wording of Article 346 TFEU only using the word “necessary”. As indicated in Chapter 2, Section 2.1, this term is used in Art.XXIII(1) WTO GPA. This may constitute an attempt to promote a convergent interpretation with a view to preventing possible variability in justifications for offsets between international trade law regimes

⁹⁹² See Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’ (n 125) 26 citing at fn 195 the observation made by Heuninckx who states that requiring licensed production facilities in an offset agreement, for example, could be considered necessary to create a local maintenance capability that could be relied on to repair the military equipment in cases where the supply chain is disrupted by conflict. On this view, offsets that clearly aim at ensuring national security and meet the test of Article 346 TFEU could still be justified, just like any other Member State measure

⁹⁹³ For instance, consider the following hypothetical. Cyprus (an EU Member State) does not have a formal offsets policy. However, suppose that it did. Cyprus considers itself at risk of a credible military threat by Turkey (a

accepted that offsets are likely to continue in some form.⁹⁹⁴ Indeed, the EDA continues to recommend the use of offsets.⁹⁹⁵

3.3. National Offset Regulation

According to the Commission Report on transposition, historically, 18 Member States maintained offset policies requiring offsets from non-national suppliers when they procured defence equipment abroad.⁹⁹⁶ Prior to the Directive's adoption, Member States varied in requiring specific offset laws, national policies or no official offset policies.⁹⁹⁷

Before the publication of the Guidance Note on Offsets, it had been argued that any national regime would be incompatible with EU law if based on a legally binding, automatic and abstract offsets requirement for all defence procurement contracts because of the need for a 'case-by-case' determination of the decision to invoke

non-EU NATO member State). However Cyprus is subject to a NATO embargo. In this instance, Cyprus requires security of supply of its military equipment, which is otherwise restricted by the embargo. Security of supply might be achieved through offset requirements such as local manufacturing. Even though such cases would be rare, it could possibly be argued that offsets could be justified especially considering the length of time it takes to build up an industrial capacity. I am grateful to Dr Baudouin Heuinckx for providing this example during the course of private correspondence on this issue. Dr Heuinckx's views were not given in a professional capacity and do not necessarily represent the views of his employers. Correspondence on file with the author

⁹⁹⁴ See Trybus, 'The tailor-made EU Defence and Security Procurement Directive' (n 125) 29. See also B Heuinckx, 'Trick or Treat?' (n 252) 26

⁹⁹⁵ See generally, EDA (Commissioned), 'Study on the innovative and competitive potential of the defence-related supplier base in the EU12', Final Report, 2009, 74-5 <<http://www.pwc.com/gx/en/eu-institutions-services/pdf/EDA-study-june-2011.pdf>> accessed 20 September 2013

⁹⁹⁶ See Commission, Report to the European Parliament and The Council on transposition of directive 2009/81/EC on Defence and Security Procurement (n 302) 8

⁹⁹⁷ See 'Study on the effects of offsets on the Development of a European Defence Industry and Market' (969) 29-31; *Fortresses and Icebergs*: (Vol. II) (n12), 343 (France); 388 (Germany); 432 (Italy); 479-481 (Poland); Romania (518-519); 554-555 (Sweden); 610-611 (UK)

Article 346 TFEU.⁹⁹⁸ This view has subsequently been confirmed by the Guidance Note on Offsets.⁹⁹⁹

The Report on transposition indicates that the Commission has, therefore, been in close contact with the 18 Member States concerned and indicates that most have now either abolished the respective rules or revised their legislation.¹⁰⁰⁰ According to the Report, “major legal changes” have, therefore, been implemented.¹⁰⁰¹ An important question remains as to whether such practices will continue irrespective of those legal changes and, if so, in what form.

4. EDA Offset Code and Third Countries

It is recalled from Section 2.3 above that whilst the EDA Codes substantially exclude third countries from their scope, the Offsets Code contains specific references to third countries as well as practices which could conceivably include third countries. For instance, the Code states that its principles and guidelines will be applied equally to all bidders from SMS and non-SMS, including third countries.¹⁰⁰² Further, the Code identifies offsets as a global phenomenon and that while addressing offset on the EU level, cognizance will need to be taken of the global practice of offset and, in particular, the involvement of third parties and their effect on European industry

⁹⁹⁸ ‘Study on the effects of offsets on the Development of a European Defence Industry and Market’ (n 969) 27

⁹⁹⁹ Guidance Note, Offsets, 7-8 para 26

¹⁰⁰⁰ Commission, Report to the European Parliament and The Council on transposition of directive 2009/81/EC on Defence and Security Procurement (n 302) 9

¹⁰⁰¹ *ibid*

¹⁰⁰² EDA Code on Offsets, 2

competitiveness.¹⁰⁰³ In addition, the Code also envisages its application not only to offsets but all compensation practices, of which government-to-government off-the-shelf defence sales are included.¹⁰⁰⁴

The EDA offsets Code contains two sets of guidelines. The first concerns transparency. In particular, the Code requires sMS to provide information on national offset practices and underpinning policies, where they exist, including the percentage and types of accepted offset, whether part of the procurement contract or agreed upon otherwise.¹⁰⁰⁵ However, the Code does not expressly stipulate whether this includes information on third country offset provision. The second set of guidelines contains six stipulations designed to “evolve” offset use.¹⁰⁰⁶ The first provides that sMS requiring offsets will clearly stipulate the requirements in the contract notice.¹⁰⁰⁷ The second is that the offset accepting sMS will make clear at the outset if offsets are a factor considered in a bid.¹⁰⁰⁸ The third is that offsets will be considered of “less significant weight” (or used as a subsidiary criteria in case of offers with the same weight) when used as a criterion for tenderer selection or contract award in order to ensure that the procurement process is based on the best available and most economically advantageous solution.¹⁰⁰⁹ The fourth is that offsets will not exceed the value of the procurement contract.¹⁰¹⁰ The fifth is that the sMS will allow foreign offset

¹⁰⁰³ *ibid*

¹⁰⁰⁴ *ibid*. It is recalled that government-to-government sales are *prima facie* excluded from the Defence Procurement Directive under Article 13(f). See Chapter 3, Section 6.3. For a brief discussion of foreign military sales in U.S. defence procurement practice, see Chapter 11, Section 3

¹⁰⁰⁵ EDA Code of Conduct on Offsets, 3

¹⁰⁰⁶ *ibid*

¹⁰⁰⁷ *ibid*, 4

¹⁰⁰⁸ *ibid*

¹⁰⁰⁹ *ibid*. However, it has been observed that it is not clear precisely what is meant by “less significant weight”. This necessitates a comparison but it is not clear to what offsets could or should be compared. See A Georgopoulos, ‘Revisiting offset practices in European defence procurement’ (n 958) 35

¹⁰¹⁰ *ibid*. In practice, many offset regimes apply a “multiplier” to the contract. A multiplier is a factor applied to the

suppliers to select the most cost effective business opportunities within the buying country to enable fair competition within supply chains where it is efficient, practical and economically or technically appropriate.¹⁰¹¹ The final guideline is that the SMS will use wherever practicable and on a voluntary basis, mutual abatements to reduce reciprocal offset commitments.¹⁰¹² With specific regard to the last issue, an EDA Study on abatement practices has specifically identified the need to address abatements, in particular, through developing what it describes as an “EDA-U.S. Government Offset Dialogue”.¹⁰¹³

An important question, therefore, is how significant could the Offset Code be for the U.S? As indicated above, the Code is, by nature, limited in terms of content. However, the above provide indications that the EDA regime could potentially have a role in engaging the U.S. on offset issues. This raises two more fundamental issues. The first concerns the continued scope of the EDA regime in light of the adoption of the Defence Procurement Directive. The second is whether, in light of the *prima facie* illegality of offsets, third country offset requirements are similarly incompatible with EU law.

actual value of certain offset transactions to calculate the credit value earned (i.e. the nominal value attributed to the actual value of the offset). Contracting authorities use multipliers to provide firms with incentives to offer offsets that benefit targeted areas of economic growth. For an example of the use of a multiplier, see A Georgopoulos, ‘Revisiting offset practices in European defence procurement’ (n 958) 36. Offset multipliers can generally range from around 100% to 135% of the contract value in some cases. See ‘Study on the effects of offsets on the Development of a European Defence Industry and Market’ (n 969) 21-22

¹⁰¹¹ EDA Code of Conduct on Offsets, 4

¹⁰¹² *ibid.* See generally EDA, ‘Abatements: A Pragmatic Offset Tool to Facilitate the Development of the European Defence Equipment Market’, 2010

¹⁰¹³ *Ibid* 18. Also observed by A Georgopoulos, ‘The European Defence Agency’s code of conduct for armament acquisitions’ (n 956) 39

4.1. Complementarity and Conflict

With regard to the first issue, specifically jurisdiction, prior to the adoption of the Offsets Code, the Commission and EDA stated that their initiatives are “complementary” and “without prejudice” to each other.¹⁰¹⁴ Indeed, the Commission considered the development of the Directive and the EDA Code of Conduct on Armaments as complementary to the Interpretative Communication on Article 296 TEC.¹⁰¹⁵ However, EU legal commentary has questioned whether complementarity is possible.¹⁰¹⁶ A host of arguments have been raised in this regard, not least that it is difficult to reconcile a Member State’s decision to exclude a contract from compliance with the EU Treaties on the basis of Article 346 TFEU in protection of essential security interests only to then proceed to publish a contract notice for the same contract on the EDA bulletin board.¹⁰¹⁷

The Guidance Note on Offsets devotes specific attention to the Offsets Code.¹⁰¹⁸ First, the Guidance Note reiterates the Code’s stipulation that its provisions have to be implemented within the framework of EU law.¹⁰¹⁹ It reaffirms that the Code is part of the intergovernmental regime on defence procurement to which participating Member States subscribed “without prejudice to their rights and obligations under the

¹⁰¹⁴ See Article 1(2) and 5(1) EDA Joint Action

¹⁰¹⁵ On the differences of view regarding the significance of the respective timing of the publication of the Interpretative Communication and the EDA Code of Conduct on Defence Procurement, see Aalto, ‘Interpretations of Article 296’ (n 81) 29; Ferraro, ‘The European Defence Agency: Facilitating Defense Reform or Forming Fortress Europe?’ (n 261) 595

¹⁰¹⁶ See Trybus, ‘The New European Defence Agency’ (n 941) 687-691; Georgopoulos, ‘Revisiting offset practices in European defence procurement’ (n 958) 53; Heuninckx, ‘Towards a coherent European defence procurement regime?’ (n 85) 16-20

¹⁰¹⁷ A Georgopoulos, ‘The Commission’s Interpretative Communication on the application of Article 296 EC’ (n 234) 49

¹⁰¹⁸ Guidance Note, Offsets, 8, points 27-28

¹⁰¹⁹ Similarly, the Offsets Code, 1 refers to the need to evolve offsets in a way which is “compatible with EU law”. It also states at 2, as part of its “overarching principles”, that the subscribing Member States commit themselves to implement the Code “within the framework of EU law”

Treaties.”¹⁰²⁰ Second, the Guidance Note states:

However, it is important to note that the application of the Code does not of itself make offset requirements compatible with EU law. In every award procedure, contracting authorities/entities first have to ensure that all their requirements comply with the provisions of the Treaty and/or the Directive. On that basis, they may then decide to apply the Code on offsets, provided that this does not put the award procedure in conflict with the Treaty and/or the Directive. In other words: the only legal criterion for the assessment of offset requirements is compliance with EU primary and secondary law.”¹⁰²¹

Given that it was stated that it is difficult to conceive of many circumstances in which offset practices can be justified under Article 346 TFEU, the purported legal effect of such a position should, in theory, confirm that the legitimate scope of the EDA Code is secondary to a primary assessment of EU law and in any event extremely limited. Nevertheless, by recognising (at least theoretically) that the EDA Code could apply, the Guidance Note accepts that it may be possible to justify offsets under Article 346 TFEU.

A 2011 NIAG Study has indicated that many European defence industry associations conclude that offsets should be dealt with on an intergovernmental level through the

¹⁰²⁰ Guidance Note, Offsets, 8, points 28

¹⁰²¹ *ibid*

EDA.¹⁰²² According to those industry associations, offsets deal with aspects closely related to national sovereignty and therefore the question of offsets in its entirety is not within the European Commission’s purview.¹⁰²³ As a result, the Study indicates that these association encourage the EU not to promote the Guidance Note on Offsets and to support the EDA’s work in this field.¹⁰²⁴

At the time of writing, the EDA states that it is currently addressing the complementarity of the EDA regime and the Defence Procurement Directive and adapting the EDA regime to the “post-directive environment”.¹⁰²⁵ An important issue will concern to what extent the EDA focuses specifically on the issue of offsets.

4.2. Compatibility of Third Country Offsets with EU Law

In 2007, the EDA commissioned a Study on the effects of offsets in the development of a European defence industry and market.¹⁰²⁶ As part of its industry questionnaire, the Study asked: “[d]oes offset tend to favour EU-based companies vs. non-EU based companies or is it neutral in this regard?”¹⁰²⁷ The overall conclusion was that the findings on offset effects on the competitiveness of European versus overseas competitors on European defence equipment markets were “rather inconclusive”.¹⁰²⁸

¹⁰²² High Level Advice Study No 154, ‘Developments in Europe to Reform Export Control and Defense Procurement Processes’ (n 60) 14

¹⁰²³ Ibid

¹⁰²⁴ Ibid

¹⁰²⁵ For more information, see <<http://www.eda.europa.eu/projects/projects-search/intergovernmental-regime-on-defence-procurement>> accessed 20 September 2013

¹⁰²⁶ ‘Study on the effects of offsets on the Development of a European Defence Industry and Market’ (n 969). The study was restricted to an analysis of defence contracts with EDA pMS as a customer but which did include third countries as suppliers

¹⁰²⁷ Ibid 44

¹⁰²⁸ Ibid 48

Most respondents stated that offsets were “neutral”.¹⁰²⁹ According to the Study’s interpretation of the data gathered, direct and indirect military offsets are seen by some as advantageous to U.S. primes as a result of their greater economies of scale and scope.¹⁰³⁰ By contrast, the Study found that it may be easier for European firms to offer indirect civil offsets in light of the fact that they are geographically and culturally closer with more developed European industrial networks.¹⁰³¹ The Study also identified that U.S. regulations on technology transfer presented a more fundamental advantage to European industries, although the Study also identified that there were indications that U.S. firms were more forthcoming in sharing their technologies than European firms.¹⁰³² Further, according to the Study, such differences in offset provision would not necessarily affect the attractiveness of the offered offset package.¹⁰³³

However, another important finding of the Study was that several respondents pointed to, and warned against, the potentially “negative effects” of “a future offset regime banning intra-European offsets but allowing them for extra-European players.”¹⁰³⁴

This issue is now brought into sharp resolution in light of the Defence Procurement Directive. It is therefore necessary to re-examine the legal position of third countries.

¹⁰²⁹ The Study observed that several pMS answered with reference to the claimed neutrality of their own procurement practices

¹⁰³⁰ *ibid*, 44-45, 48

¹⁰³¹ *Ibid* 45, 48

¹⁰³² *ibid*, 45 fn41. For a discussion of U.S. export controls laws in light of recent developments in EU law, see Chapter 5

¹⁰³³ The Study states that rather one should expect that U.S. tenderers would have to accept a lower profit margin. *ibid*, 45

¹⁰³⁴ *ibid*, 45. These “negative effects” were not specified

4.2.1. Third Country Operators

In light of the adoption of the Defence Procurement Directive, it has been argued that where a contracting authority permits a third country operator to participate in a contract award procedure in accordance with the Directive, a contracting authority cannot require offsets.¹⁰³⁵ By contrast, it has been suggested that as a consequence of the prohibition on the receipt of offsets by EU contractors, EU contracting authorities could be compelled to prefer non-EU contractors to EU contractors and that this would place third country contractors at a comparative advantage.¹⁰³⁶

According to one EU legal commentator, whether the general prohibition of offsets in light of the Directive can be implemented through subcontracting depends, *inter alia*, on the development of offsets with third countries, and especially with the U.S.¹⁰³⁷ This could be taken to suggest that the offset prohibition does not *prima facie* apply to third countries, or, alternatively, if it does, Member States may nevertheless continue to seek such offsets from third countries in contravention of EU law.¹⁰³⁸

The above 2007 EDA commissioned Study proceeds on the basis that to the degree that offsets are illegal, this illegality “lies on the receiving side irrespective of whether

¹⁰³⁵ Statement made by Mr. Burkhard Schmitt, panellist at the International Chamber of Commerce conference: ‘The new EU Directive: Towards Market-based Defence and Sensitive Security Procurement’, Paris, France, Tuesday 1 February 2011. The author has retained notes on file

¹⁰³⁶ Statement made by Mr. Michael Abels, Partner, Oppenhoff & Partner (Germany), panellist at the International Chamber of Commerce conference: ‘The new EU Directive: Towards Market-based Defence and Sensitive Security Procurement’, Paris, France, Tuesday 1 February 2011. The author has retained notes on file

¹⁰³⁷ Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’ (n 125) 29

¹⁰³⁸ For instance, this may be due to a perceived lesser risk that the Commission would seek to investigate offsets provided by third countries whereas it would be more inclined to investigate offsets provided by EU economic operators, in particular, if the issue is politically highly sensitive and could engage a dispute with the home State of the third country offset provider

suppliers are European or not or where they reside”.¹⁰³⁹ The Study further states that this is in line with Interpretative Communication on Article 296 which is “entirely geared to what the internal market demands from potential receivers of offset – irrespective of whether suppliers are European or non-European”.¹⁰⁴⁰ In fact, the Study goes even further by stating that a prohibition of offsets for EU contractors whilst still allowing offsets for third country contractors does not exclude a solution such that pMS cease to accept offset regardless of origin.¹⁰⁴¹

The legal basis for such a general EU and third country offset prohibition is not unequivocal. The reference to illegality lying on the “receiving side” may derive from Article 18 TFEU which prohibits discrimination on grounds of nationality. It could be argued that a third country offset requirement requires industrial compensation to the requiring Member State’s national industry thereby placing the Member State and its industry at a comparative advantage.¹⁰⁴² On this basis, it could be considered analogous to a “buy national” requirement that would otherwise be contrary to EU law unless justified. Alternatively, it could be argued that by enabling third country companies to provide offsets whereas EU operators would be prohibited, third country operators derive a comparative advantage e.g. by improving their ability to tender for contracts in other Member States.¹⁰⁴³ Further, the Offsets Code only applies to contracts excluded in accordance with Article 346 TFEU. Therefore, it

¹⁰³⁹ ‘Study on the effects of offsets on the Development of a European Defence Industry and Market’ (969) 11, 47

¹⁰⁴⁰ *ibid.* 45. It should be observed that there is, in fact, no such express or implied reference to the receipt of offsets by third countries in the Interpretative Communication. This may constitute further indicative evidence of a discernable trend towards the “Europeanised” conception of Article 346 TFEU. For a discussion in this regard, see Chapter 2, Section 5.2

¹⁰⁴¹ ‘Study on the effects of offsets on the Development of a European Defence Industry and Market’ (969) 11

¹⁰⁴² Again, I am grateful to Dr. Baudouin Heuninckx for bringing this possibility to my attention during the course of discussions. Again, these views were given in a personal capacity and do not necessarily represent the views of his employer

¹⁰⁴³ I am grateful to Dr. Baudouin Heuninckx for bringing this possibility to my attention during the course of discussions. Again, these views do not necessarily represent the views of his employer

could be argued that given the reference to third countries in the Code, the Code implicitly subscribes to the position that third country offset requirements are similarly *prima facie* incompatible with EU law. However, in the absence of a definitive CJEU judgment, considerable legal uncertainty will continue to exist on this issue.

The authors of the EDA Study indicated that an outcome whereby offsets were prohibited for EU contractors but permitted for third countries is “hardly a policy advocated by any European actors” and is “not likely to become a European policy”.¹⁰⁴⁴ However, as indicated in Chapter 4, the EU has not adopted a coherent policy regarding the legal position of third countries in the field of defence procurement. Therefore, an important question is whether a contracting authority can continue to require the provision of offsets by third country contractors in either circumstance that a third country is permitted to participate in a contract award procedure prescribed by the Defence Procurement Directive or otherwise in accordance with national law and policy.

4.2.2. Third Country Governments

It is recalled from Chapter 3, Section 6.3 that Article 13(f) Defence Procurement Directive provides for the exclusion of government-to-government contracts. However, the question was raised as to whether an offset accompanying the sale could similarly fall under the exclusion. As indicated, the Directive does not expressly regulate offsets. The Guidance Note on Offsets states that whilst government-to-government sales are excluded from the Directive, possible offset requirements

¹⁰⁴⁴ ‘Study on the effects of offsets on the Development of a European Defence Industry and Market’ (969) 11, 47

related to such sales would have to be justified separately as “necessary for the protection of the essential interests of the purchasing Member States”.¹⁰⁴⁵ Whilst not unequivocal, the latter appears to refer to the need to invoke Article 346 TFEU.¹⁰⁴⁶

In this regard, the Guidance Note does not explicitly differentiate between a Member State-to-Member State sales contract with an accompanying offset and a Member State-to-third country sales contract with an accompanying offset. Both options are possible in light of the fact that Article 13(f) also purports to apply to third country governments. According to this view, whilst the Directive permits a Member State to exclude a sale conducted with a third country, if a Member State requires an offset from that third country, the Member State will have to separately justify that offset by reference to its essential security interests (and which will necessarily implicate consideration of the circumstances of the third country and/or third country operator(s)). This interpretation would also appear to be consistent with the general view expounded above, namely that offsets are prohibited irrespective of whether required from an EU or third country economic operator.

However, an additional issue arises with regard to government-to-government sales contracts in light of the Offsets Code. As indicated, the Guidance Note appears to indicate that a sales contract can be legitimately excluded under Article 13(f). The implication is that it is only the offset agreement that will have to be separately justified in accordance with Article 346 TFEU. However, the Offsets Code states that

¹⁰⁴⁵ Guidance Note, Offsets, 7, point 24

¹⁰⁴⁶ It has not been suggested that a Member State can rely on one of the other exclusions of the Directive or one of the free movement exceptions in the EU Treaties

it applies to *both* offsets and government-to-government sales.¹⁰⁴⁷ It may be possible to reconcile Article 13(f) and the Offsets Code on the basis that whilst Article 13(f) is a legal basis for excluding a sale from compliance with the Directive, this does not preclude the possibility for Article 346 TFEU to provide a further legal basis for excluding a sale from compliance with the EU Treaties as a whole. This could be on the grounds that the sale may not, itself, be compatible with EU law. Alternatively, it could be on the grounds that the offset is integral to the sale and which therefore necessitates additional exclusion of an otherwise *prima facie* legitimate sale.

This raises a broader question regarding the extent to which EU law is able to convincingly discriminate between a legitimate sale and an illegitimate offset.

5. Conclusions

This Chapter has sought to highlight at least three important issues that are relevant to a transatlantic defence procurement analysis. Firstly, the EDA is developing increasing initiatives in the field of defence procurement. For instance, it has promulgated a set of procurement Codes. It maintains a procurement Gateway. It has developed initiatives which are intended to support procurement functions e.g. in relation to security of supply, security of information and technical standards. It is also beginning to cohere its initiatives on the pooling and sharing of capabilities. An increasing emphasis on EU cooperative procurement is reinforced by the flexibility accorded by Article 13(c) Defence Procurement Directive as well as the licensing

¹⁰⁴⁷ EDA Offsets Code, 2

provisions of the ICT Directive. An important question concerns the extent to which the EDA will become a primary forum for engagement with the U.S. and transatlantic international organisations such as NATO.

Secondly, it should be emphasised that the issue of the compatibility and complementarity of EU law and the EDA regime is not simply a matter for internal institutional and legal debate within the EU. As the preceding Chapters have demonstrated, both the internal and external coherence of European defence procurement regulation is of direct import to the transatlantic defence market. U.S. legal commentary has specifically identified that the use of varying procurement methods and organisations outside the EU constitutes a real challenge for the U.S., not least because of the lack of transparency which may result.¹⁰⁴⁸

Thirdly, reinforcing the observations in Chapter 3 concerning the Directive's provisions on excluded contracts, the discussion of offsets is symptomatic of the extent to which the most economically and politically significant forms of procurement are conducted absent a clear legal framework.

In reality, it should be recognized that a legal prohibition will not simply eradicate offsets. As will be discussed in Chapter 11, offsets provide a vital point of leverage for the U.S. to enter the EU market. Whilst this Chapter has not sought to subject offset practices to a comprehensive legal analysis, it has provided a sufficient indication that EU law and the EDA Codes are unlikely to radically alter Member State practices in the short term even with a robust Commission enforcement stance,

¹⁰⁴⁸ Ferraro, 'The European Defence Agency: Facilitating Defense Reform or Forming Fortress Europe?' (n 261) 611 and 615

Further, the Commission, itself, will have to determine whether it accords equal priority to the investigation of EU and third country offset provision.¹⁰⁴⁹

An important question is whether legal institutions could play a more substantial role in managing offsets, even accepting any *prima facie* illegality. This issue will need to be candidly confronted in transatlantic defence trade debates going forward.

This Chapter concludes the discussion of EU defence procurement law. This thesis now crosses the Atlantic to examine U.S. defence procurement law.

¹⁰⁴⁹ According to the Commission Report to the European Parliament and The Council on transposition of directive 2009/81/EC on Defence and Security Procurement (n 302) 9, the Commission is convinced that “a rapid phasing out of the discriminatory practice of offsets is necessary to create a truly European Defence Equipment Market” and that it will take appropriate action where this is not the case. It will also do so where Member States continue to have offset rules that are clearly incompatible with EU law. Importantly, the Commission does not distinguish between EU and third country offset provision

PART II

A VIEW FROM THE UNITED STATES OF AMERICA

Sources of U.S. Federal Defence Procurement Law

1. Introduction

For a host of reasons, the early 1990s saw increased focus on the extent to which the U.S. and EU markets were open to foreign competition in the field of procurement.¹⁰⁵⁰ It had been observed that there were a number of legal and structural impediments” which resulted in “considerable obstacles to foreign firms” attempting to enter the U.S. procurement market, certain of which will be examined in this Part.¹⁰⁵¹ Interestingly, at the time, and thus prior to the significant debates which subsequently arose regarding the role of Article 346 TFEU in defence procurement, it was observed that of all the legal and structural impediments to the U.S. market, the most obvious was national security restrictions.¹⁰⁵² In fact, it had been observed by U.S commentators that:

To be fair to the United States the restrictions are very similar to Article 223 EEC which allows for protectionism on national security grounds for E.C. Member States. In the absence of a resolve amongst E.C. Member

¹⁰⁵⁰ This was likely due, *inter alia*, to the following factors. Firstly, the U.S. and EU had been engaged in a trade dispute regarding Article 29 of the then newly implemented Utilities Directive and the supposed discrimination against goods of non-Community origin. For a discussion, see P-A Trepte, ‘The E.C.-United States trade dispute: negotiation of a partial solution’ (1993) 4 PPLR 82; M E Footer, ‘External aspects of the Community’s public procurement policy in the utilities sectors’ (1994) 6 PPLR, 187; M E Footer, ‘Case Comment C360/93 on the Community’s external powers in the area of public procurement’ (1996) 5 PPLR, 148. Secondly, the U.S. and EC were involved in negotiations regarding the scope of coverage of the GPA in advance of the next revision. For a discussion in this regard, see G De Graaf, ‘EC-United States agreement on Government procurement’ (1994) 5 PPLR 179; A Halford, ‘An overview of EC-United States trade relations in the area of public procurement’ (1995) 1 PPLR 35; For earlier commentary, see D V Anthony and C K Hagerty, ‘Cautious Optimism as a Guide to Foreign Government Procurement’ (1979) 11 (1979) Law & Pol’y Int’l Bus. 1301

¹⁰⁵¹ A Cox and S Greenwold, ‘The legal and structural obstacles to free trade in the United States procurement market’ (1993) 5 PPLR 237, 251

¹⁰⁵² *ibid*, also observing at 237 that: “[t]he resolve of the United States government to open up its own procurement market is overshadowed by national security interests and at 238 that: “[w]hile the United States can legitimately [sic] preclude imports on grounds of national security, it sometimes does so simply to curb foreign competition and to protect weak domestic companies.”

States to eradicate national preference in defence procurement there can be little scope for this barrier's being rescinded internationally.¹⁰⁵³

The idiom, "history repeats itself", is apposite given the renewed focus which U.S. commentary now brings to an assessment of the Defence procurement Directive and which this thesis now brings to bear on an assessment of U.S. procurement law.

It is recalled that the source of EU defence procurement law derives principally from the Defence Procurement Directive which, in turn, derives its legal basis from, and operates within, the broader matrix of EU Treaty provisions (as interpreted by the case law). By contrast, the sources of U.S. federal procurement law are numerous. Prior to undertaking a substantive analysis of U.S. law, it is therefore necessary to get a sense of the scale of the U.S. defence procurement edifice.¹⁰⁵⁴ This will provide the context for Chapters 9 and 10 which examine the statutory framework regulating full and open competitive and non-competitive procurement. Chapter 11 examines the specific field of international contracting under U.S. foreign acquisition law.

It should be observed at the outset that this Part is not intended to provide an exhaustive analysis of the U.S. legal and institutional framework, U.S. federal acquisition law,¹⁰⁵⁵ or full comparative analysis of U.S. law and EU law.¹⁰⁵⁶ Rather, in

¹⁰⁵³ *ibid*, 251

¹⁰⁵⁴ For a useful but now dated description of U.S. federal procurement law with specific regard to foreign contractors, see M J Golub and S L Fenske, 'U.S. Government Procurement: Opportunities and Obstacles for Foreign Contractors 20' (1986-1987) *Geo Wash J Int'l L & Econ* 567

¹⁰⁵⁵ The number of practitioner volumes on each acquisition phase exemplifies the complexity of the field. For authoritative treatises on the law regulating contract awards, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (4th edn, CCH, 2011); J Cibinic Jr, R C Nash Jr and K R O'Brien-DeBakey, *Competitive Negotiation: The Source Selection Process* (3rd edn, CCH 2011). For a specific treatment of discrete aspects of procurement, see J Cibinic Jr and R C Nash Jr, *Cost Reimbursement Contracting* (3rd edn CCH 2004); R C Nash Jr and L. Rawicz, *Intellectual Property in Government Contracts* (6th edn CCH 2008). For an authoritative treatise on contract administration, see J Cibinic Jr, R C Nash and J F Nagle, *Administration of Government Contracts* (4th edn CCH 2006); see also C S Dees, 'Enforcing the bargain: contract administration' (2002) 2 PPLR, 131

accordance with the objectives identified in Chapter 1, its purpose is to provide a frame of reference for further research. For instance, the following are just some examples of the complexities that would need to be considered in any significant comparative analysis of U.S. and EU defence procurement law.

Firstly, the legislative processes concerned in the formulation of U.S. and EU law are very different, the resulting impact of which on the nature, form and function of defence procurement legislation itself has yet to be fully discerned.¹⁰⁵⁷

Secondly, U.S. acquisition law is significantly broader than the scope of the EU procurement Directives. In addition to the conduct of contract award procedures, U.S. law also regulates the equally, if not more important, acquisition planning and contract administration stages. The determination and statement of a contracting authority's needs, the identification of potential sources and the adequacy of planning are areas of broadly regulated decision-making which may significantly affect foreign competition from the outset. It has been observed that accurate and penetrating

¹⁰⁵⁶ Whilst transatlantic comparative legal scholarship on defence procurement issues is limited, there exists a more developed literature in the field of public procurement although much of which is not comparative in its methodology. A representative and non-exhaustive list includes: J Whelan, 'An introduction to the United States Federal Government system of contracting' (1992) 3 PPLR 207; J Whelan, 'Some current problems in United States procurement' (1992) 4 PPLR 308; B Udis, 'Weapons procurement in the United States' (1992) 6 PPLR 455; J Whelan, "Public law 103-355: "streamlining" federal acquisition in the United States" (1995) 3 PPLR 64; P J Carrier, 'New policy regarding arbitration of government procurement disputes in the United States' (1996) 3 PPLR 74-80; J Linarelli, 'The proposed Freedom from Government Competition Act of 1997' (1997) 5 PPLR, 208; P H Wittie, 'Transnational concerns: domestic preferences' (2002) 2 PPLR 145; W E Wittig, 'A brief survey of U.S. procurement reform in the E.U. context' (2002) 2 PPLR 33; M Steinicke, 'Public Procurement and the Negotiated Procedure – A Lesson to Learn from US law?' (2001) 8 European Competition Law Review, 331; J-J Verdeaux, 'Public Procurement in the European Union and in the United States: A Comparative Study' (2002-2003) 32 Pub. Cont. L. J. 713; J I Schwartz, 'Learning from the United States' procurement law experience: on "law transfer" and its limitations' (2002) 2 PPLR, 115; G S Hayken, 'Comparative study: the evolution of organizational conflicts of interest law in Europe and the United States' (2006) 3 PPLR 137; C Yukins, 'Are IDIQs Inefficient? Sharing Lessons with European Framework Contracting' (2007-2008) 37 Pub. Cont. L.J. 545; M Kidalov and K F Snider, 'Once more, with feeling: federal small business contracting policy in the Obama administration' (2013) 1 PPLR, 15; W E Kovacic and R D Anderson, 'Competition policy and international trade liberalisation: essential components to ensure good performance in public procurement markets' (n 24)

¹⁰⁵⁷ To date, there has been no detailed research examining the role and effect of Congressional or the EU "dialogue" processes on the formulation of public and defence procurement legislation. For a discussion on the link between the "rule-makers" and appropriated funds, see W E Wittig, 'A brief survey of U.S. procurement reform in the E.U. context' (n 1056)

comparative law analysis is significantly undermined by differences of scope and coverage.¹⁰⁵⁸ In any event, as comparative scholars observe, direct comparisons of discrete features of different legal systems in isolation risk being unreliable or even misleading even when those features appear to fulfill parallel functions.¹⁰⁵⁹

Thirdly, the U.S. and EU procurement systems proceed from different starting points. In the U.S., military procurement predates, and therefore historically conditions, the U.S. federal public procurement architecture.¹⁰⁶⁰ Conversely, the EU Public Sector Directives predate the Defence Procurement Directive. Whilst an adaptation of the Public Sector Directive, the Defence Procurement Directive seeks to differentiate itself in a separate instrument. Basic choices of this kind are significant. It has been argued that there may be “substantial adverse consequences when military procurement is not engrossed in emerging national and international public procurement regulatory regimes”.¹⁰⁶¹ As will be discussed in Part III, this issue is also pertinent in light of the fact that it has been debated whether defence procurement should fall within the scope of the WTO GPA, an issue of particular significance for transatlantic defence procurement relations.

Fourthly, U.S. defence procurement is primarily a federal competence.¹⁰⁶² By contrast, EU defence procurement is both a matter of EU and Member State

¹⁰⁵⁸ J I Schwartz, ‘The Centrality of Military Procurement: Explaining the Exceptionalist Character of United States Federal Public Procurement Law’, The George Washington University Law School Public Law and Legal Theory Working Paper No. 111, October 17 2004, 8 <<http://dx.doi.org/10.2139/ssrn.607186> > accessed 20 September 2013

¹⁰⁵⁹ J I Schwartz, ‘The Centrality of Military Procurement: Explaining the Exceptionalist Character of United States Federal Public Procurement Law’ (n 1058) 12 and see citations at fn14 therein

¹⁰⁶⁰ For an important discussion in this regard, see *ibid*

¹⁰⁶¹ *ibid* 122-124

¹⁰⁶² For a discussion of the U.S. federal structure in terms of its effect with regard to foreign competition at the level of individual U.S. States, see A Cox and S Greenwold, ‘The legal and structural obstacles to free trade in the United States procurement market’ (n 1051) 248-9

competence. It is recalled from Chapters 2 and 4 that this gives rise to a host of complex legal issues not least because of the existence of 28 national legal regimes applying the Defence Procurement Directive.

It follows that whilst U.S. and EU defence procurement laws share certain objectives common to all forms of public procurement, they also prioritise different objectives and which affect the form and content of legislation. The *raison d'être* of the procurement Directives is to substantially prohibit national discrimination and to provide access and equal treatment to foreign i.e. EU economic operators. However, the legislation nevertheless makes concessions to national interests. By contrast, whilst U.S. procurement law is designed with an intention to ensure competition in most cases, it was not expressly designed with non-discrimination and equal treatment of foreign operators in mind. To this extent, even though U.S. law in fact permits participation of foreign competitors in defence contract awards, fundamentally, U.S. law is politically and legally configured with a specific focus on national interest, in particular, the U.S. national security interest.¹⁰⁶³ It follows that its exclusions and exceptions to full and open competition are generally broader in scope. Therefore, as will be demonstrated, whilst there may be fundamental similarities in provisions of U.S. and EU law, subtle differences may, in fact, reflect fundamental differences in their underlying objectives.

¹⁰⁶³ For instance, as will be discussed in Chapters 9 and 10, whilst certain U.S. exclusions and exceptions are comparable to the Directive's provisions permitting use of the negotiated procedure without publication, U.S. exclusions and exceptions are largely unrestrained in the fact that they are not circumscribed by certain limiting conditions on their use in the way that is perceived necessary by the EU legislator in order to prevent their misuse by Member States. Further, it is recalled from Chapter 5 that the Directive incorporates specific provisions on security of supply in order to bring greater transparency to the use of security of supply as a discriminating as opposed to discriminatory factor in defence procurement. By contrast, U.S. law simply enables the use of security of supply as a broad ground for excluding or precluding competition

Finally, perhaps most importantly, within the EU, legislation is seen as an *instrumental* and integral tool for the achievement of competition and is driven by an existential concern about the continued ability of the EU to remain competitive in the field of defence trade. By contrast, as the World's largest defence market, the U.S. has largely been self-sustaining without the need for foreign competition. To this extent, whilst U.S. law is seen as a vital tool to improve competition, all hopes do not rest on the ability of a single instrument to radically alter the competitive dynamics of a market. It is therefore unsurprising that U.S. laws and regulations limiting competition are not subject to the same intensive scrutiny as is the case with EU defence procurement legislation.¹⁰⁶⁴

However, as the following Chapters will demonstrate, it does not necessarily follow that there are no points of relation or comparison between U.S. and EU law that could provide a basis for examining possibilities to improve the role of legal institutions in pursuit of transatlantic defence trade objectives.

2. Sources of U.S. Federal Defence Procurement Law

In the U.S., the exercise of procurement competence is shared between the Executive and Legislative branches. The Executive branch has the constitutional power to execute laws and enters into contracts whilst Congress enacts statutes authorizing programmes or activities and their funding.¹⁰⁶⁵

¹⁰⁶⁴ However, as will become evident in this Part, the emphasis in the U.S. on accountability in public spend means that procurement *in practice* is subject to much more extensive public scrutiny, transparency and accountability mechanisms than is the case in the EU generally and specifically in the field of defence procurement

¹⁰⁶⁵ For a discussion of the legal basis for, and requirements governing, the federal government budget and appropriations processes, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n

2.1. Statutory Sources: ASPA, FPASA, OFPPA, DPA and CICA

There is no single statute which regulates federal procurement. The two main statutes covering most government procurement are the Armed Services Procurement Act 1948 (“ASPA”)¹⁰⁶⁶ and the Federal Property and Administrative Services Act 1949 (“FPASA”),¹⁰⁶⁷ both of which have been subject to revision since their enactment.¹⁰⁶⁸ The ASPA grants authority to the Secretaries of the armed services to make procurement decisions. ASPA also provides general guidelines under which such decisions are to be made.¹⁰⁶⁹ The ASPA applies to procurement of all property (other than land) and services undertaken by the DoD, the Department of the Army, the Department of the Navy, the Department of the Air Force, the Coast Guard and the National Aeronautics and Space Administration (“NASA”).¹⁰⁷⁰ In addition to the ASPA and FPASA, the Office of Federal Procurement Policy Act (“OFPPA”) contains a number of procurement rules covering almost all government agencies.¹⁰⁷¹ This includes the DoD¹⁰⁷² and the military departments (Army, Navy and Air Force).¹⁰⁷³ The OFPPA created the Office of Federal Procurement Policy (“OFPP”) within the Office of Management and Budget (“OMB”). Congress established the OFPP in 1974 to provide overall direction for government-wide

1055) 38-58. The final stage of the process is the passage of the annual appropriations statutes, an example of which is the annual DoD Appropriations Act. See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 43-45

¹⁰⁶⁶ 10 U.S.C. §2302 et seq

¹⁰⁶⁷ 41 U.S.C. § 251 et seq

¹⁰⁶⁸ The ASPA has been modified extensively but the FPASA tends to be modified infrequently. See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 27

¹⁰⁶⁹ The FPASA grants authority to the heads of the non-military departments and agencies

¹⁰⁷⁰ 10 U.S.C. § 2303. See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 29. In contrast, the FPASA applies to procurement undertaken by “executive agencies” with the exception of the DoD, the Coast Guard, and NASA. See 41 U.S.C. § 3101(c)(A)

¹⁰⁷¹ 41 U.S.C. § 1101 et seq. See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 33

¹⁰⁷² 41 U.S.C. § 403(1)(A)

¹⁰⁷³ 4.1. U.S.C. § 403(B)

procurement policies, regulations and procedures and to promote economy, efficiency, and effectiveness in acquisition processes.¹⁰⁷⁴ However, the above have largely been superseded by more detailed regulation discussed below.

In addition, the Defense Production Act (“DPA”)¹⁰⁷⁵ provides the President with a broad set of authorisations to ensure that domestic industrial capabilities can meet “national defense”¹⁰⁷⁶ requirements.¹⁰⁷⁷ The DPA authorizes or mandates the President *inter alia* to: (1) require acceptance and priority performance of contracts and orders in support of national defense;¹⁰⁷⁸ (2) provide financial incentives and assistance for industry to expedite production and deliveries or services under Government contract and to provide for maintenance, improvement, and expansion of production capabilities needed for national defense purposes;¹⁰⁷⁹ (3) provide antitrust protection for voluntary agreements between competitors to enable cooperation to plan and coordinate measures to increase the supply of materials and services needed for national defense purposes¹⁰⁸⁰ and (4) review national security impact of foreign investment in firms based in the U.S.¹⁰⁸¹ The DoD continues to be

¹⁰⁷⁴ Pub. L. No. 93-400, 88 Stat. 796. Further information on the OFPP can be found at <http://www.whitehouse.gov/omb/procurement_default> accessed 20 September 2013

¹⁰⁷⁵ Pub. L. No. 81-774 (1950); codified at 50 U.S.C. App. §§2061-2171, as amended

¹⁰⁷⁶ Section 702(14) defines “national defense” as: “programs for military and energy production or construction, military or critical infrastructure assistance to any foreign nation, homeland security, stockpiling, space, and any directly related activity. Such term includes emergency preparedness activities conducted pursuant to title VI of The Robert T. Stafford Disaster Relief and Emergency Assistance Act [42 U.S.C. § 5195 et seq.] and critical infrastructure protection and restoration.”

¹⁰⁷⁷ For a useful overview of the DPA, see D H Else, ‘Defense Production Act: Purpose and Scope’ 14 May 2009 Congressional Research Service <<http://www.dtic.mil/cgi-bin/GetTRDoc?AD=ADA501341>> accessed 20 September 2013

¹⁰⁷⁸ Title I (Priorities and Allocations). For a discussion of the provisions under this Title, see D H Else, ‘Defense Production Act: Purpose and Scope’ (n 1077) 2

¹⁰⁷⁹ Title III (Expansion of Productive Capacity and Supply). For a discussion of the provisions under this Title, see D H Else, ‘Defense Production Act: Purpose and Scope’ (n 1077) 3

¹⁰⁸⁰ Title VII (General Provisions). For a discussion of the provisions under this Title, see D H Else, ‘Defense Production Act: Purpose and Scope’ (n 1077) 4-5

¹⁰⁸¹ An inter-Agency body comprised of the heads of federal acquisition Departments and Agencies, the Defense Production Act Committee (“DPAC”) was established under Section 722 of the DPA and is charged with providing

the primary user of the authorities provided.¹⁰⁸² However, this power is not frequently exercised.¹⁰⁸³

Finally, the Competition in Contracting Act 1984 (“CICA”)¹⁰⁸⁴ imposes a positive statutory obligation on contracting authorities to achieve competition in federal procurement.¹⁰⁸⁵ By setting a particular level of competition as the objective, an appropriate contracting technique i.e. procedure can then be selected.¹⁰⁸⁶

CICA applies to most contracts, excluding only those subject to procurement procedures authorized by a particular statute.¹⁰⁸⁷ CICA categorizes competition according to three forms: “full and open competition”; “full and open competition after exclusion of sources”; and “other than full and open competition”. These forms will be discussed in Chapters 9 and 10.

CICA also requires competition when using simplified acquisition procedures for low value purchases,¹⁰⁸⁸ and for the award of so-called task order and delivery order (“TO/DO”) contracts, the equivalent of “framework” agreements under EU law.¹⁰⁸⁹

advice to the President on the effective use of the DPA as well as making recommendations to Congress if legislative actions are required. See <<http://www.acq.osd.mil/mibp/dpac.html>> accessed 20 September 2013

¹⁰⁸² Government Accountability Office, *Defense Production Act: Agencies Lack Policies and Guidance for Use of Key Authorities*, June 2008, Report to Congressional Committees, GAO-08-854 <<http://www.gao.gov/new.items/d08854.pdf>> accessed 20 September 2013

¹⁰⁸³ S W Feldman, *Government Contract Guidebook* (4th edn Federal Publications 2011) § 2:7

¹⁰⁸⁴ Pub. L. No. 98-369, 31 U.S.C. § 3551 et seq

¹⁰⁸⁵ CICA was enacted as part of the Deficit Reduction Act of 1984, P.L. 98-369, §§ 2701-2753, 98 Stat. 1175 (1984). CICA amended the Armed Services Procurement Act of 1947; Federal Property and Administrative Services Act of 1949; Office of Federal Procurement Policy Act of 1974. It also created a statutory basis for the bid-protest function of the GAO (discussed in more detail in Section 4 below). CICA’s competition requirements took effect on 1 April 1985. For a commentary on CICA in its historical context, see W S Cohen, ‘The Competition in Contracting Act’ (1983-1984) 14 Pub Cont LJ 1

¹⁰⁸⁶ W S Cohen, ‘The Competition in Contracting Act’ (n 1085) 2

¹⁰⁸⁷ 10 U.S.C. § 2304(a)(1)(A) & 41 U.S.C. § 3301(a)(1)

¹⁰⁸⁸ 10 U.S.C. § 2304(g)(1)(A) & 41 U.S.C. § 253(g)(1)(A)

¹⁰⁸⁹ 10 U.S.C. §§2304(a)-(d) and 41 U.S.C. §§ 41 U.S.C. 4104-06. However, the issuance of task or delivery orders under “TO/DO” contracts are not subject to CICA. See 48 C.F.R. § 6.001(e)-(f). For a discussion of this

CICA has been implemented in Part 6 of the Federal Acquisition Regulation (“FAR”) and Sub Part 206 of the Defense Federal Acquisition Regulation Supplement (“DFARS”). It is to these provisions which this Chapter now turns.

2.2. Regulatory Sources: Federal Acquisition Regulation and Supplements

Whilst Congress has not enacted a single statute governing all agencies, there is a single Government-wide Regulation.¹⁰⁹⁰ This detailed regulation is called the Federal Acquisition Regulation (“FAR”).¹⁰⁹¹ The FAR is written by the Defense Acquisition Regulation Council (“DAR”)¹⁰⁹² and the Civilian Agency Acquisition Council (“CAA”).¹⁰⁹³ The FAR is issued and maintained by the Secretary of Defense, the Administrator of General Services and the Administrator of NASA.¹⁰⁹⁴ The FAR is subject to frequent revision.¹⁰⁹⁵ Specific to defence, the DAR also recommends revisions to the Defense Federal Acquisition Regulation Supplement (“DFARS”).

All of the major agencies with procurement functions issue supplementary regulations to implement the FAR.¹⁰⁹⁶ The most significant set examined in this Part

form of contracting, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1331-1336 and 1386-1406; C R Yukins, ‘Are IDIQS Inefficient? Sharing Lessons with European Framework Contracting’ (n 1056). For a further discussion in this regard, see Chapter 10, Section 3.3

¹⁰⁹⁰ 41 U.S.C. § 1121(b)

¹⁰⁹¹ The FAR came into effect on 1 April 1984

¹⁰⁹² The DAR Council is composed of representatives of the Secretary of Defense and each of the military departments, the Defense Logistics Agency (“DLA”), and NASA. Further information on the DAR can be found on the Defense Procurement and Acquisition Policy (“DPAP”) website at <<http://www.acq.osd.mil/dpap/dars/about.html>> accessed 20 September 2013

¹⁰⁹³ The CAA Council is chaired by a representative of the Administrator of General Services. The CAA’s membership comprises representatives from the civilian agencies (the Departments of Agriculture, Commerce, Energy, and Treasury, for example). See FAR 1.201-1

¹⁰⁹⁴ 41 U.S.C. § 1303(a)

¹⁰⁹⁵ The latest version of the FAR (updated 3 September 2013) can be found at <<http://www.acquisition.gov/far/>> accessed 20 September 2013

¹⁰⁹⁶ A diagrammatic representation of the FAR System and a table of issued supplements can be found in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 35-37 at Figures 1-3 and 1-4 respectively

is the DFARS.¹⁰⁹⁷ The military departments have also issued separate supplements.¹⁰⁹⁸ In 2004, the DoD issued “Procedures, Guidance and Information” (“PGI”), a companion resource to the DFARS which contains mandatory and non-mandatory internal DoD procedures, non-mandatory guidance, and supplemental information.¹⁰⁹⁹ In limited circumstances, deviations from the DFARS are permitted.¹¹⁰⁰ The DFARS is also occasionally supplemented by the issuance of Defense Acquisition Circulars¹¹⁰¹ and Departmental Letters.¹¹⁰²

3. Exercise and Oversight of the Procurement Function

The national Ministries of Defence of the EU Member States will typically procure through their designated agencies. However, as indicated by the number of FAR supplements, in the U.S., procurement will be undertaken at various operational levels within a decentralized structure. Further, it is recalled that in the EU the Commission will exercise the primary oversight and enforcement function. By contrast, as this Section will demonstrate, the U.S. exercises a much more substantial oversight function through a well-resourced Congress.

¹⁰⁹⁷ The latest version of DFARS (updated 9 September 2013) can be found at <<http://www.acq.osd.mil/dpap/dars/dfarspgi/current/index.html>> accessed 20 September 2013

¹⁰⁹⁸ These include the Engineer Federal Acquisition Regulation Supplement (U.S. Army Corps of Engineers) (“EFRS”); Navy Marine Corps Acquisition Regulation Supplement (“NMCARS”) (48 CFR 52); Army FAR Supplement (“AFARS”) (48 CFR 51); Air Force FAR Supplement (“AFFARS”) (48 CFR 53); Defense Logistics Acquisition Directive (“DLAD”) (48 CFR 54); Special Operations (“SOFARS”) and Transportation Command (“TRANSFARS”). These are listed in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 36-37

¹⁰⁹⁹ See 69 Fed. Reg. 63326. The latest version of the PGI (updated 9 September 2013) can be found at <<http://www.acq.osd.mil/dpap/dars/dfarspgi/current/index.html>> accessed 20 September 2013

¹¹⁰⁰ Deviations from the FAR are allowed only if authorized and approved by a designated official (FAR subpt. 1.4). The same is the case for deviations from the DFARS (DFARS 201.402). All class deviations from the DFARS existing at the time of writing can be found at: <http://www.acq.osd.mil/dpap/dars/class_deviations.html> accessed 20 September 2013 > On deviations generally, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 69-71.

¹¹⁰¹ In addition to DFARS revisions, a Defense Acquisition Circular may include policies, directives, and information items

¹¹⁰² DFARS 201.304(6)

3.1. Procurement by the DoD and Military Departments

The DoD is one of the largest individual purchasing agencies in the federal Government.¹¹⁰³ The DoD includes the Office of the Secretary of Defense, the Joint Chiefs of Staff, the Military Departments, the unified commands, and other agencies that the Secretary of Defense establishes to meet specific requirements, such as the Defense Contract Audit Agency (“DCAA”) and the DLA.

Procurement is generally managed at the secretarial level by an Under Secretary (e.g. Acquisition, Technology and Logistics). Procurement operational responsibility is generally decentralised.¹¹⁰⁴ Organisation is influenced by the manner in which procurement authority is delegated.¹¹⁰⁵ Responsibility for research, development, and acquisition of hardware and other logistics aspects is generally delegated to major commands.¹¹⁰⁶ Below the command level exist hundreds of field organizations. Each of the three military departments (Army, Navy, and Air Force) purchases supplies, services, and construction to support its respective functions but other DoD component organizations also have a significant role in the procurement process.¹¹⁰⁷

Within each DoD department, the Agency Head e.g., the Secretary of each Military Department or chief official of any other defence component or Agency has the

¹¹⁰³ Total spend for FY 2012 was \$366,020,420,809. For a statistical breakdown of contract spend see <http://www.usaspending.gov/index.php?typeofview=detailsummary&overridecook=yes&carryfilters=on&q=node%2F3&maj_contracting_agency=9700&maj_contracting_agency_name=Department+of+Defense&fiscal_year=2012&tab=By+Agency> accessed 20 September 2013

¹¹⁰⁴ Feldman, *Government Contract Guidebook* (n 1083) § 2:16

¹¹⁰⁵ *ibid*

¹¹⁰⁶ *ibid*

¹¹⁰⁷ For example, the DLA provides consumable supply items and logistics services common to the military departments. Separate DLA supply centres exist for the handling of items associated with construction, electronics, fuels, general supplies, personnel support supplies, and industrial supplies. The DCAA, formerly a branch of DLA but now a separate agency, provides contract administration and support services for the DoD. See Feldman, *Government Contract Guidebook* (n 1083) § 2:16

authority and responsibility to contract for authorized supplies and services.¹¹⁰⁸ The Agency Head may also establish contracting activities and delegate broad authority to manage the Agency's contracting functions to Heads of such contracting activities.¹¹⁰⁹ Individual contracting offices within a contracting activity award or execute a contract and perform post-award functions.

The Defence Procurement and Acquisition Policy Office ("DPAP") is responsible for all acquisition and procurement policy matters in the DoD.¹¹¹⁰ The DPAP Contract Policy and International Contracting Directorate ("CPIC") is the focal point for developing and improving acquisition policies.¹¹¹¹ As will be discussed in Chapter 11, DPAP has an international contracting staff assigned to deal with matters of U.S. foreign acquisition law.¹¹¹²

3.2. Executive and Legislative Oversight of Federal Procurement

In addition to the promulgation of the FAR and Agency specific supplements, the Executive branch may exercise further control over the procurement process through the issuance of additional regulations.¹¹¹³ Executive Orders issued by the

¹¹⁰⁸ For a useful overview of defence acquisition generally, see M Schwartz, *Defense Acquisitions: How DOD Acquires Weapon Systems and Recent Efforts to Reform the Process* (Congressional Research Service) January 2013 <<http://www.fas.org/sgp/crs/natsec/RL34026.pdf>> accessed 20 September 2013

¹¹⁰⁹ See FAR 1.601(a). DoD contracting activities are listed in the definition of "contracting activity" in DFARS 202.101

¹¹¹⁰ DPAP serves as the principal advisor to the Under Secretary of Defense for Acquisition, Technology and Logistics and the Defense Acquisition Board on acquisition/procurement strategies for all major weapon systems programmes, major automated information systems programmes, and services acquisitions. The DPAP website provides a useful overview of U.S. federal defence procurement and acquisition policy, see <<http://www.acq.osd.mil/dpap/>> accessed 20 September 2013

¹¹¹¹ For more information, see <<http://www.acq.osd.mil/dpap/cpic/>> accessed 20 September 2013

¹¹¹² For more information, see <<http://www.acq.osd.mil/dpap/cpic/ic/about.html>> accessed 20 September 2013

¹¹¹³ See generally, J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 58-62

President,¹¹¹⁴ OMB Circulars and OFPP Policy Letters deal with matters having broad application throughout the Executive Branch. These regulations may be published to implement statutes or may be based on Executive branch policies.

Further, certain agencies are increasingly using guidance documents which are not issued following the rules governing the issuance of formal regulations.¹¹¹⁵ A prime example in this regard is the DoD PGI identified above. It has been suggested that documents of this kind are unlikely to be given the legal status of formal regulations.¹¹¹⁶

In addition, the Inspector General Act of 1978¹¹¹⁷ established the authority of Inspectors General in a number of departments and agencies which include the DoD.¹¹¹⁸ The Inspectors General have broad investigatory powers which are required to be exercised without agency influence.¹¹¹⁹ Generally, Inspector Generals have played a significant role in auditing and investigating the effectiveness of the procurement activities of executive agencies.¹¹²⁰

¹¹¹⁴ An example is Executive Order 12526, The President's Blue Ribbon Commission on Defense Management, July 15, 1985. The Commission was established to analyse and improve defense management practices, specifically including acquisition

¹¹¹⁵ J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 59

¹¹¹⁶ For a discussion in this regard see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 60-61

¹¹¹⁷ 5 U.S.C. App. §2

¹¹¹⁸ A list of covered departments and agencies can be found at 5 U.S.C. App. § 11. The primary duties and responsibilities of the Inspectors General are set out at 5 U.S.C. App. §4(a). For a discussion in this regard, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 62-64

¹¹¹⁹ In accordance with 5 U.S.C. App. § 3(a), Inspectors General may conduct investigations when they consider necessary or desirable with access to all agency programme and operation records (5 U.S.C. § 6(a)(1)). This includes power to issue subpoenas to obtain relevant evidence (5 U.S.C. App. §6(a)(4)). In addition, the Inspectors General must submit a semi-annual report to the relevant Head of the Agency who is, in turn, required to submit the report to the appropriate Congressional committee (5 U.S.C. App. § 5(a)). Limitations on the scope of the DoD Inspector General's investigative and reporting roles for classified and other sensitive matters are contained in 5 U.S.C. App. §8

¹¹²⁰ See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 65 citing, *inter alia*, DoD IG Rep't D-2004-015, *Contracts for Professional, Administrative and Management Support Services*

Whilst Congress exercises considerable control over procurement through its appropriation and authorization powers, Congress enables continuing oversight in at least two other significant respects. Firstly, the Budget and Accounting Act of 1921¹¹²¹ established the General Accounting Office (now General Accountability Office¹¹²²) and Comptroller General under whose control and direction the GAO functions.¹¹²³ As will be discussed in Chapters 10 and 11, the GAO and Comptroller General have assumed particular prominence in the oversight of defence procurement. Currently, the GAO audits government Agencies and their contractors, decides so-called contract award “controversies” and other procurement-related disputes, settles government financial accounts and prescribes Executive Agency accounting principles.¹¹²⁴ Again, the GAO has a number of powers at its disposal in the performance of its audit function.¹¹²⁵ In exercising its powers, the GAO regularly issues audit reports evaluating various Agencies’ implementation of the procurement process and recommending improvements.¹¹²⁶ As will be discussed in Chapters 10 and 11, the GAO has monitored the use of CICA exceptions, domestic source restrictions, the implementation of the RDP MOU’s, International collaborations, export processes, licensing exceptions and ITAR waivers. Importantly, CICA also conferred power on the GAO to make recommendations on award controversies and

¹¹²¹ 42 Stat. 20

¹¹²² Effective July 7, 2004, the GAO changed its name from the “General Accounting Office” to the “Government Accountability Office” to better reflect its expanding competences. See GAO Human Capital Reform Act of 2004, Pub. L. No. 108-271, 118 Stat. 811

¹¹²³ The Comptroller General is appointed by the President for a single 15 year term, with some qualifications. See 31 U.S.C.A. § 703(b). For commentary, see Feldman, *Government Contract Guidebook* (n 1083) § 2:5

¹¹²⁴ For commentary on the GAO’s functions, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 67

¹¹²⁵ GAO has access to all government records and each Agency is required to supply information GAO requires (31 U.S.C. § 716). This statute also grants GAO subpoena power to compel the production of documents. In addition, GAO has the right to audit directly the pertinent books and records of contractors that are awarded negotiated contracts (10 U.S.C. § 2313(B) and 41 U.S.C. § 4706(d)). J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 67

¹¹²⁶ For a list of examples of GAO Reports relating to defence acquisition, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 67

to require agencies to stay a procurement until a protest has been decided.¹¹²⁷ Secondly, Congress exercises additional oversight through the investigations and hearings of its committees. An example relevant to defence is the Armed Services Committee of the Senate and House.¹¹²⁸

4. Review under U.S. Federal Procurement Law

Whilst the Commission and CJEU have competence, respectively, to investigate and enforce EU procurement rules, there is no specifically designated EU procurement review institution under the EU procurement Directives comparable to an administrative review board, tribunal or court. The Public Sector and Utilities Directives provide for separate Directives on remedies which permit aggrieved tenderers to initiate proceedings against contracting entities within national courts and review bodies.¹¹²⁹ In contrast, whilst the Defence Procurement Directive contains specific provisions on review procedures,¹¹³⁰ there is no separate remedies Directive.¹¹³¹ To this extent, EU procurement law must be enforced through national

¹¹²⁷ In *Ameron Inc. v. United States Army Corps of Eng'rs*, 809 F.2d 979 (3rd Cir. 1986), CICA was held not to violate the U.S. Constitution because the protest procedure neither gives GAO executive power nor “interferes impermissibly with the Executive’s performance of its procurement duties”. See Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 68

¹¹²⁸ Whilst such Committees do not establish binding rules, Agencies generally accord them respect in formulating contracting policies. These Committees also supplement the GAO’s activities. The Committees have responsibility for reviewing GAO reports, making recommendations to Congress and conducting their own studies of government procurement projects. Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 65

¹¹²⁹ Council Directive 92/13/EEC of 25 February 1992 coordinating the laws, regulations and administrative provisions relating to the application of Community rules on the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors [1992] OJ L 76/14 as amended by Directive 2007/66/EC [2007] OJ L335/31; Council Directive 89/664/EEC of 21 December 1989 on the coordination of the laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts [1989] OJ L 395/31 as amended by Directive 2007/66/EC [2007] OJ L335/31. For commentary on these provisions, see C H Bovis, *EC Public Procurement: Case Law and Regulation* (n 883) 402-444; S Treumer and F Lichère (eds.), *Enforcement of the EU Public Procurement Rules* (Copenhagen: Djøf Publishing, 2011) 299–328

¹¹³⁰ See Title IV, Articles 55-64

¹¹³¹ For a discussion in this regard, see Trybus, ‘The hidden Remedies Directive’ (n 564)

courts and recognized review bodies in the first instance. It is recalled from Chapter 4 that the idiosyncratic features of each national legal system may variably impact upon the extent to which U.S. companies may seek effective judicial redress.¹¹³²

By contrast, the U.S. has an extensive review system.¹¹³³ It is beyond the scope of this thesis to engage a full analysis of the operation of the U.S. review and remedies system with regard to foreign contractors. To date, existing studies and reports have not focused extensively on this aspect of foreign treatment. However, as will be discussed in Chapter 9, Section 3, even a cursory analysis of the GAO bid protest mechanism provides interesting insights which could provide the basis for further research. This Section simply provides an explanatory overview of the review and remedies system in context.

There are currently three main institutions concerned in the review of procurement: the procuring Agencies, the Comptroller General (head of the GAO) and the Court of Federal Claims. Recourse to the boards of contracts appeals and district courts are possible; however, these generally lack the necessary jurisdiction.¹¹³⁴

In the first instance, all Agencies provide administrative procedures for resolving bid protests.¹¹³⁵ The Agency protest procedure is regulated by the FAR and is based on guidance modelled on GAO protest procedures.¹¹³⁶ The FAR is not clear on the

¹¹³² See Chapter 4, Section 3

¹¹³³ For a useful overview, see F J Lees, 'Resolving differences: protests and disputes' (2002) 2 PPLR 138

¹¹³⁴ J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1673-1674

¹¹³⁵ For commentary, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1681-1685

¹¹³⁶ *ibid* 1683

standards of review that will be used.¹¹³⁷ The formal Agency protest procedure is considered broadly comparable to an assessment of whether the actions of the contracting Agency are “reasonable”, as that concept is construed by the GAO and courts.¹¹³⁸ If a protest is brought to the Head of an Agency using the FAR Agency protest procedure, the Agency can take any action that could have been recommended by GAO.¹¹³⁹ This can include payment of appropriate costs and reimbursement of Government costs by the awardee where a protest is sustained.¹¹⁴⁰ In addition, Agencies can designate Ombudsman and alternative dispute resolution.¹¹⁴¹ The DPAP has a designated Ombudsman whose functions include dealing with foreign contractors who consider that they have been unfairly excluded from a procurement. Importantly, however, as will be discussed in Chapter 11, Section 4.6.2, it is difficult to discern the adequacy and effectiveness of this form of redress.

An alternative means of redress is the GAO which has statutory authority to hear bid protests.¹¹⁴² Whilst bid protests have generally been in decline in the U.S,¹¹⁴³ the GAO continues to be the most widely used forum in light of its expertise and relative inexpense compared to full judicial proceedings. On receipt of a protest, an Agency

¹¹³⁷ Ibid 1685-6

¹¹³⁸ FAR 33.103(d). For commentary, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1683-4

¹¹³⁹ FAR 33.102(b). For commentary, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1686-1687

¹¹⁴⁰ FAR 33.102(b)(2) and (3)

¹¹⁴¹ For a useful overview of the use of federal Ombudsman, see W R Ginsberg and F M Kaiser, ‘Federal Complaint-Handling, Ombudsman, and Advocacy Offices’, Congressional Research Services, 24 <<http://www.fas.org/sgp/crs/misc/RL34606.pdf>> accessed 20 September 2013

¹¹⁴² 31 U.S.C. § 3551. For extensive commentary on the GAO’s jurisdiction and procedural requirements relating to a GAO application, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1688-1717

¹¹⁴³ For a useful discussion of the reasons explicating possible trends, see S L Schooner, ‘Pondering the decline of federal government contract litigation in the United States’ (1999) 5 PPLR 242

can either take corrective action¹¹⁴⁴ or defend the protest.¹¹⁴⁵ The GAO review process permits the possibility of a hearing on its own initiative or at the request of one of the parties and can include the oral examination of witnesses.¹¹⁴⁶ With regard to the standard of review applied, as an administrative protest body, the GAO is not permitted to substitute its judgment for that of the Agency.¹¹⁴⁷ The GAO will review an Agency's action to determine if it "complies with statute or regulation."¹¹⁴⁸ According to this standard, a protester must establish that the Agency has prejudicially violated a statute or regulation or has taken a discretionary action without a rational basis.¹¹⁴⁹ It has been observed that the GAO has provided Agencies with a considerable degree of latitude in applying the rational basis standard.¹¹⁵⁰ This appears to incorporate an assessment of the "reasonableness" of the Agency's determination.¹¹⁵¹ In terms of prejudice, the protester must establish that but for the Agency's actions, it would have had a substantial chance of receiving the award.¹¹⁵² As will be discussed in Chapter 9, Section 3.3, recent reports on GAO bid protests have provided useful insights into reviews of protests involving major acquisitions, certain of which are of potential significance to foreign contractors.

¹¹⁴⁴ For a discussion of this option, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1717-1720

¹¹⁴⁵ For a discussion of this option, see *ibid*, 1721-1724

¹¹⁴⁶ *ibid* 1728-1729

¹¹⁴⁷ *Unisys Corp v. Department of the Air Force*, GSBICA 13119-P, 95-2 BCA ¶ 27, 622, rev'd, 98 F.3d 1325 (Fed. Cir. 1996) cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1732-1733

¹¹⁴⁸ 31 U.S.C. §3554(b)(1)

¹¹⁴⁹ J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1732

¹¹⁵⁰ *ibid*

¹¹⁵¹ *The Boeing Co.*, Comp. Gen. Dec. B-311344, 2008 CPD ¶ 144

¹¹⁵² *Armorworks Enters., LLC*, Comp. Gen. Dec. B-400394.3, 2009 ¶ 79 cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1735. For a discussion of this requirement, see 1735-1740

In terms of remedies, the GAO can make recommendations to an Agency. The GAO does not have authority to require any Agency to take action; however, Agencies rarely fail to follow these recommendations.¹¹⁵³ The GAO can also recommend that the Agency: refrain from exercising any option under the contract; re-compete the contract; issue a new solicitation or terminate the contract; and award a legitimate contract.¹¹⁵⁴ The GAO can also permit recovery of protest costs and bid costs but prohibits anticipated profits.¹¹⁵⁵

Finally, the Court of Federal Claims has confirmed jurisdiction to hear procurement protests.¹¹⁵⁶ However, the GAO is generally perceived to be the most popular bid-protest forum, not least because it reaches decisions faster than the Court of Federal Claims and at substantially lower cost.¹¹⁵⁷

To date, there is no consolidated evidence or analysis that is able to provide an indication of the extent to which foreign contractors seek redress through the U.S. procurement review system, nor the treatment of disputes involving foreign contractors. Foreign contractors are unlikely to pursue formal bid protest mechanisms independently for a host of reasons. Notwithstanding, there are instances in which U.S. subsidiaries of European firms will seek to access the U.S review system. As indicated, whilst existing studies have focused on issues of access

¹¹⁵³ For commentary in this regard, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1740 and cases cited therein

¹¹⁵⁴ 31 U.S.C. §3554(b)(1). For commentary, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1741-1743

¹¹⁵⁵ *Baker Servs. Inc.*, Comp. Gen. Dec. B-256192.3, 95-1 CPD ¶ 75 cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1743. For commentary, see 1743-1753

¹¹⁵⁶ 28 U.S.C. § 1491(b)(1). For commentary on jurisdiction, standing, procedures and standard of review, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1762-1790

¹¹⁵⁷ R S Metzger and D A Lyons, 'A Critical Reassessment of the GAO Bid-Protest Mechanism' (2007) *Wis. L. Rev* 1225

and treatment with regard to contract awards, the issue of review and remedies has not been the subject of any examination. As will be discussed in Chapter 11, Section 4.6, U.S. legal commentary has placed particular emphasis on the potential role and importance of effective review and remedies provisions in the reform of transatlantic defence procurement. To this extent, this aspect ought to be accorded sufficient priority in future research on transatlantic defence procurement issues.

5. Conclusions

It is apposite to revisit the observation of one U.S. commentator in Chapter 1 that the legal regimes governing public contract formation often erect “a dense, twisted web of rules, which may impede (and frequently intimidates) potential foreign entrants”.¹¹⁵⁸ Whilst certain larger foreign defence firms may be equipped with the resources and expertise to navigate the U.S. acquisition system, studies have identified its sheer complexity as a major obstacle to foreign market penetration, especially for medium and small firms, in particular in terms of the need to employ specialized personnel.¹¹⁵⁹

The following Chapters will provide only the most provisional assessment of certain of the core statutory and regulatory requirements which govern federal defence procurement law. It must be recognized that it cannot be presumed that there is uniformity of attitudes, approaches and practices between DoD components in terms of their treatment of foreign competition through the decentralized application of U.S.

¹¹⁵⁸ Yukins and Schooner, ‘Incrementalism: Eroding the Impediments to A Global Procurement Market’ (n 29), 530

¹¹⁵⁹ *Fortresses and Icebergs*: (Vol. II) (n 12) 627 and 654

laws and policies. To this extent, any and all conclusions drawn on the basis of available evidence recognize the necessary limitations of observation.

Full and Open Competition under U.S. Federal Procurement Law

1. Introduction

It is recalled that the Competition in Contracting Act 1984 (“CICA”) prescribes “full and open competition”, “full and open competition after exclusion of sources” and “other than full and open competition”. It has been suggested that current U.S. procurement rules encourage the consideration of foreign participation and make it more difficult than in the past to avoid open and competitive bidding on defence contracts, in particular, because specific written justifications are required to limit sources.¹¹⁶⁰ However, it has also been identified that statutory exceptions to full and open competition effectively provide programme managers with relatively broad discretionary authority to exclude foreign participation on a range of grounds.¹¹⁶¹

Before examining these exceptions, it is first necessary to examine the extent to which CICA enables full and open competition (including after the exclusion of certain sources) with regard to foreign contractors. This Chapter begins with a contextual overview of competition rates within the U.S. based on available evidence. Having placed the issue of foreign competition in context, the Chapter examines the extent to which foreign competition is affected even within the ostensible circumstance of full

¹¹⁶⁰ *Fortresses and Icebergs*: (Vol. II) (n 12) 663

¹¹⁶¹ *ibid* 662-3

and open competition. Finally, the Chapter examines the extent to which industrial mobilization and small business set asides provide a statutory basis for exclusion of foreign competition through the CICA exclusions.

2. Competition in U.S. Federal Defence Procurement

Before conducting a more detailed legal analysis, it is important to identify the evidential limitations of existing data. At the outset it should be observed that most official sources and studies do not specifically define “foreign competition” in a way that differentiates nationality according to the basis of establishment, the use of subsidiaries or, more generally, between competition from the EU and other foreign competition.

2.1. Competition in Federal Procurement: General Depiction of Recent Trends

In light of the emphasis placed on accountability in public spend in the U.S., U.S. law specifically requires evidence to be obtained and reviewed regarding the level of “competition” (broadly construed) that is achieved in procurement.¹¹⁶²

2.1.1. Federal Procurement Competition Rates

In a recent 2013 Report, the GAO identifies that the competition rate for all contract obligations has generally declined from 62.6% in 2008 to 57.1% in 2012.¹¹⁶³ In 2012,

¹¹⁶² As indicated in Chapter 8, Section 3.2, this is largely attributable to the influence and oversight exercised by Congress in the procurement process. See also *Fortresses and Icebergs: (Vol. II)* (n 12) 663

¹¹⁶³ Government Accountability Office, *Defense Contracting - Actions Needed to Increase Competition* GAO-13-325 (Washington D.C. March 2013) <<http://www.gao.gov/assets/660/653404.pdf>> accessed 20 September 2013,

the DoD obligated \$205.3 billion on competitive awards from a total of \$359.7 billion for all contract obligations.¹¹⁶⁴ This decline appears to be broadly consistent with the findings of other studies.¹¹⁶⁵ According to the *Fortresses and Icebergs Study*, between 2006-2008, only 13% (\$34.4 billion) of major programme awards were made through “open and competitive” procurement; 22% (\$60.3 billion) were offered through “limited” competition, which the Study identifies as not open to foreign participation; 5% (\$15 billion) involved international cooperative programmes; and the remaining 60% (\$163 million) were awarded on a sole source basis.¹¹⁶⁶

Whilst the DoD does not systematically identify, track, and consider the specific factors that are affecting competition when setting its annual competition goals, the GAO Report identifies three principal factors which appear to be affecting the DoD’s competition rate.¹¹⁶⁷ The first concerns reliance on an original equipment manufacturer throughout the lifecycle of a programme because of a previous decision not to purchase proprietary technical data.¹¹⁶⁸ The second concerns the general uncertainty of the budget environment resulting in continued non-competitive awards to maintain existing equipment as opposed to planning new awards for new

8 citing at 9 Figure 1: DoD ‘Competition Rate for All Contract Obligations from Fiscal Years 2008 through 2012’ (source: GAO analysis of Federal Procurement Data System – Next Generation (“FPDS-NG”) data)

¹¹⁶⁴ *ibid*

¹¹⁶⁵ This corresponds with the findings of the *Fortresses and Icebergs* study. According to the latter, approximately 62% by value of all DoD prime contracts were awarded competitively in 2006. See *Fortresses and Icebergs: (Vol. II)* (n 12) 658, Table 75 ‘Competition in U.S. Defense Contract Awards, Fiscal Year 2006’ based on U.S. Department of Defense, Summary of Procurement Awards – October 2005 - September 2006

¹¹⁶⁶ *Fortresses and Icebergs: (Vol. II)* (n 12) 658, Figure 146 (source: Documental Solutions, 2006-2008)

¹¹⁶⁷ Government Accountability Office, *Defense Contracting - Actions Needed to Increase Competition* (n 1163)

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¹¹⁶⁸ *ibid* 13-14

equipment.¹¹⁶⁹ The third concerns the amount of non-competitive foreign military sales that are awarded.¹¹⁷⁰

2.2. Foreign Competition in Federal Procurement: General Depiction of Trends

According to the Fortresses and Icebergs Study, whilst U.S. law, policy and practice emphasise competition in defence contracts as the norm as opposed to the exception, the DoD has, to a large degree, precluded foreign participation in the competitive process, especially at the prime level.¹¹⁷¹ In particular, the Study states that the reality is that the U.S. market has been “competitive but not that “open”” but suggests that an increasing number of programmes are now open to foreign competition.¹¹⁷² The Study states that available data confirms this reality.¹¹⁷³ The Study identifies that a high percentage of spending flows to a small number of large defence firms (approximately 69% of major programme contracts), a fact which the Study also attributes to the high percentage spend on legacy programmes and the post-Cold War consolidation of the market to a few select primes.¹¹⁷⁴

According to the latest DoD Report to Congress on purchases from foreign entities, DoD procurement actions recorded for Fiscal Year (“FY”) 2011 totalled approximately

¹¹⁶⁹ *ibid* 14 citing at fn 15 United States Government Accountability Office, *Continuing Resolutions: Uncertainty, Limited Management Options and Increased Workload in Selected Agencies* GAO-13-325 (Washington D.C. March 2013) <<http://www.gao.gov/assets/300/295970.pdf>> accessed 20 September 2013

¹¹⁷⁰ Government Accountability Office, *Defense Contracting: Actions Needed to Increase Competition* (n 1163)

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¹¹⁷¹ *Fortresses and Icebergs: (Vol. II)* (n 12) 658

¹¹⁷² *ibid*

¹¹⁷³ *ibid*

¹¹⁷⁴ According to the Study, Boeing, Northrop Grumman and Lockheed Martin gained approximately 57% of all major programme awards. If General Dynamics’ awards (approximately 12% of the market) are included, the DoD awards 69% of its major programme contracts to four firms. See *Fortresses and Icebergs: (Vol. II)* (n 12) 660-661 citing Figure 150 (source: Documental Solutions)

\$374 billion.¹¹⁷⁵ Of that amount, approximately, \$24 billion, or 6.4% was expended on purchases from foreign entities.¹¹⁷⁶ The Report indicates that defence equipment constitutes approximately 18% of the purchases from foreign entities.¹¹⁷⁷ The Report separately indicates the dollar value of items for which the Buy American Act was waived pursuant, *inter alia*, to an RDP.¹¹⁷⁸ The findings will be discussed in Chapter 11, Section 4.7.

2.2.1. Exclusions of Foreign Competition: Limited Competition and Sole Sourcing

The Fortresses and Icebergs Study states that with regard to the data on more recently initiated programmes, 86% (\$53 billion) were awarded competitively “in some manner”, although the Study observes that only 45% were open to foreign competition.¹¹⁷⁹ Further, approximately 32% of new purchases were awarded through “limited” rather than open competition which the Study identifies as excluding foreign participation.¹¹⁸⁰ The Study identifies that as a result of limited competition and sole source buying, approximately 52% of programme dollars were not accessible to foreign competitors.¹¹⁸¹ The remaining 6% were awarded on cooperative programmes which also included some foreign participation.¹¹⁸²

¹¹⁷⁵ Report to Congress on Department of Defense, Fiscal Year 2011 *Purchases from Foreign Entities*, Under Secretary of Defense for Acquisition, Technology and Logistics, 2. The Report was prepared Pursuant to section 827 of the National Defense Authorization Act for Fiscal Year 1997 (P.L104-201), as amended, and section 8028(b) of the Department of Defense Appropriations Act, 2011 (P.L. 112-10) <[http://www.acq.osd.mil/dpap/cpic/cp/docs/DoD_FY_2011_Purchases_from_Foreign_Entities_\(Authorization_May_10_2012\).pdf](http://www.acq.osd.mil/dpap/cpic/cp/docs/DoD_FY_2011_Purchases_from_Foreign_Entities_(Authorization_May_10_2012).pdf)> accessed 20 September 2013

¹¹⁷⁶ *ibid.* According to the report, the \$24 billion covers military hardware, subsistence, fuel, construction, services and other miscellaneous items that are for use outside the United States

¹¹⁷⁷ *ibid.*

¹¹⁷⁸ *ibid.*

¹¹⁷⁹ *Fortresses and Icebergs*: (Vol. II) (n12) 660-661 citing Figure 149 (source: Documental Solutions)

¹¹⁸⁰ *ibid.* 661 citing Figure 149 (source: Documental Solutions)

¹¹⁸¹ *ibid.*

¹¹⁸² *ibid.*

2.2.2. DoD Prime Contracts for Defence Items and Components

According to one U.S. Report based on an assessment of DoD prime contracts valued at over \$25,000 for defence items and components exclusively, in FY 2008, the DoD awarded contracts to foreign suppliers for defence items and components totaling approximately \$3.15 billion.¹¹⁸³ This constitutes less than 1% of all DoD contracts and only approximately 1.8% of all DoD contracts for defense items and components.¹¹⁸⁴ Resultantly, the Report indicates that the DoD procures very few defence items and components from foreign suppliers.¹¹⁸⁵ Further, the DoD employs foreign contractors and subcontractors “judiciously” and “in a manner consistent with national security requirements”.¹¹⁸⁶ Notwithstanding these findings, the same Report reiterates that the DoD is not acquiring military material produced overseas to the detriment of U.S. national security or its defence industrial base, that focused analyses have shown that the DoD employs a small number of non-U.S. suppliers and that the use of those suppliers does not negatively impact the long-term viability of the national technological industrial base.¹¹⁸⁷ Finally, the Report indicates that there has been no difference in “reliability” between the DoD’s U.S. and non-U.S. suppliers.¹¹⁸⁸ In particular, the Report identifies that in order for there to be a foreign “vulnerability” there must a “significant, credible and unacceptable risk of supply

¹¹⁸³ Foreign Sources of Supply FY 2008 Report, *Annual Report of United States Defense Industrial Base Capabilities and Acquisitions of Defense Items and Components Outside the United States*, Report Required by Section 812 of the National Defense Authorization Act for Fiscal Year 2004 (Public Law 108-136), as amended by Section 841 of the John Warner National Defense Authorization Act for Fiscal Year 2007 (Public Law 109-364), October 2009, Executive Summary, ii
<[http://www.acq.osd.mil/mibp/docs/Foreign_Sources_of_Supply_812_Report_to_Congress_\(FY08\).pdf](http://www.acq.osd.mil/mibp/docs/Foreign_Sources_of_Supply_812_Report_to_Congress_(FY08).pdf)>
accessed 20 September 2013

¹¹⁸⁴ ibid
¹¹⁸⁵ ibid
¹¹⁸⁶ ibid
¹¹⁸⁷ ibid 4
¹¹⁸⁸ ibid

disruption due to political intervention by the host country”.¹¹⁸⁹ The Report continues that the U.S. is not presently aware of any foreign vulnerabilities within its supply chains, although it has been observed that the DoD does not have complete visibility of its supplier base.¹¹⁹⁰

2.2.3. Foreign Competition at Sub-Contract Level

Based on a sample of 232 major U.S. RDT&E procurements (exceeding \$100 million dollars) the findings of the Fortresses and Icebergs Study indicate that foreign participation appeared to be almost exclusively European but which was also limited to the position of suppliers to a U.S. prime contractor.¹¹⁹¹

With regard to subcontracts, the Fortresses and Icebergs Study indicates that whilst little data is available on the degree of competition in subcontract awards, there is a “fair degree of competition”.¹¹⁹² At the sub-tier level, the Study identifies that the DoD has increasingly devolved responsibility to the prime contractor in sub-tier selections.¹¹⁹³ It also indicates that the pressure on primes to focus on best value and the need to consider foreign products where more affordable or capable should

¹¹⁸⁹ The Report states that DoD dependence on foreign suppliers for certain items does not equate to foreign vulnerability in the same way that dependency on reliable domestic suppliers does not result in vulnerability. In this regard, the Report cites DoD Handbook 5000.60 H *Assessing Defense Industrial Capabilities* in its assessment of “foreign dependency” and identifies at 4-5 instances in which foreign sources may constitute “unacceptable foreign vulnerability”. See Foreign Sources of Supply FY 2008 Report, *Annual Report of United States Defense Industrial Base Capabilities and Acquisitions of Defense Items and Components Outside the United States* (n 1183) 4

¹¹⁹⁰ *ibid* 5

¹¹⁹¹ *Fortresses and Icebergs: (Vol. II)* (n 12) 664-665, Table 76: ‘Top U.S. Defense Programs, 2006-2008 (Millions of Dollars - \$)’ (source: Documental Solutions). Of the 51 programmes listed, only three involved a European supplier to a U.S. prime contractor on a contract awarded under competition

¹¹⁹² *Fortresses and Icebergs: (Vol. II)* (n 12) 662. The Study indicates that DoD policies, while not always easy to enforce, are intended to dissuade non-competitive vertical sub-tier solutions in favour of best value, competed solutions even where the prime holds a capable business unit in-house

¹¹⁹³ *ibid* 670

mean that the market is more open to foreign competition.¹¹⁹⁴ However, the Study also identifies that primes recognize the difficulties in dealing with foreign contractors including problems associated with obtaining ITAR licences.¹¹⁹⁵ On this basis, it has been suggested that primes only tend to seek foreign sources where domestic sources are unavailable or are uneconomic.¹¹⁹⁶

In 2004, the DoD published a Study on the impact of foreign sourcing of systems.¹¹⁹⁷ The Study evaluated twelve programmes focusing on first, second and third tier subcontractors.¹¹⁹⁸ It concluded that foreign suppliers provide limited amounts of materiel for the systems and that using those foreign subcontractors does not impact long-term military readiness or the economic viability of the U.S. technology and industrial base.¹¹⁹⁹ For the systems studied, foreign subcontracts collectively represented approximately 4% of the total contract value.¹²⁰⁰

The Fortresses and Icebergs Study suggests that how the data is viewed is a matter of perspective.¹²⁰¹ The Study indicates that the fact that historically 45% of new procurements are open to foreign competition is “somewhat remarkable” given a legacy of relatively closed markets.¹²⁰² It also observes that there remains a significant portion of the market off-limits but qualifies this observation on the grounds

¹¹⁹⁴ *ibid*

¹¹⁹⁵ *ibid*. For a discussion of ITAR, see Chapter 5, Sections 4 and 6.3.2

¹¹⁹⁶ *Fortresses and Icebergs*: Vol. II (n 12) 670

¹¹⁹⁷ See Office of the Deputy Under Secretary of Defense for Industrial Policy, *Study on Impact of Foreign Sourcing of Systems*, January 2004, Executive Summary, iv-vi. The Study follows the 2001 Study on Impact of Foreign Sourcing of Systems mandated by section 831 of the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 <http://www.acq.osd.mil/mibp/docs/study_impact_foreign_sourcing_of_systems.pdf> accessed 20 September 2013

¹¹⁹⁸ *ibid* iv

¹¹⁹⁹ *ibid* v

¹²⁰⁰ *ibid* iv

¹²⁰¹ *Fortresses and Icebergs*: (Vol. II) (n 12) 670

¹²⁰² *ibid*

that some of the market is off limits for “legitimate security-related reasons”.¹²⁰³ Whilst not entirely unequivocal, the Study suggests that the latter is attributable, at least in part, to the use of the CICA exclusions and exceptions, the content and use of which will be examined in Section 4 below and Chapter 10.

3. Full And Open Competition

According to CICA, the Agency Head must obtain “full and open competition” and use the competitive procedure or combination of procedures best suited under the circumstances.¹²⁰⁴ Full and open competition is to be used unless circumstances exist that would permit non-competitive procedures.¹²⁰⁵ In addition, FAR Part 34 (supplemented by DFARS Part 234) contains a designated policy on major system¹²⁰⁶ acquisition, according to which a programme manager must promote full and open competition throughout the acquisition process, as it is economically beneficial and practicable to do so.¹²⁰⁷ More specifically, it provides that foreign contractors, technology, and equipment may be considered when it is “feasible and permissible to do so”.¹²⁰⁸

¹²⁰³ *ibid*

¹²⁰⁴ 10 U.S.C. § 2304(a)(1)(A) and (b) & 41 U.S.C. § 253(a)(1)(A)

¹²⁰⁵ *ibid*

¹²⁰⁶ According to DFARS Subpart 234.70, “major weapon system” means: a weapon system acquired pursuant to a major defense acquisition program, as defined in 10 U.S.C. 2430 to be a program that— (1) Is not a highly sensitive classified program, as determined by the Secretary of Defense; and (2) Is designated by the Secretary of Defense as a major defense acquisition program; or (3) Is estimated by the Secretary of Defense to require an eventual total expenditure for research, development, test, and evaluation of more than \$300,000,000 (based on fiscal year 1990 constant dollars) or an eventual total expenditure for procurement of more than \$1,800,000,000 (based on fiscal year 1990 constant dollars)

¹²⁰⁷ This includes a requirement to promote full and open competition and sustain effective competition between alternative major system concepts and sources. See FAR 34.005-1(a). This is consistent with OMB Circular A-109 *Major System Acquisitions*, April 5, 1976

¹²⁰⁸ *ibid*

“Full and open competition” is achieved when all “responsible”¹²⁰⁹ sources are permitted to submit sealed bids or competitive proposals.¹²¹⁰ “Responsibility” is broadly equivalent to a determination that qualitative selection requirements are met under the EU procurement Directives.¹²¹¹

There are several main procedures which are deemed to constitute “competitive procedures”.¹²¹² The first is sealed bidding which is broadly equivalent to the open procedure under the EU procurement Directives.¹²¹³ The introduction of CICA in 1984 ended the formal preference for sealed bidding by equalising use of competitive negotiation in fulfilment of statutory competition requirements.¹²¹⁴ The second is competitive proposals which are broadly equivalent to negotiated and competitive dialogue procedures under the EU Directives.¹²¹⁵ Finally, CICA provides for a

¹²⁰⁹ A responsible source is a prospective contractor who: (1) has adequate financial resources to perform the contract, or the ability to acquire such resources; (2) is able to comply with the required or proposed delivery or performance schedule; (3) has a satisfactory performance record; (4) has a satisfactory record of integrity and business ethics; (5) has the necessary organization, experience, technical skills, and accounting and operational controls, or the ability to obtain them; (6) has the necessary production, construction, and technical equipment and facilities, or the ability to obtain them; and (7) is otherwise qualified and eligible to receive an award under applicable laws and regulations. See 41 U.S.C. § 403(7)

¹²¹⁰ 41 U.S.C. § 107

¹²¹¹ For commentary on the responsibility determination, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 409-437

¹²¹² CICA also specifies five additional procedures that are competitive procedures meeting the statutory requirement for full and open competition. See 10 U.S.C. § 2302(2)(A) – (E) and 41 U.S.C. § 152. For a detailed discussion of these procedures, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) Chs 7 and 8

¹²¹³ Contracting officers must use sealed bidding if: (i) time permits the solicitation, submission, and evaluation of sealed bids; (ii) the award will be made on the basis of price and other price-related factors; (iii) it is not necessary to conduct discussions with the responding sources about their bids; and (iv) there is a reasonable expectation of receiving more than one sealed bid. See § 2304(a)(2)(A) and 41 U.S.C. § 3301(a)(1). See *Defense Logistics Agency*, 67 Comp. Gen. 16 (B-227055.2), 87-2 ¶ 365, discussed in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 332-333. The requirements for sealed bidding are implemented in FAR Part 14 and DFARS Part 214. For a comprehensive discussion of sealed bidding, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 501-656

¹²¹⁴ It is estimated that less than 10% of federal procurement dollars are spent in sealed bid procurements. See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 501

¹²¹⁵ The requirements for competitive negotiation are implemented in FAR Part 15 and DFARS Part 215. For a detailed discussion of competitive negotiation, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 334-336, 673-995 and the accompanying text J Cibinic Jr, R C Nash Jr and K R O'Brien-DeBakey, *Competitive Negotiation: The Source Selection Process* (n 1055)

combination of procedures.¹²¹⁶ In this regard, U.S. law prescribes “two-step sealed bidding” (a combination of sealed bidding and competitive proposals).¹²¹⁷ With the general decline of sealed bidding and increase in negotiated procurement, two step-sealed bidding is rarely used.¹²¹⁸

3.1. Exclusion of Foreign Competition through Requests for Proposals

As indicated in Chapter 1, it is imperative to question the relation or correspondence between the role of legal institutions and their effects in practice. As will be discussed in Section 4 and Chapter 10, U.S. commentary has acknowledged the possibility for statutory exclusions and exceptions to restrict foreign competition. However, the reality is that whilst these provisions exercise a vital gate-keeping function in determining whether foreign competition is even admissible, beyond these basic legal requirements, it is not clear how any other rules and their interpretation and application “impact” on a tenderer that is admitted to a contract award procedure. For instance, there is little empirical research available which is able to shed light on how competitive negotiation has operated with regard to foreign contractors e.g. through the formulation and application of technical specifications, selection and award criteria. As will be discussed in Section 3.3 below, a recent review of U.S. Air Force acquisitions (certain of which have involved foreign competition) has highlighted not

¹²¹⁶ See 10 U.S.C. §2304(a)(1)(b) and 41 U.S.C. § 3301(a)(2)

¹²¹⁷ In the first step, the Agency publishes a Request for Technical Proposals (“RFTP”). Bidders then submit one or more unpriced technical proposals to satisfy these requirements and discussions may be held with the offerors. Only those offerors who have submitted acceptable technical proposals are invited to submit step-two sealed bids on price. Offerors bid only on their own proposals under rules similar to sealed bidding. Award is made to the low responsible bidder submitting a responsive bid. For a discussion of two-step sealed bidding, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 656-672

¹²¹⁸ See Feldman, *Government Contract Guidebook* (4th edn Federal Publications 2011) (n 1083) § 5:42 citing ‘Two-Step Sealed Bidding: The Curse of the Responsiveness Rule’, 17 *Nash & Cibinic Rep.* 36 (June 2003); ‘Two Step Sealed Bidding: An Idea Whose Time Has Passed’, 1 *Nash & Cibinic Rep.* 34 (April 1987)

only the complexity but also considerable subjectivity of decision-making in this regard.¹²¹⁹

The Fortresses and Icebergs Study has suggested that acquisition officials also have the “informal ability, if not the authority”, to preclude foreign participation without the use of formal legal exceptions.¹²²⁰ The Study indicates that there is “some credible history” of situations where authorities have used their discretionary authority to effectively precluded foreign participation at the prime contract level on a number of major defence programmes¹²²¹ through a variety of means, in particular through the specific terms of the Requests for Proposals (“RFP”) and informal guidance.¹²²² It has been stated that this has been the case even though officials have not sought justification under government contracting rules for these types of informal decisions.¹²²³

The Study indicated that the reasons for these decisions were often not well developed or vague.¹²²⁴ Further, it was identified that these reasons probably reflect an “outright hostility to foreign participation” in some cases and an “undifferentiated mix of reasons” in other cases, of which industrial base considerations and national

¹²¹⁹ For a useful insight into the decision-making of contracting officials in two high-profile U.S. Air Force awards (CSAR-X and KC-X) and the GAO review of those decisions, see T Light, F Camm, M E Chenoweth, P A Lewis and R Rudavsky, *Analysis of Government Accountability Office Bid Protests in Air Force Source Selections over the Past Two Decades*, RAND, 2012 (cited with the kind permission of RAND) < http://www.rand.org/pubs/documented_briefings/DB603.html > accessed 20 September 2012; F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary*, RAND 2012 (cited with the kind permission of RAND) <http://www.rand.org/pubs/documented_briefings/DB603.html> accessed 20 September 2013

¹²²⁰ *Fortresses and Icebergs*: (Vol. II) (n 12) 666

¹²²¹ These major programmes were not expressly identified in the Study

¹²²² *ibid* 666

¹²²³ *ibid*. Whilst the Study does not explicitly identify such justifications, U.S. law does prescribe legal requirements pertaining to the use of determinations and findings (“D&F”) and formal justifications and approvals (“J&A”) for limiting/excluding competition. These are examined in Section 4.1.1 below and Chapter 10, Section 2

¹²²⁴ *Fortresses and Icebergs*: (Vol. II) (n 12) 666

security were cited.¹²²⁵ Importantly, the Study further suggested that these informal exclusions are probably the most significant barrier to the U.S. market because such informal exclusions are less legal or regulatory in nature than institutional, cultural and decentralized, in turn, making them more difficult to address.¹²²⁶ The study reported that while there is some sense among those interviewed that they are encountering less of this type of conduct now as compared to five or ten years ago, it is nevertheless still present.¹²²⁷

Therefore, it is important for a thesis on legal aspects of defence procurement to recognize the point at which legal institutions find their limitations in the exercise of culturally informed political discretions and which also ought to be the subject of proper study by lawyers. Nevertheless, it is submitted that even acknowledging the inherent limitations of rules in light of the possibility for their discretionary interpretation and application, these observations raise a question as to whether legal institutions could better regulate broadly conferred discretions in the defence procurement context through what might be termed a “negative restraint” on their use.¹²²⁸

Returning to the discussion of how such discretionary authority has been apparently used through RFP requirements, the Fortresses and Icebergs Study has identified a

¹²²⁵ *ibid.* As will be discussed in Section 4.1 below and Chapter 10, these reasons may provide the basis for use of a statutory exclusion or exception; however, even if foreign competition is not excluded through the use of one of the exceptions, such broader concerns may incentivise a national award even if foreign competitors are admitted to a competition

¹²²⁶ *ibid.*

¹²²⁷ *Ibid.*

¹²²⁸ By this, it is simply meant that even if, by nature, defence procurement rules have to be sufficiently broad so as to respect the exercise of certain competences and to give recognition to legitimate interests (on which there is scope for debate), these institutions could be subject to better regulated restraints on their use, either through the terms of the provisions themselves or through use of accountability mechanisms. As will be discussed in Chapter 10, so called J&As may provide a sufficient but by no means adequate legal control on the exercise of discretion

number of ways to exclude foreign tenderers.¹²²⁹ Firstly, the RFP can include requirements such as “no foreign personnel allowed” or “NOFORN”.¹²³⁰ Secondly, it is possible to impose a requirement to hold a facility security clearance¹²³¹ which foreign firms cannot obtain unless they have a cleared U.S. subsidiary.¹²³² More generally, the Study notes that several firms observed situations where a programme was designated “U.S. Eyes Only” even though the matters were not classified and there was no legitimate basis for such restriction.¹²³³ Thirdly, it has been suggested that foreign firms can also be effectively excluded through very short timelines between RFP release and proposal submission.¹²³⁴ It has been suggested that this is generally not a problem for U.S. companies, whose business development departments maintain close contacts with sponsoring Agencies and thus know the general content of an RFP weeks in advance.¹²³⁵ However, the situation for foreign companies is said to be very different not least because of their inability to maintain a

¹²²⁹ On the rules regulating RFPs under U.S. law, see generally J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 727-749; J Cibinic Jr, R C Nash Jr and K R O’Brien-DeBakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 304-360

¹²³⁰ The National Industrial Security Program Operating Manual (“NISPOM”), Section 3, 9-303 defines “Not Releasable to Foreign Nationals” (“NOFORN”) as: “classified information that may not be released in any form to foreign governments, foreign nationals, foreign organizations, or non-U.S. citizens without permission of the originator.” See The National Industrial Security Program Operating Manual, February 2006, Incorporating Change 1 March 28 2013, DoD 5220.22-M. <<http://www.fas.org/sqp/library/nispom/nispom2006.pdf>> accessed 20 September 2013. The National Industrial Security Program (“NISP”) was established by Executive Order (E.O.) 12829 (reference (a)) for the protection of information classified under E.O. 13526 (reference (b)), or its successor or predecessor orders, and the Atomic Energy Act of 1954, as amended (reference (c)). See Section 1-101

¹²³¹ FAR 4.403 requires contracting officers to ensure that any contractor has the appropriate security clearances when classified information is required for contract performance. If any prospective contractors have not obtained clearances under the Defense Industrial Security Program, they will be unable to participate in any competition. See J Cibinic Jr, R C Nash Jr and K R O’Brien-DeBakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 185-186. This issue must be addressed in the acquisition planning process in order to enable contractors to become part of the programme and obtain security clearances. See *ibid* 186

¹²³² *Fortresses and Icebergs*: (Vol. II) (n 12) 667

¹²³³ *ibid*

¹²³⁴ FAR 5.203(c) requires that the response time for actions over the simplified acquisition threshold must be at least 30 days after the issuance of the solicitation. FAR 5.203(e) provides that for research and development procurements, the required waiting period for the closing date for receipt of proposals is 45 days. See According to J Cibinic Jr, R C Nash Jr and K R O’Brien-DeBakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 363, these requirements only prescribe minimum periods and that many procuring Agencies have found that extending the periods increases competition

¹²³⁵ *Fortresses and Icebergs*: (Vol. II) (n 11) 667

continuous presence at U.S. military development centres.¹²³⁶ In this regard, the Study identifies an example in which, on one large development programme, the U.S. lead integrator called for proposals in 30 days but that given the ITAR lead times involved in securing licenses, the company was effectively precluded from competing.¹²³⁷

In light of the above, it is necessary to consider how issues such as personnel restrictions, facility security clearances and submission timeframes are dealt with under the EU Defence Procurement Directive.

3.1.1. No Foreign Personnel

With regard to the issue of “no foreign personnel allowed”, the EU Guidance Note on Security of Information identifies contracts for which all staff involved in the contract’s execution are required to have personal security clearances and be citizens of the procuring Member State because security clearances of other Member States are not deemed sufficient.¹²³⁸ According to the Guidance Note, such a ‘national eyes only’ condition infringes the principle of non-discrimination on the ground of nationality and can only be justified on the basis of Article 346 TFEU, the possibility for which is likely to be significantly reduced in light of the Directive.¹²³⁹ Instead, the Guidance Note advocates either limiting national personnel requirements through a specific contract performance condition justified on the basis of Article 346 TFEU or award a

¹²³⁶ *ibid*

¹²³⁷ *ibid*

¹²³⁸ Guidance Note, Security of Information, 12, point 32

¹²³⁹ *ibid*, 12-13. See Recital 16 of the Defence Procurement Directive and the general discussion of Article 346 TFEU in Chapter 2. See also Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’ (n 125) 14, 23

separate contract to the main contract for those aspects requiring national personnel.¹²⁴⁰ It is beyond the scope of this thesis to examine the practicability and likelihood of such a proposal. However, there is at least a question as to whether contracting officials would, in the majority of cases, be prepared to take such measures to enable foreign participation, in particular, going as far as to award an entirely separate contract. In the absence of further empirical evidence, it is difficult to see whether contracting officials would, in the majority of cases, prefer to simply avoid foreign contractors. Notwithstanding, this approach at least aims to consider possible ways in which to mitigate discrimination that could result through national personnel requirements.

3.1.2. Facility Security Clearances

For the purposes of qualitative selection, Article 42(1)(j) Defence Procurement Directive enables a contracting authority to require evidence of the ability to process, store and transmit classified information at the level of protection required by the contracting authority.¹²⁴¹ Article 42(1)(j) further provides that in the absence of EU harmonisation of national security clearance systems, Member States may require that this evidence has to comply with the relevant provisions of their respective national laws on security clearance.¹²⁴² According to Recital 43, it is for the contracting authorities or Member States to determine whether they consider security clearances issued in accordance with the national law of another Member State as equivalent. However, Article 42(1)(j) specifies that Member States *must* recognize

¹²⁴⁰ Guidance Note, Security of Information, 13, point 32, para 2

¹²⁴¹ Article 42(1)(j) para 1

¹²⁴² Article 42(1)(j) subparagraph 2. See also Recital 68

security clearances which they consider equivalent to those issued under their national law, notwithstanding the possibility to conduct further investigations of their own if necessary.¹²⁴³ Further, Recital 68 states that even where Member States have bilateral agreements or arrangements on security of information, it is possible to verify the capacities of economic operators from other Member States with regard to security of information. In particular, such verification can normally be performed by the designated authority of the Member State in which the economic operator is located.¹²⁴⁴ In this regard, Article 42(1)(j) also provides that the contracting authority may ask the designated authority of the candidate's Member State to undertake relevant checks.¹²⁴⁵ Such verification should be carried out in accordance with the principles of non-discrimination, equal treatment and proportionality.¹²⁴⁶ Finally, Article 42(1)(j) provides that a contracting authority may grant candidates which do not yet hold security clearances additional time to obtain them.¹²⁴⁷ In particular, the Guidance Note emphasises that contracting authorities should make use of this possibility wherever possible in order to broaden the supply base to include non-established operators.¹²⁴⁸

To this extent, a Member State is able to continue to legitimately require an operator to obtain a facility security clearance where it does not deem an existing clearance

¹²⁴³ Article 42(1)(j) subparagraph 2 and Recital 68. As the Guidance Note, Security of Information, 4, point 12, para 1 observes: “[i]n many cases, Member States have bilateral security agreements or arrangements concerning the equivalence of security classifications and security requirements, such as security clearances for a company's facilities or personnel. In such cases, contracting authorities/entities shall accept security clearances granted by National/Designated Security Authorities of another Member State as evidence of a candidate's capacity to ensure the security of classified information in accordance with national security laws and regulations and the bilateral agreements or arrangements.” For commentary on this provision, see Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’ (n 125) 24

¹²⁴⁴ Guidance Note, Security of Information, 5, point 12, para 2

¹²⁴⁵ Article 42(1)(j)

¹²⁴⁶ Recital 68

¹²⁴⁷ Article 42(1)(j) subparagraph 3

¹²⁴⁸ Guidance Note, Security of Information, 5-6, point 12, para 3

issued by another Member State to be equivalent. However, the Directive nevertheless emphasises the primary importance of assessing evidence in order to determine equivalence, recognition of equivalence where this is possible and the need to enable sufficient time to obtain clearances for new market entrants, although it is observed that the Directive does not specify a time limit for obtaining a security clearance in this regard.

The Fortresses and Icebergs Study has identified the possibility of the Directive's provisions on security of information to generate a risk of potential discrimination against U.S. contractors on two grounds.¹²⁴⁹ The first is if an EU information security arrangement¹²⁵⁰ is established which could be utilised as a discriminator by national source selection authorities in grading bids.¹²⁵¹ The second is that even if no arrangement is established, the Directive affords significant discretion to the national authorities because the Directive requires compliance with national provisions on security clearances, which could be used to discriminate against foreign bidders or their subcontractors whether from the EU or third countries.¹²⁵²

However, as the Study itself acknowledges, one would expect U.S. firms to be able to satisfy security of information requirements given their experience in meeting DoD requirements as well as the existence of bilateral security arrangements between the

¹²⁴⁹ *Fortresses and Icebergs*: (Vol. I) (n 12) 224.

¹²⁵⁰ See Recital 9 which states: "[...] an [sic] Union-wide regime on security of information, including the mutual recognition of national security clearances and allowing the exchange of classified information between contracting authorities/entities and European companies, would be particularly useful. At the same time, Member States should take concrete measures to improve security of supply between them aiming at the progressive establishment of a system of appropriate guarantees."

¹²⁵¹ *Fortresses and Icebergs*: (Vol. I) (n 12) 224

¹²⁵² *ibid*

U.S. and EU countries.¹²⁵³ Further, as yet, the EU has not adopted an EU-wide security arrangement. Even if it did, there is no suggestion that U.S. contractors would be less able to satisfy contracting authorities of their ability to meet these requirements. The Fortresses and Icebergs Study states that EU officials may seek to model an EU approach on the Lol FA, an initiative that is “having a real effect and being adopted EU wide”.¹²⁵⁴ Yet, as Chapter 5, Section 7.3.1 suggested, real questions must be asked about the effectiveness of any such initiative in practice. In addition, it has been questioned whether these provisions will radically alter the existing position with regard to the treatment of EU economic operators from other Member States in the absence of full mutual recognition of security clearances.¹²⁵⁵

3.1.3. Time Limits

Finally, with regard to the issue of limited time between the issuance of the RFP and proposal submission, the Defence Procurement Directive contains a specific provision on time limits for receipt of requests to participate and for receipt of tenders.¹²⁵⁶ However, there does not appear to be any indication that U.S. companies (and more likely EU established subsidiaries) would experience particular difficulties in meeting such deadlines.

As indicated, there is substantially no evidence or analysis examining individual EU Member State approaches to issues such as RFP formulation and associated

¹²⁵³ *ibid.* Although, Chapter 5, Section 7.3.1 highlighted the inherent limitations of reliance on bilateral arrangements as providing any form of guarantee with regard to security of supply. The same observation applies to security of information

¹²⁵⁴ *ibid.*

¹²⁵⁵ Trybus, ‘The tailor-made EU Defence and Security Procurement Directive’ (n 125) 23; Heuninckx, ‘Trick of Treat?’ (n 252) 21-22

¹²⁵⁶ See Article 33

requirements. Nevertheless, the above suggests possible ways in which to mitigate the potential effects of such requirements albeit that questions may be asked as to their utility.

3.2. Exclusion through Technical Standards and Specifications

It is recalled that Chapter 6 examined U.S. claims that the Defence Procurement Directive's provisions on technical specifications could potentially discriminate against foreign contractors. It has similarly been observed in the U.S. that the specificity of U.S. technical standards for defence products has posed challenges for foreign firms, in particular, the detailed system of military specifications ("MIL-SPECs") and standards ("MIL-STDs") which are detailed specifications and performance standards.¹²⁵⁷

Historically, the DoD used thousands of military specifications and standards in its procurement.¹²⁵⁸ According to the Fortresses and Icebergs Study, the the U.S.' long association with NATO means that U.S. military products are tied to NATO STANAGs where these exist; however, due to the number of product specifications and standards developed by the DoD beyond the STANAG level or outside their setting, even European products that meet STANAGs do not necessarily meet other

¹²⁵⁷ *Fortresses and Icebergs: (Vol. I)* (n 12) 698. For an overview of the historical development of US MIL-SPECs, see 'Study into the Role of European Industry in the Development and Application of Standards' (n 866) 36-38

¹²⁵⁸ For a discussion of U.S. military specifications generally, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 368-369; J Cibinic Jr, R C Nash Jr and K R O'Brien-DeBakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 166-175

U.S. standards that would allow them to readily compete in the transatlantic market.¹²⁵⁹

However, it has been observed that the possibility for standards to become trade barriers is mitigated to a certain extent. Firstly, as discussed in Chapter 6, Section 4.5, the RDPs contain agreements concerning certification of conformity covering products manufactured by suppliers of the selling nation.¹²⁶⁰ Whilst the extent of the use or effect of the RDP provisions in practice is not precisely clear, it has been suggested that this type of provision helps facilitate mutual recognition of testing and standards.¹²⁶¹ Secondly, it has been suggested that an increasing move away from procurement based on military standards and specifications towards a greater reliance on commercial standards and specifications (with recourse to military requirements only when necessary), as well as a commercialisation of defence procurement generally, may begin to mitigate their use and, by implication, their effect in practice.¹²⁶² A modern solicitation must describe the Agency's needs with performance or non-government standards.¹²⁶³ As indicated in Chapter 6, Section 4.2 this is similarly reflected in the prescribed methods for drawing up specifications identified in the Defence Procurement Directive. Thirdly, in practice, the Fortresses and Icebergs Study did not learn of any specific situations where technical standards were used to protect domestic producers and markets against foreign defence

¹²⁵⁹ *Fortresses and Icebergs: (Vol. II) (n 12) 697*

¹²⁶⁰ *Ibid.*

¹²⁶¹ *ibid*

¹²⁶² *ibid* 698. This shift was precipitated by a DoD policy issued by the then Defense Secretary William Perry mandating greater use of performance and commercial specifications in place of military specifications. See The Memorandum for Secretaries of the Military Departments (June 29, 1994) cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 368; see also G M Marks and N J Fry, 'Commercialization in Defense Sourcing and Other Responses to Post-Cold War Defense Industry Transformation' (2006-2007) 38 *Geo J Int'l L* 577, 610

¹²⁶³ J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 369

products.¹²⁶⁴ Finally, as discussed in Chapter 6, Section 5, consideration has been given to the possibility for the screening of U.S. MIL-SPECs to ensure compatibility with European standardization efforts.¹²⁶⁵

Therefore, whilst the absence of detailed empirical research on the use of technical specifications renders it difficult to assess the precise effects on foreign competition, a general shift towards the use of performance and functional requirements may further reduce the significance of national standards. As indicated in Chapter 6, an important issue concerns the extent to which compatibility is achieved between standardization initiatives within the EU, US and NATO.

3.3. KC-X Aerial Refuelling Tanker Contract

As indicated above, it is not possible on the basis of available evidence to conduct an extensive review of competitive awards made to foreign contractors. However, a notable example that will be discussed in this Section concerns the 2008 KC-X aerial refueling tanker award. As will be discussed, the contract has attracted attention from U.S. and EU legal commentators. Further, it is recalled from Section 3.1 above that in 2008 the U.S. Air Force and the Office of Secretary of Defense commissioned a detailed review of U.S. Air Force source selection policies and practices in large acquisitions.¹²⁶⁶ The review was precipitated, in large part, by the conduct of the KC-X contract which was a highly visible, openly competed award and which resulted in

¹²⁶⁴ *Fortresses and Icebergs*: (Vol. II) (n 12) 698

¹²⁶⁵ 'Study into the Role of European Industry in the Development and Application of Standards' (n 866) 38

¹²⁶⁶ T Light, F Camm, M E Chenoweth, P A Lewis and R Rudavsky, *Analysis of Government Accountability Office Bid Protests in Air Force Source Selections over the Past Two Decades*, RAND, 2012; F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary*, RAND 2012 (n 1219)

a sustained GAO bid protest. Whilst it is beyond the confines of this thesis to engage a detailed examination of the Review's findings, these will inform the discussion which follows.

3.3.1. Background to the Award

The U.S. Air Force has an ageing tanker fleet consisting of the medium-sized KC-135 and larger KC-10.¹²⁶⁷ The Air Force intended to replace the older KC-135 tankers through its procurement of the KC-X, a contract conservatively estimated at approximately \$35 billion in value.¹²⁶⁸ A lease and purchase contract was overturned in 2004 after it was confirmed that U.S. officials had engaged in corruption.¹²⁶⁹ In 2007, a full competition for the contract was conducted. The solicitation provided that award of the contract would be on a "best value" basis, and stipulated a detailed evaluation scheme that identified technical and cost factors and their relative weights.¹²⁷⁰ The Air Force received proposals and conducted several rounds of

¹²⁶⁷ The KC-135 aircraft currently has an average age of 46 years and is the oldest combat weapon system in the Agency's inventory

¹²⁶⁸ For a useful overview of this contract see J Gertler, 'Air Force KC-46A Tanker Aircraft Program' (Congressional Research Service) May 14 2013 < <http://www.fas.org/sgp/crs/weapons/RL34398.pdf> > accessed 20 September 2013; C Bolkcom and W Knight, 'Air Force Air Refueling: The KC-X Aircraft Acquisition Program' (Congressional Research Service) 4 August 2008 <<http://www.dtic.mil/cgi-bin/GetTRDoc?AD=ADA486067>> accessed 20 September 2013; R O'Rourke, 'Air Force KC-X Tanker Aircraft Program: Background and Issues for Congress' (Congressional Research Service) 23 October 2009 <http://assets.opencrs.com/rpts/RL34398_20091023.pdf> accessed 20 September 2013; N Hensel, 'Globalization and the U.S. Defense Industrial Base: the Competition for a New Aerial Refueling Tanker: What are the Real Issues?' Business Economics, October 2008

¹²⁶⁹ See C R Yukins and S L Schooner, 'Incrementalism: Eroding the Impediments to a Global Public Procurement Market' (n 29) 547-555. Whilst this thesis does not examine the issue of corruption, the following observations of the authors at 549 are pertinent: "[f]or our purposes here, the Druyun case is interesting because she improperly and corruptly favoured Boeing, a domestic supplier, over a foreign supplier, European Aeronautic Defense and Space Company ("EADS") (footnote omitted). But it was not discrimination against a foreign supplier that landed Ms. Druyun in prison. Rather, it was the corruption, *her personal self-dealing* that triggered the discrimination and landed Ms. Druyun in jail. Indeed, any discriminatory favoritism Ms. Druyun afforded Boeing would have been against a backdrop of fervent domestic support for Boeing, a leading U.S. manufacturer (footnote omitted). What the Druyun case illustrates is that an anti-corruption legal regime – even one as strong as that of the United States' – can attack only corruption, and can do little (if anything) to dissipate anti-foreign discrimination that can, in effect, block access to a procurement market [...]" See also J Branstetter, 'Darleen Druyun: An Evolving Case Study in Corruption, Power and Procurement' (2005) 34 Pub Cont LJ 443

¹²⁷⁰ For a discussion of these various requirements and their assessment by the GAO, see F Camm, M E

negotiations with Boeing and Northrop Grumman, both of which are U.S. owned companies. Boeing had previously supplied the Air Force's needs for airborne refueling capacity for over 50 years. The Northrop Grumman bid was a consortium bid which also comprised the European Aeronautic Defence and Space Company ("EADS") – the parent of Airbus Industries. On February 29 2008, the Agency selected Northrop Grumman's proposal. To date, the contract is the largest ever awarded by the US military to a supplier partially based in Europe.

Certain commentators had welcomed the award as a flagship contract that could achieve two principal objectives. Firstly, EU legal commentary had indicated that the decision could have reduced concerns about alleged favouritism displayed by U.S. authorities for U.S. contractors as well as tempered calls for a more protectionist European market in response.¹²⁷¹ Secondly, it was suggested that the decision could have created a positive precedent for the development of closer transatlantic industrial partnerships.¹²⁷² Similarly, the Fortresses and Icebergs Study identified that the decision could have provided anecdotal evidence of a possible change in attitudes in the U.S. acquisition community, providing a "salutary prospect that a Transatlantic defence market could evolve" on the basis of best value rather than nationality or employment considerations.¹²⁷³ However, Boeing filed a bid protest at the GAO challenging the award to Northrop Grumman on grounds that the Air Force did not assess the relative merits of the proposals in accordance with the evaluation criteria identified in the solicitation.

Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219) 65-91

¹²⁷¹ See A Georgopoulos, 'US Air Force air tanker contract: revisiting American protectionism in defence procurement?' (2008) 17 PPLR, 162, 163

¹²⁷² *ibid*

¹²⁷³ *Fortresses and Icebergs: (Vol I)* (n 12) 87

3.3.2. Bid Protest: Government Accountability Office Findings

The GAO sustained Boeing's protest, finding a number of significant errors in the Air Force's technical and cost evaluation and that the Agency had conducted misleading and unequal discussions with Boeing.¹²⁷⁴

Firstly, the RFP did not assess the relative merits of the proposals in accordance with the evaluation criteria identified in the solicitation, which provided for a relative order of importance for the various technical requirements. The Agency also did not take into account the fact that Boeing offered to satisfy more non-mandatory technical "requirements" than Northrop Grumman, even though the solicitation expressly requested offerors to satisfy as many of these technical "requirements" as possible.¹²⁷⁵

Secondly, the Air Force used the fact that Northrop Gruman proposed to exceed a key performance parameter objective relating to aerial refueling to a greater degree than Boeing. This was inconsistent with the solicitation which provided that "no consideration will be provided for exceeding [key performance parameter]

¹²⁷⁴ Press Release, GAO Sustains Boeing Bid Protest: Agency Recommends Air Force Reopen the Bid Process, Washington, DC, June 18, 2008 <http://www.gao.gov/press/press-boeing2008jun18_3.html> accessed 20 September 2013; GAO, United States Government Accountability Office, Decision in the Matter of The Boeing Company, File: B-311344; B-311344.3; B-311344.4; B-311344.6; B-311344.7; B-311344.8; B-311344.10; B-311344.11, document for public release, June 18 2008 <<http://www.gao.gov/decisions/bidpro/311344.pdf>> accessed 20 September 2013; United States Government Accountability Office, Testimony before the Air and Land Forces Subcommittee, Committee on Armed Services, House of Representatives, Air Force Procurement, Aerial Refueling Tanker Protest, Statement of Daniel I. Gordon, Deputy General Counsel, 10 July 2008 <<http://www.gao.gov/new.items/d08991t.pdf>> accessed 20 September 2013

¹²⁷⁵ See GAO Press Release (n 1274). For a detailed discussion of this ground, see F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219) 72-74. The RAND Report observes at 74: "[w]e make one basic observation regarding this sustainment: [c]learly, problems existed in the design and evaluation of the KC-X RFP, particularly in the area of requirements and the methodology for evaluating the proposal against them. There are three components to this problem. First, the RFP did not clearly identify key discriminators nor carefully restrict trade space to key discriminators. Second, the RFP used imprecise language on the weighting and evaluation methodology for items in the trade space. And third, the documentation provided by the Air Force did not clearly link specific evaluation language to the RFP [...] Unfortunately, GAO and its well-established precedents make clarity a must, as well as rigorous adherence to stated and implied evaluation criteria. The Air Force must take into account this basic reality when it designs and executes its RFPs."

objectives."¹²⁷⁶

Thirdly, the protest record did not demonstrate the reasonableness of the Air Force's determination that Northrop Grumman's proposed tanker could refuel all current tanker-compatible receiver aircraft compliant with Air Force procedures in accordance with the solicitation.¹²⁷⁷

Fourthly, the Air Force conducted misleading and unequal discussions with Boeing. The Air Force had informed Boeing that it had fully satisfied a key performance parameter objective but later determined that Boeing had only partially met this objective. The Air Force did not notify Boeing but continued to conduct discussions with Northrop Grumman concerning its satisfaction of the same requirement.¹²⁷⁸

¹²⁷⁶ See GAO Press Release (n 1274). For a detailed discussion of this ground, see F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219) 75-77. As the RAND Report observes at 75-76: "[p]roposals had to meet all KPP threshold values but the RFP explicitly stated that no credit would be awarded for exceeding a KPP objective. The RFP laid out nine KPPs. The second KPP was fuel offload range which was defined using a chart equivalent to the KC-135 capabilities. The fuel offload vs. unrefueled range KPP threshold required equaling the fuel offload capabilities of the KC-135 at various unrefueled ranges as indicated on the chart. The KPP objective was merely to exceed the threshold. Both the Boeing and the Northrop Grumman/EADS proposals met and exceeded the threshold, and thus both also met the objective. However, the KC45 offload capability significantly exceeded that of the Boeing KC-767. As a result, fuel offload at unrefueled range ultimately became one of the most important discriminators for the Air Force. Common sense suggests that this should not be surprising, given the basic mission of an aerial refueling tanker. The language in the RFP failed to reflect this common sense interpretation [...]" The RAND Report further observes at 77: "[o]ur major lesson from this sustained protest is that the Air Force, with all its extensive scrubbing and review of the RFP, failed to detect a very small but key inconsistency in the RFP language buried in a couple of sentences in totally different parts of the RFP [...]"

¹²⁷⁷ See GAO Press Release (n 1274). For a detailed discussion of this ground, see F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219) 78-80 which observes at 78: "[t]his was a key shortcoming, in that the number one KPP threshold requirement evaluated under the aerial refueling area of the key system requirement subfactor necessitated this capability. In principle, if a proposal failed to satisfy this KPP threshold requirement, it was automatically disqualified from the competition."

¹²⁷⁸ See GAO Press Release (n 1274). For a detailed discussion of this ground, see F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219) 81-82 which observes at 82: "[m]any knowledgeable observers in the Air Force and industry believed that this protest issue bordered on the frivolous. The Air Force argued that it was not obligated to inform Boeing of the changed rating, because this element was part of the trade space and, even after the change in rating, Boeing's proposal was still ranked with a strength in this area, rather than having been changed to a deficiency. Second, the Air Force maintained that this error in ranking and subsequent change had taken place after all discussions with the offerors had been closed, so that it was not appropriate to hold discussions with Boeing over the change. Finally, and perhaps most important, the Air Force claimed that the change had absolutely no material effect on the outcome of the competition [...]" GAO countered the Air Force arguments with three basic points. First, GAO reiterated the basic point that whatever the

Fifthly, a solicitation requirement specified that that the offerer would plan and support the Agency to achieve initial organic depot-level maintenance within 2 years of delivery.¹²⁷⁹ Northrop Grumman did not clearly commit to the 2 year time frame and on being informed stated that it would be resolved at “contract award”.¹²⁸⁰ The GAO concluded that the Air Force had unreasonably determined that Northrop Grumman’s actions were merely an administrative oversight.¹²⁸¹

Sixthly, during the protest, the Air Force conceded that it made a number of errors in evaluating military construction costs for the purposes of calculating the offeror’s most probable life cycle cost. On correction, Boeing would have had the lowest most probable life cycle cost. Further, the evaluation did not take account of the offeror’s specific proposals. In addition, the calculation of military construction costs based on a notional (hypothetical) plan was not reasonably supported.¹²⁸²

Finally, the Air Force improperly increased Boeing's estimated non-recurring

reason or context, the Air Force had misled Boeing and treated it unequally in this case. Second, GAO claimed the Air Force did reopen discussions with the offeror on other topics after RFP, so why not on this topic? Finally, GAO insisted that this error could have reasonably prejudiced Boeing’s proposal, since it involved the only KPP objective assessed in the operational utility area under the key system requirements subfactor [...] GAO made it clear that GAO precedent clearly states that the government must scrupulously treat all offerors equally. In the case of this protest, the Air Force unquestionably misread GAO’s oversight policy and determination to apply strict interpretations of precedent.”

¹²⁷⁹ See GAO Press Release (n 1274)

¹²⁸⁰ F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219) 83

¹²⁸¹ *ibid* 83 which observes that: “[a]fter reviewing this issue, GAO concluded that the organic repair requirement was a material requirement which had been consciously rejected by Northrop Grumman/EADS. In GAO’s interpretation, this behavior technically disqualified the entire Northrop Grumman/EADS proposal.” Further, the RAND Report indicates at 84 that in its conclusion: “[...] once again the Air Force failed to adequately document why Northrop Grumman’s logistics, maintenance and repair support for the KC-X was acceptable within the two-year time frame required by the RDP [...]”

¹²⁸² See F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219) 85-87 which observes at 86-87: “[...] GAO once again highlighted two basic principles. The Air Force must (1) follow the evaluation criteria laid out in the RFP and (2) clearly document the assumptions and approach it uses to calculate MILCON costs [...] The second point is perhaps more surprising. By arguing that the Air Force must carefully and thoroughly document the methodology and key assumptions it uses in its evaluations of proposal costs, the GAO decision demonstrated that it will not defer to the Air Force on the sufficiency of these assumptions without extensive documentation.”

engineering costs in calculating its most probable life cycle costs to account for risk associated with Boeing's failure to satisfactorily explain the basis for how it priced this cost element, where the Agency had not found that the proposed costs for that element were unrealistically low.¹²⁸³ In addition, the Air Force's use of a simulation model to determine Boeing's probable non-recurring engineering costs was unreasonable because the Air Force used as data inputs in the model the percentage of cost growth associated with weapons systems at an overall programme level and there was no indication that these inputs would be a reliable predictor of anticipated growth in Boeing's non-recurring engineering costs.¹²⁸⁴

3.3.3. Relative Significance for Transatlantic Defence Procurement

After the bid protest, and prior to the subsequent re-award to Boeing, certain U.S. commentators argued that neither the GAO's decision nor its underlying reasoning called into question the merits of non-discriminatory and competitive approaches to defence procurement; rather, the GAO review simply identified apparent deficiencies

¹²⁸³ See GAO Press Release (n 1274). For a detailed discussion of this ground, see F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219) 88-89 which observes at 88: “[i]n GAO's seventh sustained ground for protest, it played an activist role we did not see in any of the sustainments discussed above – or in any other decision we examined over the course of this study. It sustained a ground for protest that even the protester had not raised in its protest. Rather, GAO originated a ground for protest of its own [...] It continues at 89: “[g]iven how unusual the activist stance behind this sustainment was, it is had to draw a clear lesson from it. Perhaps the best lesson to draw is that future protesters can raise the kind of objection that GAO generated itself in this sustainment. To avoid such an objection, the Air Force must comply with very strictly drawn procedural rules when it dollarizes risk. These rules derive from broad policy stated in FAR Parts 15.305 and 15.404, implemented through a very pointed GAO interpretation. More broadly, for better or worse, this sustainment indicates that the Air Force did not fully understand or appreciate GAO precedent relevant to the adjustment of unrealistic cost estimates, or the full technical implications of that precedent for the interpretation of the FAR.”

¹²⁸⁴ See GAO Press Release (n 1274). For a detailed discussion of this ground, see F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219) 90-91 which observes at 91: [t]he lesson for the Air Force from the eighth sustained ground for protest is virtually the same as the sixth. The Air Force must thoroughly justify and document the cost-estimating methodology that it uses to assess offeror's cost estimates. Without such documentation, GAO will not defer to the assumptions made by the Air Force.”

in the process by which the contract was initially awarded in that particular case.¹²⁸⁵

Whilst it is beyond the confines of this thesis to engage a detailed analysis of the KC-X award, the RAND Report's findings raise interesting issues from a legal perspective. The RAND report emphasises an apparent difference between the priority accorded by the U.S. Air Force to the "needs of the warfighter as it enforces federal regulations within its own acquisition system" and the GAO which "focuses on the regulations themselves and deliberately keeps its distance from substantive issues".¹²⁸⁶ It continues that in its reviews of bid protests, GAO sees itself as "simply applying legislative language to the specific facts" but that over the course of time, however, GAO has developed a history of decisions that it draws on as "precedents" which provide an "implicit set of rules".¹²⁸⁷ According to the Report, these rules are as follows: (1) Did the Agency follow the evaluation criteria in the RFP?; (2) Were the Agency determinations reasonable and properly documented?; (3) Did the Agency violate any statute or regulation?¹²⁸⁸ The Report concludes by suggesting that with an "appropriate understanding of how these rules operate in any particular setting", the Air Force could better design and execute source selections to avoid protests and make more informed decisions about corrective action.¹²⁸⁹ It is pertinent to observe that the Report itself identifies that "despite close vetting by Air Force attorneys, senior Air Force officials misread the implicit rules GAO used to make decisions" and

¹²⁸⁵ R D Anderson and W E, 'Competition Policy and International Trade Liberalisation: Essential Complements to Ensure Good Performance in Public Procurement Markets' (n 24) 99. The GAO was careful to state that: "[t]he GAO decision should not be read to reflect a view as to the merits of the firms' respective aircraft. Judgments about which offeror will most successfully meet governmental needs are largely reserved for the procuring agencies, subject only to such statutory and regulatory requirements as full and open competition and fairness". See GAO Press Release (n 1274)

¹²⁸⁶ See F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219) xi

¹²⁸⁷ *ibid*

¹²⁸⁸ *ibid*

¹²⁸⁹ *ibid*

that “the better Air Force decision-makers understand how GAO applies these implicit rules in practice, the easier it should be to avoid protest sustainments”.¹²⁹⁰

It is submitted that the Report’s findings appear to be predicated largely on the basis that the GAO’s adjudicatory method is clearly discernable by reference to a system of “precedent”, in fact referring to the need for officials to execute and document their evaluations in a way that complies with GAO’s “expectations”.¹²⁹¹ However, it is at least arguable from the KC-X award that these “implicit” rules are not clear. For instance, the Report itself indicates that ambiguity in the KC-X RFP gave the GAO “large openings to impose its own judgment about what a “reasonable person would think the Air Force intended in its RFP”.¹²⁹² Further, as the Report also acknowledges, the GAO had not applied a “common sense” approach to certain of the grounds and which arguably reflect more of a strict linguistic, and even legalistic, interpretation.¹²⁹³ In addition, the GAO sustained a ground of protest that had not even been raised by the protester, namely ground 7 in relation to non-recurring engineering costs. The Report suggests that the sustainment indicates that the Air Force did not fully understand or appreciate GAO precedent relevant to the adjustment of unrealistic cost estimates, or the full “technical implications of that precedent for interpretation of the FAR”.¹²⁹⁴ In addition to the issue of the GAO’s

1290 *ibid*

1291 *ibid*

1292 *ibid*

1293 See for example, the arguments in relation to ground 2 concerning the basis for meeting and exceeding “thresholds” and “objectives. For a discussion in this regard, see (n 1276) above and F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219), and 76-77

1294 It is recalled that this concerned FAR Part 15.305. For a discussion in this regard see (n 1283) above and F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219) 88

general competence and jurisdiction to adjudicate grounds that are not pleaded¹²⁹⁵ the Report appears to confirm the necessity for a legalistic approach which has focused on a “narrow reading of FAR Part 15 and GAO precedent”.¹²⁹⁶ The RAND Report also makes repeated references to the GAO’s assessment of “reasonableness”.

In light of the above, it is at least open to question the nature and form of the GAO’s administrative review or adjudicatory methodology. It may be difficult to sustain the argument that this ostensible quasi-judicial methodology is clear given that experienced Air Force attorneys were unable to pre-empt the application of many of these so-called “implicit rules”. More generally, it is questionable whether the GAO’s assessment maintains a sufficiently discrete separation of review from a substantive examination of the merits. A whole host of issues may be raised in this regard, not least whether a “reasonable person” “test” is an adequate and effective standard of review for application in highly complex and technical tenders. All of the above raise potential issues of administrative and legal uncertainty for foreign contractors seeking to utilise the U.S. review system.¹²⁹⁷

The KC-X award provides not only an interesting perspective for foreign contractors but also for U.S. contracting officials that intend to facilitate foreign competition in contract awards. As will be discussed below, the KC-X was largely based on a pre-existing commercial design. It has been observed that this presents difficulties if the

¹²⁹⁵ The RAND Report (n 1219) itself observes at 95 that: “[o]n several of the specific grounds for protest, real questions can be raised regarding the materiality of the issues reviewed and sustained by GAO. Several of the sustained grounds for protest do not seem to meet GAO’s standard of materiality.”

¹²⁹⁶ *ibid* 89

¹²⁹⁷ The expectation might be that foreign operators can simply instruct U.S. attorneys in light of their specialist knowledge of U.S. government contract litigation. Yet, the indications above could suggest that even this may not provide any greater assurance

Air Force, for example, wishes to maintain competition and avoid choosing the winner in its statement of requirements.¹²⁹⁸ For instance, the more precisely the Air Force states its requirements the easier it is for potential offerors to compare available designs against the requirements and determine the likely winner; consequently, unless the RFP left enough room for at least two offerors to make credible proposals, it would not be rational for anyone but the frontrunner to enter.¹²⁹⁹ It has been observed that in light of increasing U.S. focus on competitive prototyping and preliminary design review prior to source selection the more precise the understanding of system requirements will be, in turn, making it more difficult to sustain competition.¹³⁰⁰ On the one hand, in this instance, if the requirements are then known, it may be logical not to hold a competition.¹³⁰¹ On the other hand, the simple fact of permitting another competitor to bid can impose cost discipline on the frontrunner.¹³⁰² The RAND Report observes that in the KC-X acquisition, the Air Force knew this and had to frame its requirements with “exceptional subtlety” to induce enough offerors to participate and that this became necessary because of the public profile of the award.¹³⁰³ In turn, this exposes a greater liability to subtle elements of the RFP being challenged. Given that possible awards to foreign contractors will almost always gain significant public interest, this risk is particularly apparent. Further, the RAND Report observes that whilst it found no evidence that Congressional interest affected decision making within the Air Force or GAO, “individual decision-makers do not deliberate in a vacuum and could not avoid being

¹²⁹⁸ F Camm, M E Chenoweth, J C Graser, T Light, M A Lorell and S K Woodward, *Government Accountability Office Bid Protests in Air Force Source Selections, Evidence and Options— Executive Summary* (n 1219) 100-101

¹²⁹⁹ *ibid* 101

¹³⁰⁰ *ibid*

¹³⁰¹ *ibid*

¹³⁰² *ibid*

¹³⁰³ *ibid*

affected by political arguments in the wider debate”.¹³⁰⁴

In light of the above discussion, it is important to undertake a more measured assessment of the KC-X award. In a discussion of perceptions of access of foreign contractors to a reciprocal transatlantic defence market, it is important for EU observers to avoid treating the tanker contract as adversely prejudicing EU competitors, or for U.S. observers to use the award to advocate protectionist measures. It is stark to consider that one instance of U.S. legal commentary has sought to argue that Boeing won the contract on objective grounds when it ought to have been awarded the contract exclusively in consideration of socio-economic factors or requirements as part of the evaluation process (e.g. such as job creation and protection) and that Congress should be encouraged to change existing defence procurement law and policy to ensure future contracts are awarded “fairly and efficiently using domestic preference policies, and not to leave major acquisition decisions to primarily price”.¹³⁰⁵

Yet, even U.S. commentary written after the initial award to the Northrup Grumman–EADS consortium identified that the significance of decisions like the KC-X tanker award for the Transatlantic defence relationship must be tempered on several grounds. First, the “changing attitude” towards transatlantic competition which is said to be evidenced by the initial award is not universal but simply constitute *ad hoc* decisions by particular DoD components.¹³⁰⁶ Second, it was recognized that a

¹³⁰⁴ *ibid* 102

¹³⁰⁵ L I McCarl, ‘Foreign Competition in U.S. Defense Contracts: Why the U.S. Government Should Favor Domestic Companies in Awarding Major Defense Procurement and Acquisition Contracts’ (2011) *Pac. McGeorge Global Bus & Dev LJ* 303

¹³⁰⁶ *Fortresses and Icebergs: (Vol II)* (n 12) 669

significant portion of the value of the programme must be provided in the U.S.¹³⁰⁷ Thus, substantial content is U.S. based and that had the Northrup Gruman–EADS bid won, the latter would have been required to open U.S. manufacturing facilities.¹³⁰⁸ Third, as indicated above, the reality is that the foreign participant would have only provided what was essentially a commercial aircraft and not a defence system as such. Thus, it cannot be said in cases of this kind that there is a substantial reliance on a foreign defence system and it remains to be seen whether this is ever likely to be the case in the near future.¹³⁰⁹

To this extent, the KC-X award should be considered as an important case study for analysis in transatlantic defence procurement relations not as a basis for perceived openness or protectionism within the transatlantic defence market but more specifically for the issues it raises in relation to e.g. the formulation of RFPs, the application of evaluation criteria and the role of review mechanisms such as the GAO.

4. Full and Open Competition After Exclusion of Sources

The preceding Sections have concerned instances in which full and open competition is possible. However, it is recalled that CICA also enables full and open competition after the exclusion of sources.¹³¹⁰ Whilst, as indicated below, U.S. legal commentary has identified the relevance of small business set asides in a transatlantic defence

¹³⁰⁷ *ibid*

¹³⁰⁸ *ibid*

¹³⁰⁹ *ibid*

¹³¹⁰ 10 U.S.C. § 2304(b)(1) and 41 U.S.C. § 3303(a)(1)

procurement context, there has been substantially no focus on the industrial mobilization exclusion. It is necessary to examine this provision in light of the fact that there are corresponding CICA exceptions (rather than exclusions) on this ground which permit non-competitive procedures.¹³¹¹

4.1. Establishing or Maintaining Alternative Sources

It has been suggested that CICA was, in part, adopted as “protectionist legislation” designed to reinforce industrial mobilization in response to a fear of too great a reliance on foreign suppliers for defence material.¹³¹² Irrespective of the extent to which this was historically accurate and remains the case today, the formal priority accorded to industrial mobilization is clearly reflected by its inclusion as both an exclusion and exception under CICA. In FAR 6.202, the six circumstances permitting full and open competition after exclusion of sources are grouped under the single head of “establishing or maintaining alternative sources”. This Chapter only focuses on the main exclusions.¹³¹³

Before examining this exclusion, it is important to observe that according to USASpending.gov data, for FY 2012, exclusion on grounds of establishment or maintenance of alternative sources constituted only 0.24%¹³¹⁴ of competed

¹³¹¹ For a discussion in this regard, see Chapter 10, Section 4

¹³¹² A Cox and S Greenwold, ‘The legal and structural obstacles to free trade in the United States procurement market’ (n 1051) 241

¹³¹³ The other two concerns an exclusion to satisfy projected needs on the basis of a history of high demand and an exclusion to satisfy a critical need for medical, safety or emergency supplies. See FAR 6.202(5) and (6), respectively

¹³¹⁴ By amount, this totalled \$153,320,727.19

dollars.¹³¹⁵ The data does not provide a further breakdown as to which particular circumstances are invoked. Nor does it provide an indication as to whether foreign competition was even possible. Notwithstanding, it is necessary to examine the provisions in full.

4.1.1. Increase or Maintain Competition and Likely Cost Reduction

The first circumstance enables an Agency to exclude a particular source or sources if the Agency Head determines that to do so would increase or maintain competition and likely result in reduced overall costs for the acquisition, or for any anticipated acquisition.¹³¹⁶ This circumstance enables the development of a competitive second source by precluding an existing sole source contractor from participating in the second source competition. It also enables the maintenance of an alternate source by precluding the primary source from being awarded all of the Agency's requirements.¹³¹⁷

The ability of the U.S. to ensure the availability of two or more options absent any threat to a primary source is indicative of stark contrasts between the political and economic circumstances of the U.S. and EU defence markets. Whilst CICA enables free-standing industrial mobilization grounds to enable dual sourcing, EU law is only likely to permit the most exceptional use of Article 346 TFEU for industrial

¹³¹⁵ This excludes orders subject to fair opportunity. See USASpending.gov data for Fiscal Year 2012. Available at http://www.usaspending.gov/pie-summary-tabular?q=node%2F91&tab=By+Agency&fromfiscal=yes&carryfilters=on&typeofview=detailsummary&fiscal_year=2013&maj_contracting_agency=9700&maj_contracting_agency_name=Department+of+Defense&cdtype=0&page=1&rp=15&sortname=sum&sortorder=desc&dtype=Comp accessed 20 September 2013

¹³¹⁶ FAR 6.202(a)(1)

¹³¹⁷ J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 320-321 citing *Hawker Eternacell, Inc.*, Comp. Gen. Dec. B-283586, 99-2 CPD ¶ 96

mobilization and only then to justify the continued existence of a single capability. Any such form of assistance could also constitute a form of State aid.

However, use of this exclusion is subject to important regulatory limitations. FAR 6.202(b) provides that a determination and findings (“D&F”) by an Agency head or designee must support the decision to exclude particular sources.¹³¹⁸ Each D&F must set out enough facts and circumstances to “clearly and convincingly” justify the determination.¹³¹⁹ After exclusion, an Agency is required to establish full and open competition using one of the competitive procedures.¹³²⁰ DFARS Subpart 206 imposes an additional requirement in relation to the information to be included in the D&F.¹³²¹ PGI 206.202 requires the following. Firstly, the acquisition history of the supplies or services must be included.¹³²² Secondly, it is necessary to state the circumstances that make it necessary to exclude the particular source including: the

¹³¹⁸ See FAR 1.707. According to FAR 1.701 “Determination and Findings” means: “a special form of written approval by an authorized official that is required by statute or regulation as a prerequisite to taking certain contract actions. The “determination” is a conclusion or decision supported by the “findings.” The findings are statements of fact or rationale essential to support the determination and must cover each requirement of the statute or regulation.” According to FAR 1.702(a), a D&F applies ordinarily to an individual contract action. Further, the approval granted by a D&F is restricted to the proposed contract action(s) reasonably described in that D&F. D&F’s may provide for a reasonable degree of flexibility. Furthermore, in their application, reasonable variations in estimated quantities or prices are permitted, unless the D&F specifies otherwise. It is also possible to use class D&F’s. According to FAR 1.703(a), a class may consist of contract actions for the same or related supplies or services or other contract actions that require essentially identical justification. In accordance with FAR 1.703(b), the findings in a class D&F shall fully support the proposed action either for the class as a whole or for each action. A class D&F shall be for a specified period, with the expiration date stated in the document. Further, FAR 1.703(c) provides that the contracting officer shall ensure that individual actions taken pursuant to the authority of a class D&F are within the scope of the D&F

¹³¹⁹ According to FAR 1.704, as a minimum, each D&F shall include, in the prescribed agency format, the following information: (a) Identification of the agency and of the contracting activity and specific identification of the document as a “Determination and Findings.” (b) Nature and/or description of the action being approved. (c) Citation of the appropriate statute and/or regulation upon which the D&F is based. (d) Findings that detail the particular circumstances, facts, or reasoning essential to support the determination. Necessary supporting documentation shall be obtained from appropriate requirements and technical personnel. (e) A determination based on the findings, that the proposed action is justified under the applicable statute or regulation. (f) Expiration date of the D&F, if required. (g) The signature of the official authorized to sign the D&F and the date signed

¹³²⁰ See FAR 6.201

¹³²¹ DFARS 206.202(b)

¹³²² PGI 206.202 (b)(i). This includes, for example, sources, prices, quantities and dates of award

reasons for the lack of, or potential loss of, alternative supplies¹³²³ and the current annual requirement and projected needs.¹³²⁴ Thirdly, it must be identified whether the existing source must be totally excluded or whether a partial exclusion is sufficient.¹³²⁵ Fourthly, it must provide information on the potential effect of exclusion on the excluded source in terms of loss of future capability.¹³²⁶ Further, with regard to the determination of reduced overall costs, information must include start-up, facility and administrative costs as well as economic order quantities and life cycle cost considerations.¹³²⁷

At least formally, this D&F requirement appears to provide a useful check on the invocation of the exclusion. It is recalled from Chapter 2 that there is no comparable evidential requirement for the use of the exceptions under EU law. However, whilst, as will be discussed in Chapter 10, Section 2.2, there is available evidence regarding the extent to which justifications and approvals (“J&A”) are effectively utilised, there is no similar evidence in relation to the use of D&Fs. It is therefore difficult to determine the extent to which, if at all, these act as effective accountability mechanisms for investigating the extent of foreign exclusion.

4.1.2. Interest of National Defence and Industrial Mobilization

The second and third circumstances permit exclusion because it would be in the “interest of national defence” either in having a facility (or a producer, manufacturer,

¹³²³ For example, the technical complexity and “criticality” of the supplies or services. See DFARS 206.202(b)(i)(B)(1)

¹³²⁴ 206.202(b)(i)(B)(1) and (2)

¹³²⁵ 206.202(b)(i)(C)

¹³²⁶ DFARS 206.202(b)(i)(D)

¹³²⁷ DFARS 206.202(b)(i)(E). This corresponds with FAR 6.202(b)(3)

or other supplier) available for furnishing the supplies or services in case of a national emergency or industrial mobilization, or in establishing or maintaining an essential engineering, research, or development capability to be provided by an educational or other nonprofit institution or a federally funded research and development centre.¹³²⁸

It is not precisely clear how these two exclusions relate to the third exception permitting other than full and open competition discussed in Chapter 10, Section 4. The latter permits the use of a non-competitive procedure where it is necessary to award the contract to a particular source or sources for the two reasons permitting the exclusion of sources identified above. Notwithstanding the similarity in wording, it is important to distinguish the formal effect of the exclusion which still requires use of a competitive procedure and the exception which permits use of a non-competitive procedure. There is no tangible evidence providing an indication as to the circumstances in which an Agency would invoke the former instead of the latter. Further, it is not clear how decisive the decision to have recourse to the former or latter is in excluding foreign competition. The fact that both the exclusions and exceptions are very similar may raise fundamental questions about the potential for their indiscriminate use.

Again, with regard to the second exclusion, DFARS Subpart 206 imposes an additional requirement in relation to the information to be included in the D&F. PGI 206.202 requires that when relying on this exclusion, the D&F must include information regarding: the current annual mobilization requirements for the supplies or services, citing the source of, or the basis for, the data; a comparison of current

¹³²⁸ FAR 6.202(a)(2) and (3). The second and third exclusions are said to be similar to the former 10 U.S.C. § 2304(a)(16), which permitted the use of negotiated procurement to maintain multiple producers that were part of the mobilization base. See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 320

production capacity with that that necessary to meet mobilization requirements; an analysis of the risks of relying on the present source; and a projection of the time required for a new source to attain capacity necessary to meet mobilization requirements.¹³²⁹

In the absence of available evidence, it is not clear whether this authority could simply enable a decision to stop sourcing from a foreign supplier. The addition of an assessment of “risk” under the D&F is also uncertain. To this extent, again it is not clear whether the D&F constitutes an effective check.

4.1.3. Continuous Availability of a Reliable Source of Supply

The fourth circumstance is where the exclusion of a source would ensure the continuous availability of a reliable source of supply of such property or service.¹³³⁰ It is not clear how significant this exclusion is in practice.¹³³¹ Again, this exclusion is extremely broad. It is not clear what “ensuring” “continuous availability” means or in what circumstances it would be required. Further, it is recalled from Chapter 5 that the Defence Procurement Directive contains a number of references to “reliability”.¹³³² As indicated, “reliability” is highly subjective.¹³³³ Theoretically, this exclusion would not automatically exclude foreign competition.¹³³⁴ However, it is

¹³²⁹ DFARS 206.202(b)(i)(E)

¹³³⁰ FAR 6.202(4)

¹³³¹ There is no commentary on this exclusion in the leading treatise on U.S. Government Contracts. See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 320

¹³³² See Recitals 65 and 67 and Article 39(2)(e)

¹³³³ For instance, there may not need to be any diminution (howsoever determined) in the reliability of a producer in order to justify recourse to the exclusion so as to test or increase its reliability. The breadth of the exclusion may justify limitations on sources simply to maintain an already reliable supplier

¹³³⁴ For instance, it is possible that even where there is one or more national producers, it may be considered necessary to also ensure that a reliable foreign supplier can also provide the same goods

possible to conceive of instances in which a foreign source had been an exclusive provider (in the absence of a national provider) but which is now deemed “unreliable” and *vice versa*. It is not clear whether “reliable” is synonymous with “national”. Beyond these limited findings, in the absence of clear evidence it is nevertheless important to reinforce the commonality of references to ill-defined terms such as “reliability” and which expose the considerable generality of legal prescriptions in this field, in turn, conferring considerable discretion on contracting authorities.

Finally, there is no additional D&F requirements stipulated for this exclusion beyond those contained in FAR 6.202.¹³³⁵

5. Small Business Set Asides

Another major exclusion falling within the category of full and open competition after exclusion of sources concerns small business set asides.¹³³⁶ CICA recognizes that the Head of an Agency may provide for the procurement of property or services using competitive procedures but excluding concerns other than small business concerns in furtherance of the Small Business Act.¹³³⁷ An important difference from the other CICA exclusions, however, is that Agencies making small business set asides do not need to provide a separate D&F.¹³³⁸

¹³³⁵ FAR 6.202(b)(1)

¹³³⁶ FAR 6.203-6.208

¹³³⁷ 10 U.S.C. 2304(b)(2) and 41 U.S.C. § 253(b)(2). U.S. Code, The Small Business Act, Public Law No. 83-163, 67 Stat. 232 (July 30, 1953), currently codified as amended in U.S. Code Title 15, ss.631–657(o) (2010)

¹³³⁸ FAR6.203(b)

The Small Business Act was enacted in 1953, setting as its objective the possibility to secure the “maximum practicable opportunity” for small businesses to win a “fair proportion” of federal contracts.¹³³⁹ Supported by the Small Business Administration (“SBA”), the U.S. maintains substantial socio-economic programmes through federal procurement.¹³⁴⁰ The DoD is similarly committed to the pursuit of such programmes, *inter alia*, through its Mentor-Protégé Program.¹³⁴¹ USASpending.gov data provides a breakdown by amount and percentage of the various types of small business set aside. For Fiscal YR 2012, the largest category in this regard totals 7.75%¹³⁴² of competed dollars.¹³⁴³

Whilst historically, the EU has not utilised procurement expressly as an instrument to achieve socio-economic objectives, the EU has strategically focused on so-called small and medium sized enterprises (“SMEs”) in recent years. For instance, the EU has committed to a Small Business Act for Europe¹³⁴⁴ which is supported by a set of policy initiatives.¹³⁴⁵ Similarly, the role of SMEs in the defence sector is increasingly recognized.¹³⁴⁶

¹³³⁹ (n 1337)

¹³⁴⁰ For a useful up to date overview of the U.S. small business law and policy framework, see M V Kidalov and K F Snider, ‘Once more, with feeling: federal small business contracting policy in the Obama administration’ (n 1056) 1 PPLR 15

¹³⁴¹ Details are available at: <<http://www.acq.osd.mil/osbp/sb/programs/mpp/>> accessed 20 September 2013

¹³⁴² By amount this totals \$6,070,090,516.47

¹³⁴³ This excludes orders subject to fair opportunity. Available at: <http://www.usaspending.gov/pie-summarytabular?q=node%2F91&tab=By+Agency&fromfiscal=yes&carryfilters=on&typeofview=detailsummary&fiscal_year=2013&maj_contracting_agency=9700&maj_contracting_agency_name=Department+of+Defense&cdtype=0&page=1&rp=15&sortname=sum&sortorder=desc&dtype=Comp> 20 September 2013

¹³⁴⁴ Commission, ‘“Thinks Small First” A “Small Business Act” for Europe COM (2008) 394 final <<http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0394:FIN:EN:PDF>> accessed 20 September 2013

¹³⁴⁵ More information is available at: <<http://ec.europa.eu/small-business/policy-statistics/policy/>> accessed 20 September 2013

¹³⁴⁶ EU (Commissioned) ‘Study on the Competitiveness of European Small and Medium sized Enterprises (SMEs) in the Defence Sector’, Final Report, 5 November 2009 <http://ec.europa.eu/enterprise/sectors/defence/files/20091105_europe_economics_final_report_en.pdf> accessed 20 September 2013. See also Commission, ‘Towards a more competitive and efficient defence and security sector’ (n 7) 9-10

It is beyond the aims of this thesis to even outline U.S. and EU law and policy in this field.¹³⁴⁷ However, specifically relevant to the present thesis, U.S. legal commentary has recently sought to respond to successive EU Commission Reports on U.S. Barriers to Trade and Investment which have claimed that U.S. small business set aside schemes are discriminatory measures which limit bidding opportunities for EU contractors.¹³⁴⁸

In particular, it has been argued that the Defence Procurement Directive and EDA policies evidence a shift in focus away from the EU's historical approach of merely encouraging SME opportunities towards providing measurable participation outcomes for SME's in specific contracts and which are akin to legally binding reservations and set asides at the prime contracting level in the U.S.¹³⁴⁹ It has been suggested that the Defence Procurement Directive goes even further than the Public Sector Directive by tying support for SMEs to competitiveness and national security goals.¹³⁵⁰

¹³⁴⁷ On social objectives in public procurement generally, see C McCrudden, *Buying Social Justice: Equality, Government Procurement and Legal Change* (OUP 2007); S Arrowsmith and P Kunzlik (ed.) *Social and Environmental Policies in EC Procurement Law: New Directives and New Directions* (CUP 2009); For general commentary on U.S. policies assisting small businesses, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1573-1613. For a non-exhaustive list of the extensive literature contained in the UK Public Procurement Law Review alone, see G O'Brien, 'Public procurement and the small or medium enterprise (SME)' (1993) 2 PPLR 82; D Mardas, 'Sub-contracting, small and medium enterprises (SMEs) and public procurement in the European Community' (1994) 1 PPLR 19; A Erridge 'Involvement of SMEs in public procurement' (1998) 2 PPLR 37; S L Schooner, 'United States: mixed messages: heightened complexity in social policies favouring small business interests' (1999) 3 PPLR 78; M Burgi, 'Small and medium-sized enterprises and procurement law - European legal framework and German experiences' (2007) 4 PPLR 284; D C Specht, 'The SBIR program: small businesses and "individuals" on the cutting edge' (2008) 2 PPLR 99-118; R Williams, 'European Code of Best Practices Facilitating Access by SME's to Public Procurement Contracts' (2008) 6 PPLR 249; M V Kidalov and K F Snider, 'Once more, with feeling: federal small business contracting policy in the Obama administration' (n 1056). The U.S. literature is too voluminous to recite in this footnote

¹³⁴⁸ M V Kidalov, 'Small Business Contracting in the United States and Europe: A Comparative Assessment' (2011) 40(2) Pub Cont LJ 443 citing at 445 Commission, *U.S. Barriers to Trade and Investment Report for 2008* (July 2009), 15

<http://trade.ec.europa.eu/doclib/docs/2009/july/tradoc_144160.pdf> accessed 20 September 2013

¹³⁴⁹ M V Kidalov, 'Small Business Contracting in the United States and Europe: A Comparative Assessment' (n 1348) 460

¹³⁵⁰ According to Kidalov at 456 this is evidenced by Recital 3 which states in relevant part that: "[...] Member States may use different tools, in conformity with Community law, aiming at a truly European defence equipment market and a level playing field at both European and global levels. They should also contribute to the in-depth

On this basis, it has been suggested that it could pose serious long-term industrial competitiveness challenges to the U.S. defence and civilian sectors if the U.S. fails to maintain strong set asides and other small business preferences and would be “well justified in refusing European demands to waive or repeal the Small Business Act”.¹³⁵¹ More specifically, it has been suggested that “abandoning the Small Business Act or generally opening up U.S. business procurements to European firms would be short-sighted and detrimental to the U.S. national interests”.¹³⁵²

It is necessary to examine these claims in more detail. For the sake of analytical clarity, this Section separates the analysis of EU law from EU SME policy. It is also important to identify at the outset that it is not exactly clear what evidence there is to substantiate the effects (and extent) of small business laws and policies on transatlantic defence procurement. This reflects a more fundamental underlying uncertainty regarding the extent to which socio-economically oriented laws and policies actually achieve their functions without adversely impacting on fundamental goals of the procurement system.¹³⁵³ Therefore, observations which attribute particular significance to the effects of such laws and policies ought to be treated with some caution.¹³⁵⁴

development of the diversity of the European defence-related supplier base, in particular by supporting the involvement of small and medium-sized enterprises (SMEs) and non-traditional suppliers in the European Defence Technological and Industrial Base, fostering industrial cooperation and promoting efficient and responsive lower tier suppliers. In this context, they should take into account the Commission’s Interpretative Communication of 7 December 2006 on the application of Article 296 of the Treaty in the field of defence procurement and the Commission Communication of 5 December 2007 on a Strategy for a stronger and more competitive European defence industry.”

¹³⁵¹ *ibid* 509

¹³⁵² *ibid*. These “national interests” are not defined

¹³⁵³ See S L Schooner, ‘United States: mixed messages: heightened complexity in social policies favouring small business interests’ (n 1347) 83. On these ‘goals’ more generally, see S L Schooner, ‘Desiderata: objectives for a system of government contract law’ (2002) 2 PPLR 103

¹³⁵⁴ Of course, this does not mean to say that the use of small business laws and policies, if empirically substantiated, could not be utilized to improve transatlantic defence procurement

5.1. Subcontracting under the Defence Procurement Directive

It is recalled from Chapter 5, Section 2, that the Defence Procurement Directive contains specific subcontracting provisions. In this regard, it has been asserted that Article 20 Defence Procurement Directive “approves the use of subcontracting, including subcontracting driven by social consideration [*sic*], as conditions of contract performance”.¹³⁵⁵ However, it must be questioned to what extent the Directive emphasises the use of subcontracting driven by social considerations. Strictly speaking, Article 20 provides that performance conditions may, in particular, concern subcontracting *or* take social considerations into account.¹³⁵⁶ Further, the Directive’s provisions on subcontracts awarded by successful tenderers make no express reference to social considerations.¹³⁵⁷ In addition, whilst a contracting authority may require a successful tenderer to apply criteria chosen by the contracting authority when selecting subcontractors, in the absence of any reference to social considerations, the Directive merely provides that the criteria chosen by the successful tenderer must be objective, non-discriminatory and consistent with the criteria applied by the contracting authority for the selection of tenderers for the main contract.¹³⁵⁸

U.S. legal commentary has itself recognized that the extent to which it is possible for Member States to facilitate social considerations has been significantly reduced under the Directive. For instance, it has been suggested that whilst European

¹³⁵⁵ M V Kidalov, ‘Small Business Contracting in the United States and Europe: A Comparative Assessment’ (n 1348) 501

¹³⁵⁶ Emphasis added. This emphasis is further reinforced by the fact that social considerations feature last in Article 20 after subcontracting, security of information and security of supply, reflecting a possible priority accorded to the former

¹³⁵⁷ See Articles 50-54

¹³⁵⁸ Article 53(1). See also Guidance Note, Subcontracting, 11 point 39

defence procurement has largely been utilised to facilitate socio-economic programmes,¹³⁵⁹ the Directive attempts to ease socioeconomic goals, specifically jobs creation, from defence procurements by insisting that no performance conditions may pertain to requirements other than those relating to the performance of the contract itself and that this is intended at least in part to exclude extraneous conditions including socio-economic requirements that are not directly related to contract performance.¹³⁶⁰ Most importantly, it is recalled from Chapter 7, Section 3.2, that a core rationale underlying the subcontracting provisions is an attempt to eliminate recourse to offsets. It is difficult to sustain the assertion that the Directive's subcontracting provisions will simply result in the exchange of one form of national socio-economic preference for a European socio-economic preference. To this extent, there is limited basis for suggesting that the Directive would render it any more or less likely that social considerations become an increasingly important (let alone decisive) factor in a way that would adversely impact against U.S. contractors.

More significantly, Article 21(4) of the Defence Procurement Directive has been cited within the U.S. legal commentary as an example of an instance of an increasing EU focus on "measurable identifiable participation outcomes",¹³⁶¹ which operates "essentially as a subcontracting set-aside required of prime contractors"¹³⁶² and represents the Commission's "strong endorsement of mandatory subcontracting set-asides".¹³⁶³ Article 21(4) provides that a contracting authority may require subcontracting for a certain share of the main contract (described as the 'minimal

¹³⁵⁹ Yukins, 'The European Defense Procurement Directive: An American Perspective' (n 311) 4

¹³⁶⁰ *ibid* 4 citing Recital 45 and Article 20

¹³⁶¹ M V Kidalov, 'Small Business Contracting in the United States and Europe: A Comparative Assessment' (n 1348) 460, fn75

¹³⁶² *ibid* 501

¹³⁶³ *Ibid*

percentage' and capped at 30% of contract value) in competition while the successful tenderer decides which parts are to be subcontracted in competition.

It is argued that Article 21(4) is not “essentially”, or equivalent to, a “mandatory subcontracting set-aside”. Firstly, this does not correspond with the formal effect accorded to this provision. It was not a requirement that Article 21(4) be transposed.¹³⁶⁴ According to the Commission Report on transposition, only two Member States have chosen not to provide for compulsory subcontracting.¹³⁶⁵ However, whilst all of the other Member States have given their contracting authorities the possibility to require subcontracting, contracting authorities are not required to use compulsory subcontracting.¹³⁶⁶ Secondly, Article 21(4) specifies no more than an option to award a percentage of subcontracts in competition. It follows that the contracting authority cannot require the successful tenderer to subcontract specific parts of the contract.¹³⁶⁷ Further, Article 21(4) does not permit a contracting authority to require a successful tenderer to award subcontracts to specific subcontractors or to subcontractors of a specific nationality, and does not permit sole source awards to certain classes of small business. Thirdly, by design and/or result, through its optional provisions, the Defence Procurement Directive is intended to be receptive to the effect of any subcontracting requirements on the existing supply chain of an EU prime contractor (which may comprise third country elements).¹³⁶⁸

¹³⁶⁴ See Guidance Note, Subcontracting, 4, point 17, para 2

¹³⁶⁵ Commission, Report to the European Parliament and The Council on transposition of directive 2009/81/EC on Defence and Security Procurement, Brussels' (n 302) 7

¹³⁶⁶ *ibid*

¹³⁶⁷ The successful tenderer is free to decide which subcontracts it wants to award to meet the percentage required. See Guidance Note, Subcontracting, 5, para 17

¹³⁶⁸ For example, the negotiated and competitive dialogue procedures allow for discussion of the impact of the subcontracting provisions with suppliers in order to reduce the risk of causing unnecessary harm to an existing supply chain. Further, see Guidance Note Subcontracting, 4-5, paras. 16-17 which states: [t]he Directive points out that an excessive distortion of the supply chain should be avoided: Article 21 (4) states that the range of percentages defined 'shall be proportionate to the object and value of the contract and the nature of the industry

The Guidance Note on Subcontracting expressly identifies the need to avoid “excessive distortion” of the supply chain, through a consideration of the importance of the nature of the industry sector involved, the level of competition in the relevant market as well as the relevant technical capabilities of the industrial base.¹³⁶⁹ To this extent, Article 21(4) is far from constituting a mandatory set aside.

5.2. EU SME and Subcontracting Policies

The same U.S. legal commentary has identified a number of intergovernmental initiatives, in particular the EDA, as addressing not only the issue of opportunity to compete, but also (to an admittedly lesser extent) share of participation in public procurement through the “reservation” of certain procurement opportunities for SMEs at the prime and sub-contract levels. For instance, the EDA’s Code of Best Practice in the Supply Chain has been identified as effectively permitting subcontracting with SMEs as award criteria.¹³⁷⁰ Similarly, it has been argued that the EDA further

sector involved, including the level of competition in that market and the relevant technical capabilities of the industrial base. Recital 40 insists that ‘the proper functioning of the successful tenderer’s supply chain should not be jeopardised. Therefore, the percentage that can be subcontracted to third parties at the request of the contracting authority/entity should appropriately reflect the object and value of the contract.’ Similarly, the Guidance Note on Security of Supply, 13, point 40 in relation to Article 23(c) (concerning the organization and location of a tenderer’s supply chain) states that: “[i]n this context, one has also to take into account that the organisation of the tenderer’s supply chain might be influenced by the contracting authority/entity, if the latter makes use of Article 21(3) and/or (4) to oblige the successful tenderer to award subcontracts by a competitive procedure under Articles 51-53. In such a case, both the tenderer and the contracting authority/entity must try to reconcile these two obligations.” For a discussion of Article 23(c), see Chapter 5, Section 6

¹³⁶⁹ Guidance Note, Subcontracting, *ibid*, 5

¹³⁷⁰ See M V Kidalov, ‘Small Business Contracting in the United States and Europe: A Comparative Assessment’ (n 1348) 502, fn 350 citing the Code which provides in relevant part: “[i]n Assessing what is economically advantageous in the selection of Suppliers, it shall be taken into consideration that both Buyers and Suppliers need to take strategic sourcing decisions that are wider than individual contract or programme requirements [...] In evaluating tenders of Suppliers, buyers will consider, amongst other things, the approach undertaken or proposed for the selection of sources of supply (including where appropriate, make or buy plans), having regard to the principles of the CoBPSC [...] Monitoring arrangements will be introduced to the extent to which the CoBPSC is being applied. It will be based on Prime Contractors providing information on sub-contract opportunities advertised.”

recognizes offsets, including subcontracting requirements, to local industry as one of the best value selection criteria.¹³⁷¹

However, it is recalled from Chapter 7, Section 2.3 that whilst the political significance of the EDA Codes is arguable, the EDA Codes are limited intergovernmental, voluntary Codes of conduct which do not have legal effect and whose scope is confined to procurement excluded pursuant to Article 346 TFEU. Further, it is recalled that in light of the Defence Procurement Directive, the possibility for extensive recourse to offsets is likely to be significantly reduced. It is re-emphasised that these practices are determined to be *prima facie* incompatible with EU law. It therefore cannot be argued that the EU, or indeed the EDA, actively supports widespread use of offsets (especially through the use of subcontracting) even if they acknowledge their existence.¹³⁷²

Importantly, notwithstanding, the same U.S. commentary has also stated that it does not follow that the U.S. and EU cannot ever negotiate a trade agreement to provide reciprocal procurement opportunities to each other's small businesses.¹³⁷³ It has been suggested that such cooperation is better suited to limited procurement programmes e.g. where both sides contribute financially, agree on a common definition of a small business and on related measures and devise common assistance tools for small firms.¹³⁷⁴ NATO procurements have been proposed as

¹³⁷¹ M V Kidalov, 'Small Business Contracting in the United States and Europe: A Comparative Assessment' (n 1348) 502

¹³⁷² For a discussion in this regard, see Chapter 7, Section 4.2

¹³⁷³ M V Kidalov, 'Small Business Contracting in the United States and Europe: A Comparative Assessment' (n 1348) 502

¹³⁷⁴ *ibid*

suitable candidates for such initiatives.¹³⁷⁵ It should be observed that in 2012, the U.S. and EU signed an MoU Concerning Cooperation on Small and Medium-Sized Enterprises.¹³⁷⁶ However, the MoU does not make any reference to SMEs in the defence sector. In any event, as this Section has indicated, it is submitted that, in the first instance, there ought to be more detailed research undertaken of the role and effects of small business regulation and policy on defence procurement practice both nationally and on a transatlantic scale.

6. Conclusions

Whilst U.S. law prescribes “full and open competition”, statistics indicate that the extent of permitted foreign competition is limited. In light of the inherent generality of the legal prescriptions which constitute the exclusions to full and open competition, It is unsurprising that the Fortresses and Icebergs Study identifies that it is the contracting authority’s discretionary authority which constitutes the most significant barrier to trade.

However, this Chapter has demonstrated that it is extremely difficult to pinpoint how certain discretions may be utilized to affect foreign competition. Further, the findings of the analysis of the CICA exclusions were limited. As expected, the exclusions were broadly defined. These appear to reflect the overriding emphasis of U.S.

¹³⁷⁵ *ibid*

¹³⁷⁶ Memorandum of Understanding Between U.S. Department of Commerce International Trade Administration and European Commission Directorate-General for Enterprise and Industry Concerning Cooperation on Small and Medium-Sized Enterprises, 3 December 2012
< <http://www.ustr.gov/sites/default/files/12042012%20U.S.-EU%20SME%20MOU.pdf>> accessed 20 September 2012

procurement on protecting the industrial base, maintaining a self-sustaining national competition through dual-sourcing and overt promotion of national socio-economic objectives. Whilst these exceptions may be utilized to exclude foreign competition, they are not designed, or operate, specifically with the exclusion of foreign competition in mind. Notwithstanding, this Chapter has identified the need for further analysis of precisely how U.S. law and its discretionary application may be used to exclude foreign competition. At the very least, it is suggested that there is a basis for re-evaluating the current formulation of the CICA exclusions. The thesis is not naïve to the fact that if it is intended to exclude foreign competition, a limited set of statutory provisions, no matter how well formulated, will be unlikely to prevent exclusion. Nevertheless, it may be questioned to what extent the provisions themselves, as well as the determinations and findings, could better regulate decision-making in relation to foreign competition if only to increase accountability and transparency. The EU experience is extremely limited by comparison. However, this Chapter has sought to indicate, where possible, the extent to which EU law focuses on restricting the potential for legislation to be used to exclude or discriminate against foreign competition.

Finally, the discussion of U.S. claims about EU law and policy on SMEs and subcontracting revealed the current limits but also potentialities of comparative legal scholarship. The analysis cautioned the necessity of asking fundamental questions about the extent to which this particular field of activity impacts, in real terms, on the transatlantic market before determining whether, and if so how, transatlantic legal or other institutions may usefully operate.

Other than Full and Open Competition under U.S. Federal Procurement Law

1. Introduction

It is recalled from Chapter 9 that CICA provides for “other than full and open competition”. CICA refers to, but does not provide a statutory definition of, other than full and open competitive procedures. Therefore, any procurement contract entered into without full and open competition is, by default, non-competitive. However, it does not follow that every such contract infringes CICA. CICA permits an exhaustive list of seven circumstances in which other than competitive procedures may be used.¹³⁷⁷ The exceptions are implemented in FAR Subpart 6.3 and supplemented by DFARS Subpart 206.3. Recourse to one of the exceptions is not automatic. Even if one of the exceptions applies, the contracting officer is still required to request offers from as many potential offerors as is “practicable”.¹³⁷⁸

Whilst Chapter 9 examined the extent to which contracting authorities could possibly exercise what has been described as their “informal exclusion authority” to exclude foreign competition, it has been identified that the statutory CICA exceptions

¹³⁷⁷ 10 U.S.C. § 2304(c) and 41 U.S.C. § 3304(a). CICA does not explicitly refer to these circumstances as “exceptions” to its competition requirements. However, the term “exception” is used by CICA in reference to these circumstances in its requirement for justifications and approvals of contracts awarded using other than full and open competition and commentators commonly refer to the “CICA exceptions” when describing these circumstances. See 10 U.S.C. § 2304(f)(3)(B) and 41 U.S.C. § 253(e)(2)(B). For a general discussion of the CICA exceptions, see J D Clark, *Overcoming the Critical Challenges of Contingency Contracting, Understanding the Flexibility Permitted by CICA, Simplified Acquisition Procedures and Small Purchases* (1999) 28 Pub Cont LJ 503

¹³⁷⁸ FAR 6.301(d). For a discussion of this requirement and corresponding case law, see J Cibinic Jr, R C Nash Jr and K R O'Brien-DeBaakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 116-117

“effectively provide managers with the discretionary authority to exclude foreign participation in acquisition programs”.¹³⁷⁹

In the last two years, two GAO Reports have been published with a specific focus on competition in procurement. According to a 2012 Report, out of the nearly \$1.5 trillion that DoD obligated for all contracts during FY 2007-2010, 41% (\$606.3 billion) were based on other than full and open competition,¹³⁸⁰ primarily through the CICA exceptions.¹³⁸¹ According to the latest 2013 Report, DoD’s overall competition rate has declined 5.5% from 62.6% percent in FY 2008 to 57.1% in 2012.¹³⁸² Considerable variation also exists between the DoD components.¹³⁸³

This Chapter examines the exceptions of most potential relevance to a defence procurement analysis.¹³⁸⁴ As will be demonstrated, certain of the exceptions broadly correspond with the provisions of the Defence Procurement Directive which permit exceptional use of the negotiated procedure without publication of a contract notice. However, as indicated in Chapter 8, Section 1, points of comparison and contrast

¹³⁷⁹ *Fortresses and Icebergs: (Vol. II) (n 12) 662-663*

¹³⁸⁰ These statistics are based on data from the FPDS-NG data for FY 2007-2010. See Government Accountability Office, *Defense Contracting – Improved Policies and Tools Could Help Increase Competition on DOD’s National security Exception Procurements* GAO-12-263, 6 (Washington D.C. January 2012 <<http://www.gao.gov/assets/590/587681.pdf>> accessed 20 September 2013

¹³⁸¹ *ibid*

¹³⁸² Government Accountability Office, *Defense Contracting - Actions Needed to Increase Competition* (n 1163) 8-9 citing Figure 1 DOD Competition Rate for All Contract Obligations from Fiscal Years 2008 through 2012 (Source: GAO analysis of FPDS-NG data)

¹³⁸³ The Air Force had the lowest competition rate at 37.1%. The DLA had the highest at 83.3%. See Government Accountability Office, *Defense Contracting - Actions Needed to Increase Competition* (n 1163) 10-11 citing Figure 3 Competition Rates by DOD Component for Fiscal Years 2008 through 2012

¹³⁸⁴ This Chapter does not consider the permissible use of other than full and open competition where a statute expressly authorizes or requires that the procurement be made through another executive agency or from a specified source, or the agency’s need is for brandname commercial items for authorized resale. See 410 U.S.C. 2304(c)(5). Guidance is located at FAR 6.302-5 and DFARS 206.302-5. This exception does cover small business set-asides. For a discussion of this exception, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 318-319 and J Cibinic Jr, R C Nash Jr and K R O’Brien-DeBaakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 114-115

reveal the idiosyncratic features of the U.S. and EU legal, political and economic systems.

2. Justification and Approvals

Before examining the CICA exceptions, it is first necessary to emphasise that CICA requires that Agency contracting officials must justify and obtain J&As for use of other than competitive procedures.¹³⁸⁵ Justification must be in writing, certifying the accuracy and completeness of the Agency's justification.¹³⁸⁶ Further, Agencies must post the J&A documents for all contracts awarded pursuant to a CICA exception on FedBizOpps¹³⁸⁷ within 14 days of award.¹³⁸⁸ In order to rely on a CICA exception permitting use of a non-competitive procedure, the J&A requirement must be satisfied.¹³⁸⁹

¹³⁸⁵ 10 U.S.C. § 2304(f). For a general discussion of Justifications and Approvals, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 286 – 288 and J Cibinic Jr, R C Nash Jr and K R O'Brien-DeBakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 129-131

¹³⁸⁶ 10 U.S.C. § 2304(f)(1)(A)

¹³⁸⁷ Federal Business Opportunities, or FedBizOpps, is the government wide single-point-of-entry on the internet for all federal government contracting opportunities. It lists all major federal government solicitations, contract awards, subcontracting opportunities, surplus property sales and foreign business opportunities. For further information, see <<https://www.fbo.gov>> accessed 20 September 2013

¹³⁸⁸ CICA originally required Agencies to make their justifications for noncompetitive awards, as well as "any related information," available to the general public under the Freedom of Information Act (10 U.S.C. § 2304(f)(4) and 41 U.S.C. § 253(f)(4)). The National Defense Authorization Act for FY2008 amended CICA by requiring that Agencies also post the justification and approval documents for all contracts awarded in reliance on a CICA exception on FedBizOpps within 14 days of contract award (P.L. 110-181 § 844, 122 Stat. 236-39 (Oct. 14, 2008)). When the noncompetitive award is made on the basis of unusual and compelling urgency, Agencies have up to 30 days after the award to post it on FedBizOpps. Under CICA, Agencies are also required to publish notices regarding certain noncompetitive contracts that they propose to award on FedBizOpps prior to their award (10 U.S.C. § 2304(f)(1)(C) and 41 U.S.C. § 253(f)(1)(C)). See generally 41 U.S.C. § 416(b)(5) (notice requirements)). These notices identify the intended recipient of the noncompetitive contract award and state the Agencies' reasons for making a noncompetitive award. Because notice of these proposed awards precedes the awards, other contractors could submit proposals to the Agency or protest the proposed award

¹³⁸⁹ FAR 6.303-1

2.1. Content of a Justification and Approval

It is recalled that DFARS Subpart 206 imposes an additional requirement in relation to the information to be included in the D&F for use of a CICA exclusion.¹³⁹⁰ By contrast, the DFARS does not provide a supplemental requirement in relation to the use of a CICA exception beyond the basic J&A requirements of the FAR even though it authorises the use of non-competitive procedures.¹³⁹¹

An important requirement is that Agency officials of a higher rank than the contracting officer must approve Justifications, the appropriate official determined on the basis of the contract's dollar value.¹³⁹² In terms of the general content of a J&A, the document must *inter alia*: identify the statutory authority permitting other than full and open competition;¹³⁹³ demonstrate that the proposed contractor's unique qualifications or the nature of the acquisition requires use of the authority;¹³⁹⁴ identify efforts made to ensure solicitation from as many sources as practicable;¹³⁹⁵ provide a determination that the cost will be fair and reasonable;¹³⁹⁶ provide a description of market research;¹³⁹⁷ and provide any other factors in support.¹³⁹⁸

¹³⁹⁰ DFARS 206.202(b). See PGI 206.202 discussed in Chapter 9, Section 4.1.1

¹³⁹¹ See DFARS 206.303

¹³⁹² FAR 6.304

¹³⁹³ FAR 6.303(b)(4)

¹³⁹⁴ FAR 6.303(b)(5)

¹³⁹⁵ FAR 6.303(b)(6)

¹³⁹⁶ FAR 6.303(b)(7)

¹³⁹⁷ FAR 6.303(b)(8)

¹³⁹⁸ FAR 6.303(b)(9)

2.2. Evidence of the Use of Justifications and Approvals in Practice

The above 2013 GAO Report found that J&As generally met FAR requirements.¹³⁹⁹ However, as this Chapter will discuss in reference to the Report's findings, a number of general issues have been identified. These can be summarised as follows. Firstly, there are reported instances in which J&A's have been prepared in advance of issuing a presolicitation notice with the effect of excluding consideration of a viable source. Secondly, J&A's only specify a minimum content requirement. Whilst identifying general compliance with FAR requirements, the above Report also identified that Justifications provided limited insight into the reasons for the non-competitive award.¹⁴⁰⁰ It is therefore important to question whether this minimum is sufficient and, further, whether the DoD encourages officers to exceed the minimum. For instance, as will be discussed, GAO Reports have identified that with regard to certain exceptions, the justification was not adequate.¹⁴⁰¹ Thirdly, it is possible for the DoD to issue what is termed a "class justification", a single J&A document that applies to multiple contracts. As will be discussed, a GAO report has identified concerns about the extent to which class justifications can limit competition within the admitted class as well as limit access of new entrants.¹⁴⁰² Further concern has been expressed regarding the level of review of contracts awarded under class justifications.¹⁴⁰³

¹³⁹⁹ United States Government Accountability Office, *Defense Contracting - Actions Needed to Increase Competition* (n 1163) 17

¹⁴⁰⁰ As will be discussed below, the FAR requirements relating to J&As only set a minimum standard required

¹⁴⁰¹ See the discussion of the unusual and compelling urgency exception in Section 6 below

¹⁴⁰² See the discussion of the national security exception in Section 5.1 below

¹⁴⁰³ *ibid*

2.3. Justifications for the Use of the Negotiated Procedure without Publication

EU legal commentary has not examined in any particular detail the issue of accountability (including as a matter of administrative process) with regard to the use of exceptions permitting non-compliance with EU public procurement law. For instance, whilst there has been substantial debate regarding the conditions for use of Article 346 TFEU, it is recalled that Article 346 TFEU contains no requirement of *ex ante* or *ex post* notification. Assessment of a Member State's justification will only generally occur if the Commission is notified by a third party or takes its own initiative to commence or consider commencing proceedings. Similarly, whilst Article 30(3) Defence Procurement Directive requires that the use of the negotiated procedure without publication must be justified, Article 37(d) simply requires that the circumstances referred to in Article 28 which justify the use of the procedure must be stated. Beyond a statement of the circumstances, no other formal requirement is imposed.

In light of the broad legal prescriptions contained within exclusions and exceptions to competitive procurement, transparency and accountability mechanisms of a kind similar to D&Fs and J&As could provide an important check on their use. However, as this Chapter will also demonstrate, it is open to question how effective such requirements are in practice.

3. Sole Source

As indicated in Chapter 9, Section 2.1.1, the most common circumstance justifying use of a non-competitive procedure is where the requested property or services are available from only one responsible source or, in the case of the DoD, only a limited number of responsible sources, and no other type of property or service will satisfy the Agency's needs.¹⁴⁰⁴ Guidance on the use of this exception can be found at FAR 6.302-1 and DFARS 206.302-1.¹⁴⁰⁵ It has been stated that this exception is the broadest and possibly most utilized exception to the requirement of full and open competition.¹⁴⁰⁶

An Agency determination that a proposed contractor is the only source capable of meeting the technical needs of the Agency is subject to close scrutiny but will not be overturned if the Agency has properly justified its needs and there is a reasonable basis for its determination.¹⁴⁰⁷ The GAO has held that the availability of only one source has to be demonstrated "convincingly"¹⁴⁰⁸ but that in most protests, Agencies have been able to meet this test.¹⁴⁰⁹ An Agency's legitimate need to standardize equipment has been determined to provide a reasonable basis for imposing

¹⁴⁰⁴ 10 USC 2304(c)(1) and 41 U.S.C. § 3304(a)(1). For a discussion of this exception, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 282 – 295 and J Cibinic Jr, R C Nash Jr and K R O'Brien-DeBakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 93-109

¹⁴⁰⁵ DFARS 206.302

¹⁴⁰⁶ J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 282 – 295

¹⁴⁰⁷ See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 301 and cases cited therein and K R O'Brien-DeBakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 94 and cases cited therein

¹⁴⁰⁸ J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 302 citing *Daniel H. Wagner Assocs.*, 65 Comp. Gen 305 (B-220633) CPD ¶ 166

¹⁴⁰⁹ J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 302 citing *EADS N. Am., Inc.*, Comp. Gen. Dec. B-291805, 2003 CPD ¶ 51

restrictions of competition.¹⁴¹⁰ Protests of sole source determinations have, however, been sustained if the facts indicate that other sources could satisfactorily meet the government's needs, for example, where records show that another potential vendor has been given an incorrect understanding of the Agency's requirements¹⁴¹¹ and where the pre-solicitation notice generated an expression of interest from a second source but the J&A was prepared in advance of the notice and did not consider the viability of the second source.¹⁴¹²

Importantly, however, it is not possible to determine the extent to which this exception has specifically affected foreign competition. Aside from the uncertainty of determining whether a foreign source is capable of meeting a government need in the first instance, it is also difficult to determine, for example, the extent to which specific considerations e.g. relating to standardization or interoperability could provide a basis for excluding foreign competition. In addition, whilst the issue of predeterminations made under J&As raises further questions about the extent to which the use of exceptions are properly justified, it is not possible to discern any specific effect on foreign contractors.

Notwithstanding, as indicated in Chapter 1, even where no foreign competition is possible, it necessary to determine the extent of sole source contracting in the U.S. not least because an internally competitive U.S. market is in general the interests of the transatlantic defence market in the same way that U.S. commentators have

¹⁴¹⁰ See K R O'Brien-DeBaakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 95 and cases cited therein

¹⁴¹¹ J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 303 citing *Lockheed Martin Sys. Integration – Owego*, Comp. Gen. Dec. B-287190.2, 2001 CPD ¶ 110

¹⁴¹² K R O'Brien-DeBaakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 96 citing *Barnes Aerospace Group*, Comp. Gen. Dec. B-298864, 2006 CPD ¶ 204

emphasised the importance of an internally competitive EU defence market. The opening of non-competitive contracts to more national competition could, in turn, create the possibility for further foreign competition.¹⁴¹³

The determination to procure on a sole source basis may be justified according to several other circumstances which are considered in turn.

3.1. Privately Developed Items and Reasons Connected with Exclusive Rights

One circumstance in which sole source procurement may be necessary concerns items developed at private expense e.g. patented and copyrighted items or items described by proprietary data.¹⁴¹⁴ it may be necessary to undertake sole source procurement because the government may have no other proprietary data package,¹⁴¹⁵ or identifying alternative sources may result in unacceptable costs or delay e.g. where a new contractor would need to gain a working knowledge of data, where delivery is urgent or where reverse engineering is prohibitive.¹⁴¹⁶

According to the 2013 GAO Report, for services supporting DoD weapons programmes, the Government's lack of access to proprietary data as a result, *inter alia*, of failures in previous years to purchase technical data packages to support

¹⁴¹³ For example, even where sole source awards are made to a U.S. contractor, it may be possible for that contractor to rely on foreign supply chains at the lower tiers

¹⁴¹⁴ For a discussion in this regard, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 303-309 and K R O'Brien-DeBailey, *Competitive Negotiation: The Source Selection Process* (n 1055) 96-104

¹⁴¹⁵ Similarly, an Agency may not even have adequate data to establish qualification requirements for an item because the data necessary to do so is in the possession of the original designer thereby precluding a sound determination about how to achieve acceptable performance. See for e.g. *Masbe Corp.*, Comp. Gen. Dec. B-260253.2, 95-1 CPD ¶ 253 cited in K R O'Brien-DeBailey, *Competitive Negotiation: The Source Selection Process* (n 1055) 101

¹⁴¹⁶ See K R O'Brien-DeBailey, *Competitive Negotiation: The Source Selection Process* (n 1055) 101-101 and cases cited therein

purchased solutions¹⁴¹⁷ and a heavy reliance on specific contractors for expertise, have limited or precluded the possibility of competition and resulted in single source awards under this CICA exception.¹⁴¹⁸

Again, available evidence does not provide a clear indication of the extent to which foreign competition may be “locked out” of contract awards on the basis of retention of, or access to, proprietary data. It cannot be presumed that foreign contractors would have comparable data packages. Further, it is not clear the extent to which contracting authorities would be expected to identify competitive foreign data packages for future procurements.

In comparison, the Defence Procurement Directive similarly provides for use of the negotiated procedure without publication when the contract may be awarded only to one particular economic operator for technical reasons or reasons connected with the protection of exclusive rights.¹⁴¹⁹ Whilst, as indicated above, there is no specific J&A procedure under the Directive, according to Recital 52, these reasons should be rigorously defined and justified on a case-by-case basis. Recital 52 provides a number of examples (which are not exhaustive) of permissible justifications. These include: strict technical impracticability for a candidate other than the chosen economic operator to achieve the required goals; the necessity to use specific know-how, tools or means which only one operator has at its disposal (e.g. the modification or retrofitting of complex equipment); and specific interoperability or safety

¹⁴¹⁷ United States Government Accountability Office, *Defense Contracting - Actions Needed to Increase Competition* (n 1163) 19-20

¹⁴¹⁸ *ibid*, 18-24

¹⁴¹⁹ Article 28(e)

requirements which must be fulfilled in order to ensure the functioning of the armed or security forces.¹⁴²⁰

As indicated above, U.S. case law appears to indicate that the exception covers substantially the same circumstances. It is not yet clear how or to what extent the exception will be utilised under the Defence Procurement Directive. Further, there is no indication of the extent to which U.S. contractors would likely be excluded on these grounds. However, as indicated in Chapter 2, the CJEU has been prepared to scrutinise the legitimacy of decisions to reserve contracts to national operators on grounds of “interoperability”.¹⁴²¹

3.2. Follow-on Contracts and Additional Deliveries

In addition to the protection of exclusive rights, U.S. law also permits sole source contracting for follow-on contracts,¹⁴²² namely where an award other than to the original source would result in substantial duplication of cost to the U.S. and which it does not expect to recover through competition,¹⁴²³ or unacceptable delays.¹⁴²⁴ It is recalled from Chapter 9, Section 2.1 that in light of the number of on-going legacy programmes, there is a relatively high proportion of follow-on work awarded to incumbent contractors.

¹⁴²⁰ *ibid*

¹⁴²¹ Case C-337/05 *Commission v Italy* [2008] ECR I-2173, para 59. See Chapter 2, Section 4.3

¹⁴²² See 10 U.S.C. § 2304(d)(1)(B). See generally J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 310 and J Cibinic Jr, R C Nash Jr and K R O'Brien-DeBakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 107

¹⁴²³ See e.g. *Aerospace Research Assocs.*, Comp. Gen. Dec. B-201953, 81 CPD ¶ 36 cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 313. However, the Agency is required to determine and document that the cost of the initial capital investment made by the developer of new items cannot be offset by savings that would result from competing the item. See J Cibinic Jr, R C Nash Jr and K R O'Brien-DeBakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 107

¹⁴²⁴ *Raytheon Co.*, Comp. Gen. Dec. B-400610, 2009 CPD ¶ 8 cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 312

It has been suggested that such an exception is “eminently logical” in that it would make no sense to seek bids on old programmes where an award was competitively bid years ago unless the prime contractor is failing to deliver.¹⁴²⁵ However, it is not clear the extent to which the DoD is prepared to conduct rigorous investigations into levels of prime contractor performance, or the viability of alternative foreign competitors. Again, this would, however, assume that foreign competitors would be equally capable of performing the work.

The Defence Procurement Directive also permits the award of a contract by negotiated procedure without publication for additional deliveries by the original supplier under a supply contract.¹⁴²⁶ Two circumstances for use are specifically identified. The first is for a partial replacement of normal supplies or installations.¹⁴²⁷ The second is for extensions of existing supplies or installations, where a change of supplier would oblige the contracting authority to acquire material having different technical characteristics which would result in incompatibility or disproportionate technical difficulties in operation and maintenance.¹⁴²⁸ This is the case, for example, for the integration of new components into existing systems or for the modernisation of such systems.¹⁴²⁹ It has been acknowledged that there is some degree of overlap with the technical reasons or exclusive rights grounds under the Directive.¹⁴³⁰

¹⁴²⁵ *Fortresses and Icebergs*: (Vol. II) (n 12) 666

¹⁴²⁶ Article 28(3). There is a similar provision with regard to works and services under Article 24(a) and (b)

¹⁴²⁷ *ibid*

¹⁴²⁸ *ibid*. See Recital 51 which states: “[...] incompatibility or disproportionate technical difficulties in operation and maintenance justifying the use of the negotiated procedure without publication of a contract notice in the case of supply contracts for additional deliveries should be assessed in the light of this complexity and the associated requirements for interoperability and standardisation of equipment. This is the case, for example, for the integration of new components into existing systems or for the modernisation of such systems.”

¹⁴²⁹ *ibid*

¹⁴³⁰ See Defence and Security Public Contracts Regulations 2011, Chapter 8 - Procurement Procedures (Guidance) 21 August 2011, 14 para 88 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/27658/dscpr_c8_procurement_procedures_apr12.pdf> accessed 20 September 2013

In addition, the Directive provides that the length of such contracts as well as recurrent contracts may not exceed five years except in “exceptional circumstances”.¹⁴³¹ These circumstances are not defined. The length of such contracts must be determined by taking account of the expected service life of any delivered items, installations or systems and the technical difficulties in operation and maintenance.¹⁴³²

The additional deliveries justification under the Defence Procurement Directive is possibly slightly narrower than the circumstances permitting the award of sole source follow-on contracts under U.S. law because the latter covers not only continued production but also continued development of a major system, whereas the former is confined to additional deliveries of existing items that have already been produced. Further, it is recalled that U.S. law may justify single source awards for follow-on contracts on the basis of “substantial duplication of costs” and “unacceptable delays”. There is no equivalent provision or justification under the Directive. In addition, unlike the Directive, U.S. law does not appear to place time restrictions on contracts or their use in “exceptional circumstances”, to the extent that any such restrictions could act as an effective check on the use of this exclusion.

3.3. Framework Contracting

In contrast to the limited discussion of protection of exclusive rights and follow-on work, U.S. legal commentary has identified one specific form of sole source contracting which may be liable to appreciably affect foreign competition, namely the

¹⁴³¹ Article 28(3)(a), subparagraph 2

¹⁴³² *ibid*

use of framework contracting, a specific variety of which is known as “indefinite delivery-indefinite quantity (“IDIQ”) contracts under U.S. law.¹⁴³³

Under U.S. law there are a number of discrete types of so-called variable quantity contract that might otherwise fall under the general category of “framework” agreements or arrangements under EU law.¹⁴³⁴ Task (services) and Delivery (supplies) Order Contracts (“TODO”) are one example.¹⁴³⁵ TODO’s are contracts for services or goods that do not procure or specify a “firm quantity”.¹⁴³⁶ Instead, TODO’s provide for the issuance of orders for the delivery of supplies during the period of the contract. An initial contract may be awarded in competition, followed by further orders under the initial contract which may or may not be awarded in competition and under which one or more vendors may be eligible for award.¹⁴³⁷

Procurement notices and competition are generally not required for the issuance of TODO’s under either single or multiple award contracts.¹⁴³⁸ However, each contractor must nevertheless be provided a “fair opportunity to be considered” for each order unless one of the following circumstances are met.¹⁴³⁹ The first is where the Agency’s need is of such “unusual urgency” that providing an opportunity to all contractors would result in unacceptable delays. The second is where only one contractor is capable of providing the services or property. The third is where the

¹⁴³³ For commentary on the categories of framework contracts, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1331-1434

¹⁴³⁴ For a discussion of this comparison, see C Yukins, ‘Are IDIQs Inefficient? Sharing Lessons with European Framework Contracting’ (n 1056)

¹⁴³⁵ For a discussion of TODO contracts, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 148-152

¹⁴³⁶ 10 U.S.C. §2304(d)(1) and (2) and 41 U.S.C. § 4101(1) and (2)

¹⁴³⁷ J Cibinic Jr, R C Nash Jr and K R O’Brien-DeBakey, *Competitive Negotiation: The Source Selection Process* (n 1055) 148-152

¹⁴³⁸ 10 U.S.C. § 2304c(a) and 41 U.S.C. § 1708(b)(1)(D)

¹⁴³⁹ See 10 U.S.C. § 2304c(b)

TODO should be issued on a sole source basis in the interest of economy and efficiency because it is a logical follow-on to a task or delivery order already competitively issued. The final circumstance is where it is necessary to place the order with a particular contractor in order to satisfy a minimum guarantee.¹⁴⁴⁰ Non-competitively awarded TODO's can potentially cover a broad spectrum depending on the nature and scope of the work statement under the basic contract.¹⁴⁴¹

Recently, more competition and notice requirements have been introduced,¹⁴⁴² as well as protests to the GAO of IDIQ orders over \$10 million.¹⁴⁴³

It is recalled from Chapter 4 that the Defence Procurement Directive contains a specific provision on framework agreements.¹⁴⁴⁴ According to Article 29, the term of a framework may not exceed seven years, except in exceptional circumstances in accordance with an appropriate justification.¹⁴⁴⁵ Again, these are not elaborated in any detail.

U.S. legal commentary has identified framework agreements as a serious potential barrier to foreign vendors not least because unlike other so-called categories of barriers to procurement (e.g. domestic content, socioeconomic requirements etc) there is no institutional resistance to framework agreements because government Agencies themselves foster barriers in pursuit of objectives such as efficiency, for

¹⁴⁴⁰ *ibid.* The statutory exemption of task and delivery orders from competition is implemented in FAR 6.001(d)-

(f)
¹⁴⁴¹ see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 328-330

¹⁴⁴² FAR 8.405 and FAR 16.505

¹⁴⁴³ 10 U.S.C. § 2304c(e) and 41 U.S.C. § 253j(e)

¹⁴⁴⁴ Article 29

¹⁴⁴⁵ Article 29(2)

example.¹⁴⁴⁶ Generally, framework contracting in the U.S. has been criticised on grounds of lack of competition, limited transparency and accountability e.g. through lack of publication requirements and limited protest jurisdiction, even though U.S. law requires that suppliers are offered a “fair opportunity” to compete for subsequent orders.¹⁴⁴⁷ Particular instances have been identified in the DoD.¹⁴⁴⁸

More specifically with regard to barriers faced by foreign vendors, these include the initial difficulty for a newcomer discovering a framework agreement because of failure to publicize their existence (let alone any awards made); the practical problem of actually joining a framework which, after initial award, may in certain instances be closed for up to a decade¹⁴⁴⁹ as well as the fact that there are a number of uncertainties in call-off competitions.¹⁴⁵⁰ These include the generality of stated award criteria that may favour an incumbent contractor and the general absence or unwillingness to pursue protests.

¹⁴⁴⁶ C R Yukins and S L Schooner, 'Incrementalism: Eroding the Impediments to a Global Public Procurement Market' (n 29) 529, 556

¹⁴⁴⁷ *ibid.* Yukins and Schooner usefully summarise the findings of official reports as follows: “[c]entralized purchasing agencies, which establish the framework agreements in the first instance, will feel pressure to accommodate customer agencies by allowing tasks to be awarded to those customer agencies' favored contractors. To ease award to a favored contractor- often the incumbent contractor-the contracting agency may (1) fail to notify other vendors (other framework agreement holders) of an available task, (2) provide inadequate notice, (3) fail to provide useful specifications, (4) impose biased technical requirements, (5) allow a slanted evaluation of offers, (6) inadequately assess the reasonableness of the favored vendor's proffered price, or (7) ignore the many other rules meant to ensure vigorous, transparent competition”. (footnotes omitted). *Ibid* 552

¹⁴⁴⁸ *ibid.* 551 and citations at fn67 and 68

¹⁴⁴⁹ According to Article 29(2) of the Defence Procurement Directive, the term of a framework agreement may not exceed seven years, except in exceptional circumstances determined by taking into account the expected service life of any delivered items, installations or systems, and the technical difficulties which a change of supplier may cause

¹⁴⁵⁰ C R Yukins and S L Schooner, 'Incrementalism: Eroding the Impediments to a Global Public Procurement Market' (n 29) 556 who observe: “[w]hen the competition for an order is held, the agency may keep its stated criteria for award to a breezy minimum, and, because debriefings and protests often are not required, the agency's discretionary award decision may be completely immune from challenge or review. To add insult to injury, the data on the award may be spotty, and the terms used-because the standing contracts are generically crafted with little particularity-may well favor a savvy, incumbent contractor.”

However, it is important to observe that there is no substantial research examining the effects of framework contracting specifically on foreign competition in defence procurement either with regard to U.S. or EU operators. To this extent, the general conclusions drawn regarding their effects on foreign vendors in public procurement may indicate similar trends with regard to defence procurement but which cannot be taken to be conclusive. In short, more research needs to be done to determine to what extent foreign competition is affected by the use of framework contracting in the field of defence procurement.

4. Maintenance of the Industrial Base

As indicated in Chapter 9, Section 4.1, CICA permits the exclusion of sources on industrial mobilization grounds. CICA also provides for the use of non-competitive procedures in two circumstances where it is necessary to award the contract to a particular source(s).¹⁴⁵¹ The first is in order to maintain a facility, producer, manufacturer, or other supplier so that the maintained entity will be available to meet the government's request in the case of a national emergency or to achieve industrial mobilization.¹⁴⁵² The second is to establish or maintain an essential engineering, research, or development capability provided by an educational or other nonprofit institution or a federally funded R&D centre.¹⁴⁵³ Guidance on the use of this exception is located at FAR 6.302-3 and DFARS 206.302-3.

¹⁴⁵¹ 10 U.S.C. § 2304(c)(3)(B) and (C) and 41 U.S.C. § 3304(a)(3)(B) and (C)

¹⁴⁵² *ibid*

¹⁴⁵³ *ibid*

This Section focuses on the first circumstance which has been interpreted to address situations akin to dual sourcing. The FAR specifies a number of broad circumstances permitting such use. These include, *inter alia*, maintaining vital suppliers in business; training of a selected supplier to furnish critical supplies or prevent the loss of a supplier's ability and employees' skills; maintaining active engineering, research, or development work; maintaining properly balanced sources of supply for meeting the requirements of acquisition programs in the interest of industrial mobilization; continue in production, contractors that are manufacturing critical items when there would otherwise be a break in production; and divide current production requirements among two or more contractors to provide for an adequate industrial mobilization base.¹⁴⁵⁴ Again recourse to the exception must be justified. An Agency's decision to rely on this exception will not be questioned as long as it can demonstrate that its determinations are related to its industrial mobilization needs.¹⁴⁵⁵

It is clear from references to terms such as "vital", "national emergency", "critical" loss of "ability" and "skills", "properly balanced" sources of supply, "industrial mobilization", and maintaining an "adequate" industrial base that the above is exceptionally broad in its authorisation.

4.1. Industrial Mobilization under the Defence Procurement Directive

The Defence Procurement Directive does not contain a free-standing industrial mobilization ground permitting use of the negotiated procedure without publication. It

¹⁴⁵⁴ See FAR 6.302-3(b)(1)(i)-(vii)

¹⁴⁵⁵ See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) and cases cited at 317-318

has been suggested that protection of any such interest would require Article 346 TFEU to be invoked.¹⁴⁵⁶ It is further recalled from Chapter 2, Section 5.1 that it has been suggested that there must be a discrete separation of permissible non-economic (i.e. security) considerations and impermissible economic (i.e. job and employment-related) considerations.¹⁴⁵⁷ Whilst the extent to which a strict separation is, at all, possible, is questionable for the purposes of EU law, it appears that U.S. law does not make any formal distinction on the basis of interests which may comprise the broader interest of “industrial mobilization”.

Therefore, there is a clear contrast between an express industrial mobilization ground under U.S. law and the comparable absence of such a ground under EU law except to the extent permitted by Article 346 TFEU and only then on security grounds. As indicated in Chapter 8, Section 1 this reflects fundamentally different predispositions. U.S. procurement law has a fundamentally national orientation. In contrast, EU procurement law is designed to enable domestic and foreign competition. However, it is open to question whether the absence of a primary focus of the U.S. system on foreign competition should continue to legitimate exceptionally broad grounds such as “industrial mobilization” without their being subject to conditions or other limitations on their terms and use, an issue to which this Section now turns.

¹⁴⁵⁶ Guidance Note, Security of Supply, 2, point 4

¹⁴⁵⁷ See also Guidance Note, Security of Supply, 2, point 419-20, point 4

4.2. Continued Role of Industrial Mobilization Exceptions

Whilst the Fortresses and Icebergs Study states that there are legitimate bases for precluding foreign sources from participating in certain sensitive areas,¹⁴⁵⁸ the Study also candidly states:

While the U.S. retains the legal basis to take many extraordinary actions in time of war or other emergency such as excluding foreign sources on “industrial base and mobilization” grounds, industrial mobilization has in fact not been included in strategic planning or spending since the end of the Cold War. In the context of twenty first century warfare, the entire notion of requiring domestic production to ensure wartime industrial ramp-up is antiquated: the short duration of modern wars and the complexity of modern weapon systems make the rapid expansion of production for anything other than munitions extremely difficult.

In addition, in a global industrial economy, maintaining several domestic sources can be both costly and unnecessary from both a security of supply standpoint (because foreign sourcing does not necessarily imply vulnerability) or to ensure competition. In the past, the industrial base exclusion has been used where a DoD component sought to maintain two competitive sources in order to maintain competition [...] In today’s economy, it may make more sense to allow a foreign producer to provide

¹⁴⁵⁸ The examples identified are system integrators on stealthy vehicles. See *Fortresses and Icebergs: (Vol II)* 666

the competition rather than require the maintenance of a second source.¹⁴⁵⁹

It should be observed that whilst the above implies that industrial mobilization has been used to exclude foreign competition, as indicated in Chapter 9, Section 4.1, the extent of its use is not clear. It is beyond the scope of the thesis to engage the political debate regarding the importance to be attributed to industrial mobilization in defence policy. However, from a legal perspective, it is important to question whether there is a basis for limiting the potential for broadly stated grounds to legitimate the exclusion of competition. This thesis does not necessarily posit specific means by which this could be achieved. However, it would involve a fundamental consideration of the interests which must be legally defined, whether specific terms within a provision can limit its use as well as whether it can be controlled through more stringent notification and justification requirements. This fundamental thinking resonates with the debate provoked in Chapter 5, Section 3 regarding the necessity for broadly defined security of supply requirements.

5. National Security

Another important exception permitting the use of non-competitive procedures allows an Agency to limit the number of sources from which it solicits bids or proposals if disclosure of the Agency's needs would otherwise compromise national security.¹⁴⁶⁰

¹⁴⁵⁹ *ibid.* For a contrary view, see W R Hawkins, 'The Need for Socioeconomic Guidance in Defense Procurements', (2004-2005) 40(4) Procurement Law, 8
¹⁴⁶⁰ 10 U.S.C. 2304(c)(6) and 41 U.S.C. § 3304(a)(6)

Guidance on this exception is located at FAR 6.302-6.¹⁴⁶¹ DFARS does not provide any additional supplementation.

This exception must not be used merely because the acquisition is classified or access to classified material will be necessary to submit a proposal or to perform the contract.¹⁴⁶² Contracts awarded pursuant to the exception must continue to be supported by written J&As but need only stipulate the minimum essential information.¹⁴⁶³ A contracting officer need not submit a notice in the Governmentwide Point of Entry (“GPE”) when the contracting officer determines that the synopsis cannot be worded to preclude disclosure of an Agency’s needs.¹⁴⁶⁴ Notwithstanding, Agencies must request offers from as many potential sources as is practicable under the circumstances.¹⁴⁶⁵

It should be observed that according to one leading treatise, there have been no reported protests on the use of this exception.¹⁴⁶⁶ It is not clear what this could indicate about the use of the national security exception. The National Defense Authorization Act for Fiscal Year 2011 required the Comptroller General to review the use of this exception.¹⁴⁶⁷ As indicated in Section 1 of this Chapter, this included

¹⁴⁶¹ FAR 6.302-6(b)

¹⁴⁶² FAR 5.202(a)

¹⁴⁶³ FAR 6.302-6(c)

¹⁴⁶⁴ FAR 5.202

¹⁴⁶⁵ FAR 6.302-6(c)(3)

¹⁴⁶⁶ J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 319

¹⁴⁶⁷ Ike Skelton National Defense Authorization Act for Fiscal Year 2011, Pub. L. No. 111-383, §844. §844(b) provided that this included review of the following: (1) the pattern of usage of the national security exception by acquisition organizations within the Department to determine which organizations are commonly using the exception and the frequency of such usage; (2) the range of items or services being acquired through the use of such exception; (3) the process for reviewing and approving justifications involving such exception; (4) whether the justifications for use of such exception typically meet the relevant requirements of the Federal Acquisition Regulation applicable to the use of such exception; (5) issues associated with follow-on procurements for items or services acquired using such exception; and (6) potential additional instances where such exception could be

publication of a 2012 GAO Report.¹⁴⁶⁸ The Report indicated that dollar obligations under the national security exception were small relative to other exceptions to full and open competition in that only approximately 2% of DoD's other than full and open competition obligations (\$13 billion) were obligated under the national security exception.¹⁴⁶⁹

The GAO Report made a number of findings in relation to the use of the exception, to which this Chapter now turns. It should be observed that it did not make any specific findings in relation to its use with regard to foreign competition.

5.1 Class Justifications and Approvals

With regard to J&A's, the 2012 GAO Report identified that for the contracts reviewed, most DoD entities used a single J&A document, otherwise identified by the FAR as a "class justification" which applies to multiple contracts.¹⁴⁷⁰ It was reported that despite the number of firms listed in the class justification, competition among them for a given contract award was rare due to the fact that only one of the firms was capable of meeting requirements or that amending existing class justifications to add new entrants to the market had proved difficult, thereby reducing competition by limiting

applied and any authorities available to the Department other than such exception that could be applied in such instances

¹⁴⁶⁸ See United States Government Accountability Office, *Defense Contracting, Improved Policies and Tools Could Help Increase Competition on DOD's National Security Exception Procurements* (n 1380)

¹⁴⁶⁹ *ibid* 6 citing at 7 Figure 1: Percentage of Total DOD Obligations Based on Other Than Full and Open Competition, by FAR Exceptions to Competition, Fiscal Years 2007 through 2010 (source: GAO analysis of FPDS-NG data)

¹⁴⁷⁰ According to the Report, among the contracts reviewed, \$3.3 billion in obligations during the period of fiscal years 2007 through 2010 used class justifications, while less than \$0.1 billion was obligated during that period under individual justifications. See United States Government Accountability Office, *Defense Contracting, Improved Policies and Tools Could Help Increase Competition on DOD's National Security Exception Procurements* (n 1380) 12-14 citing Figure 5: Relationship of Contracts Reviewed to Type of Justifications Used by the Military Departments and Associated Obligations for Fiscal Years 2007 – 2010 (source: GAO analysis of DOD files and FPDS-NG data).

the ability to work with new entrants to the market.¹⁴⁷¹ The Report also identified that some officials had also noted concerns about the level of review of individual contracts awarded without full and open competition under class justifications.¹⁴⁷² It was suggested that the existence of class justifications may render it easier to forego competition.¹⁴⁷³ Importantly, the Report identified that irrespective of the choice to use individual or class justifications, all those reviewed met FAR standards for approving justifications.¹⁴⁷⁴

5.2. Competition Failures

The 2012 GAO Report also indicated that whilst the military departments sought to provide competition to the greatest extent practicable as required by the FAR, they attributed failure to ensure sufficient competition to a number of reasons. The first concerned the small number of firms able to meet the security requirements for the goods and services being procured.¹⁴⁷⁵ Importantly, military departments typically did not achieve competition in national security exception contracts because the DoD only received one proposal.¹⁴⁷⁶ Further, contracts receiving only one proposal are considered competitively awarded if the solicitation was open to multiple potential offerers; therefore, contracts reported in FPDS-NG that received only one proposal

¹⁴⁷¹ *ibid* 18, reporting the statements of U.S. Air Force Officials

¹⁴⁷² According to the Report, the Air Force revised its process in a recently approved national security class justification for an intelligence, surveillance, and reconnaissance program office, requiring individual contract actions over \$85.5 million to be submitted to the Air Force senior procurement executive for expedited review. This class justification also includes a mechanism for adding new firms after the initial approval of the justification. Officials indicated that they anticipate an increase in competition rates as a result of this new flexibility. *ibid*

¹⁴⁷³ *ibid* 26

¹⁴⁷⁴ *ibid* 18-19

¹⁴⁷⁵ *ibid* 22

¹⁴⁷⁶ The Report indicates that of the more than 11,300 DoD military department contract actions citing the national security exception from fiscal years 2007 through 2010, the DoD only received one proposal for \$10.6 billion of its obligations (approximately 84% of the total \$12.7 billion in obligations under this exception). See *ibid*, 20

may have been awarded using competitive procedures.¹⁴⁷⁷ A second reason concerned constraints on soliciting new vendors including proprietary data and reliance on incumbent contractor expertise.¹⁴⁷⁸ A third reason concerned general constraints regarding not having the tools to increase market research and solicit vendors in a secure environment.¹⁴⁷⁹ Another reported concern was that FedBizOpps.com is not suitable for security sensitive contracting, Agencies preferring to conduct their own market research and provide solicitations to firms directly.¹⁴⁸⁰

The Fortresses and Icebergs Study has indicated that this exception serves a legitimate function, for example, where it is deemed necessary to safeguard a unique U.S. capability that may be compromised were details released to foreign companies.¹⁴⁸¹ However, as indicated above, in those instances identified, a particular issue concerns the relatively low number of possible contractors able to tender for contracts. The ability to meet security requirements may be one factor.¹⁴⁸² However, it has also been identified that most foreign defence firms are able to adapt to ensure compliance with such requirements.¹⁴⁸³ It is also conceivable that most foreign contractors may simply lack the capability to tender for such contracts.

¹⁴⁷⁷ According to the Report, the data on the extent to which national security exception contracts were awarded competitively were not sufficiently reliable but the available data confirmed that competition is infrequent in that less than 25% of military department obligations under this exception were competitively awarded. See *ibid*, 21

¹⁴⁷⁸ It is recalled from Section 3 above that similar reasons appear to be responsible for the award of follow-on contracts to incumbent contractors without competition under the sole source exception

¹⁴⁷⁹ *ibid*, 22

¹⁴⁸⁰ *ibid* 23

¹⁴⁸¹ *Fortresses and Icebergs: (Vol. II) (n 12) 666*

¹⁴⁸² *ibid* 689. For instance, the Fortresses and Icebergs Study indicates that it may also be difficult for companies with a foreign element to satisfy security requirements. In particular, even where such a company can secure special security arrangements, it cannot obtain access to “proscribed information” without a “National Interest Determination” in the absence of which a firm would be precluded from competing for, or participating in, classified contracts. In particular, it has been stated that a firm under a Special Security Agreement (“SSA”) may not even become aware of an opportunity to compete for a contract with proscribed data

¹⁴⁸³ *ibid* 689

Notwithstanding, a common issue which appears to recur in relation to the exceptions concerns proprietary data, the relevance of incumbent contractors, mechanisms used to retain approved suppliers as well as difficulties experienced in terms of the resources and capability necessary to expand searches for new sources. Further, whilst the Report identified general compliance with J&A approvals, there had been some concern expressed about the level of review of individual contracts awarded without full and open competition under class justifications. As indicated, there is no substantial evidence that is able to discern the effects, if any, which may result to foreign contracts from limitations placed on national competition.

5.3. National Security Exceptions under U.S. and EU Law

It is recalled from Chapter 2, Section 2.1 that Article 346(1)(a) TFEU provides that “no Member State shall be obliged to supply information the disclosure of which it considers contrary to the essential interests of its security.” The protection accorded to this interest is reflected in a specific exclusion contained within the Defence Procurement Directive. Article 13(a) provides 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.

However, it is further recalled from Chapter 2 that there is no case law concerning the invocation of Article 346(1)(a) TFEU. The replication of Article 346(1)(a) TFEU in Article 13(a) may be intended to limit the effect of this Treaty exception in practice.

Importantly, it is recalled that the Defence Procurement Directive contains a set of designated provisions designed to safeguard sensitive information certain of which were briefly discussed in Chapter 10, Section 3.1.

It would appear that the U.S. national security exception has not occupied as decisive a role as Article 346 TFEU. However, it is difficult to speculate on the precise reasons for this position. One possible factor is that competition is predominantly national.¹⁴⁸⁴ A second factor might be that the CICA sole source and industrial mobilization exceptions provide a sufficiently broad legal basis to limit competition in most instances, including national security. It is also recalled that it is possible to rely on more than one exception in order to justify a limitation on competition. Unlike Article 346 TFEU which is intended to be limited by the concepts of “essentiality” and “necessity”, the U.S. national security exception only refers to the “compromise” of national security.

Drawing on earlier observations of this Chapter, this brief comparison raises broader questions as to whether, in the absence of a legal definition of matters such as “national security” and the necessity and essentiality of the security interest, more extensive provision could and/or should be made in relation to J&A requirements. In addition, it may be possible to argue that Article 346 TFEU should be subject to similar requirements.

¹⁴⁸⁴ By contrast, it is recalled from Chapter 2, Section 4 that Member States have sought to rely on Article 346 TFEU generally to preclude the participation of foreign competition out of a concern to maintain or respect confidentiality (including in relation to third countries)

6. Unusual and Compelling Circumstances

Another circumstance permitting other than full and open competition is where the Agency's need for property or services is of such an unusual and compelling urgency that the government would be seriously injured unless the Agency is permitted to limit the number of sources from which it solicits bids or proposals.¹⁴⁸⁵ For this exception, the J&A may be made and approved after contract award when preparation and approval prior to award would unreasonably delay the acquisition.¹⁴⁸⁶ This exception is implemented in FAR 6.302-2 and DFARS Subpart 206.302-2(b) and supplemented by PGI 206.302-2(b).

It has been stated that this exception is narrowly construed because the acquisition planning process is intended to overcome all but the most compelling urgency situations.¹⁴⁸⁷ Legitimate circumstances enabling the exception have included the continuation of weapons tests vital to national security,¹⁴⁸⁸ as well as where only one company could ensure supply for the military for immediate use in operations.¹⁴⁸⁹ Urgency does not necessarily justify sole source procurement (i.e. competition may be limited to two or more contractors) but an Agency may limit competition to the only firm that it reasonably believes can perform the work promptly.¹⁴⁹⁰ CICA does not

¹⁴⁸⁵ 10 U.S.C. 2304(c)(2) and 41 U.S.C. § 3304(a)(2)

¹⁴⁸⁶ FAR 6.302-2(c)(1)

¹⁴⁸⁷ J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 313

¹⁴⁸⁸ See e.g. *Support Sys. Assocs.*, Comp. Gen. Dec. B-232473, 89-1 CPD ¶ 11 cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 314

¹⁴⁸⁹ *Greenbrier Indus., Inc* Comp. Gen. Dec. B-241304-91 CPD ¶ 92 cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 314

¹⁴⁹⁰ See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 314 and cases cited therein

define what type of “serious injury” must result in order to justify limiting competition; however, the GAO has included possible financial injury.¹⁴⁹¹

When Agencies use the urgency exception, they must limit the quantity of the supply or services being procured to only the amount necessary to meet their needs and should not continue for more than a minimum period prior to the time when competition can be obtained.¹⁴⁹²

In contrast to the use of the sole source and national security exceptions, there is even less data available to discern the use of this exception by the DoD in practice. A 2004 Inspector General Report which reviewed use of the exception by NASA, found that in 20% of the contract actions reviewed, the justification for use of this exception was not adequate, in particular, in failing to adequately address (or failing to cite) the specific nature and extent of the harm to the Government necessitating its use and in failing to include a statement as to whether any other parties expressed an interest in the requirement.¹⁴⁹³ Again it is not clear to what extent this exception has been used to exclude foreign competition. However, this Report may corroborate general findings in relation to the use of J&A’s.

The Defence Procurement Directive also provides for use of the negotiated procedure without publication of a contract notice in cases of urgency in two circumstances. The first is where the periods laid down for use of the restricted

¹⁴⁹¹ See *Arthur Young Co.*, Comp. Gen. Dec. B-221879, 86-1 CPD ¶ 536 cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 316

¹⁴⁹² J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 317 and cases cited therein

¹⁴⁹³ Office of Inspector General, *Review of Sole-Source and Limited Competition Contract Actions Citing “Unusual and Compelling Urgency”*, January 8 2004, IG-04-007, 3 <<http://oig.nasa.gov/audits/reports/FY04/ig-04-007.pdf>> accessed 20 September 2013

procedure and negotiated procedure with publication of a contract notice are incompatible with the “urgency resulting from a crisis”.¹⁴⁹⁴ The second is where the time-limit for the above procedures cannot be complied with and the negotiated procedure without publication is “strictly necessary for reasons of extreme urgency brought about by events unforeseeable by the contracting authority”.¹⁴⁹⁵ The Directive adds the important qualification that the circumstances invoked to justify extreme urgency must not be attributable to the contracting authority.¹⁴⁹⁶ Similar to the other exceptions examined, the Directive contains no specific additional notification or justification requirements.

Again, it is not possible to discern the extent to which this kind of exception is likely to impact on foreign competition. At the least, it appears that the exception in the Directive imposes limitations by reference to “strict necessity”, “extremity” and “unforeseeability”, in contrast to the CICA exception which refers only to “unusual” and “compelling urgency”.

7. Requirements of International Agreements

Another important exception relates to international agreements and refers to two circumstances. The first is where the U.S. is to be reimbursed by a foreign nation,

¹⁴⁹⁴ Article 28(1)(c). Article 1(10) defines a ‘crisis’ as: “any situation in a Member State or third country in which a harmful event has occurred which clearly exceeds the dimensions of harmful events in everyday life and which substantially endangers or restricts the life and health of people, or has a substantial impact on property values, or requires measures in order to supply the population with necessities; a crisis shall also be deemed to have arisen if the occurrence of such a harmful event is deemed to be impending; armed conflicts and wars shall be regarded as crises for the purposes of this Directive [.]”

¹⁴⁹⁵ Article 28(1)(d)

¹⁴⁹⁶ *ibid*

and that country has specified in written direction, such as a Letter of Offer and Acceptance, that the supplies or services are to be procured from a particular firm e.g. foreign military sales.¹⁴⁹⁷ The second is where the planned contract is for services to be performed, or supplies to be used, in the sovereign territory of another country and the terms of a treaty or agreement specify or limit the sources to be solicited.¹⁴⁹⁸ There is no requirement that the foreign government initiate a sole source designation.¹⁴⁹⁹ Guidance on the use of this exception is located at FAR 6.302-4 and DFARS 6.302. DFARS 206.302-4 adds the limitation that the J&As described in FAR 6.303 and 6.304 are not required if the Head of the contracting activity prepares a document that describes the terms of an agreement or treaty or the written directions, such as a Letter of Offer and Acceptance, that have the effect of requiring the use of other than competitive procedures.¹⁵⁰⁰ As will be discussed in Chapter 11, Section 3, it is beyond the scope of the thesis to examine foreign military sales contracting. However, the relation of foreign military sales to offsets will be discussed.¹⁵⁰¹

It is recalled from Chapter 3, Sections 3 and 6 that the Defence Procurement Directive contains international contract exclusions and a specific exclusion on government-to government contracts.¹⁵⁰² With regard to the second circumstance comprising the CICA exception, the Defence Procurement Directive contains two specific exclusions. The first relates to contracts awarded pursuant to international

¹⁴⁹⁷ 41 U.S.C. 2304(c)(4) and 41 U.S.C. § 3304(a)(4) and FAR 6.302-4(b)(1) and (2)

¹⁴⁹⁸ *ibid*

¹⁴⁹⁹ See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 318

¹⁵⁰⁰ DFARS 206.302-4

¹⁵⁰¹ See Chapter 11, Section 3. For a useful legal discussion of foreign military sales contracting, see C B Barry, 'Contracting by Competitive Negotiations in Support of FMS' (1993-1994) *DISAM Journal of International Security Cooperation Management*, 89; L D Anderson, 'Foreign Military Sales Sole Source Exception: The Current USASAC Practice' (1993) *DISAM Journal of International Security Cooperation Management* 83

¹⁵⁰² Article 12(a) and Article 13(f)

agreements and arrangements relating to the stationing of troops and the undertakings of a Member State or third country.¹⁵⁰³ It has been observed that this likely covers NATO Status of Forces Agreements.¹⁵⁰⁴ The second exclusion under the Directive relates to contracts awarded in a third country, including for civil purchases, carried out when forces are deployed outside EU territory where operational needs require them to be concluded with economic operators located in the area of operations.¹⁵⁰⁵

Whilst the CICA exception and the above exclusions do not directly correspond, common to both forms, it is not possible to discern the full effect of these exclusions on foreign competition, and which is, in any event, limited to the exigencies of a limited number of circumstances outside national territory.

8. Necessary in the Public Interest

The final CICA exception concerns an instance in which the Head of an Executive Agency determines that it is necessary in the public interest to use other than competitive procedures in a particular procurement. Guidance is located at FAR

¹⁵⁰³ Recital 26 and Article 12(b). Article 15(b) Public Sector Directive contains a broadly comparable provision. For a discussion of the differences, see Heuninckx, 'Lurking at the boundaries' (n 80) 110. For earlier commentary, see Trybus, *European Union Law and Defence Integration* (n 47) 226; Arrowsmith, *The Law of Public and Utilities Procurement* (119) point 6.100

¹⁵⁰⁴ See Agreement Between the Parties to the North Atlantic Treaty Regarding the Status of Their Forces, London, June 19, 1951 ("NATO SOFA"); Agreement between the Member States of the European Union concerning the status of military and civilian staff seconded to the institutions of the European Union, of the headquarters and forces which may be made available to the European Union in the context of the preparation and execution of the tasks referred to in Article 17(2) of the Treaty on European Union, including exercises, and of the military and civilian staff of the Member States put at the disposal of the European Union to act in this context (EU SOFA) [2003] OJ C 321/02. Discussed in Heuninckx, 'Lurking at the boundaries' (n 80) 108 and 110. See also Guidance Note, Defence- and security-specific exclusions, 3, point 2.3

¹⁵⁰⁵ Article 13(d). For guidance on this provision, see Guidance Note, Defence- and security-specific exclusions, 8-9, point 3.5

6.302-7 and DFARS 6.302-7.¹⁵⁰⁶ This exception has a residual application and only applies when none of the other exceptions apply.¹⁵⁰⁷ The public interest exception is subject to four limitations. Firstly, a written determination for use must be made by the Head of an Executive Agency (i.e. the Secretary of Defense), an authority which cannot be delegated.¹⁵⁰⁸ Secondly, Congress must be notified in writing of such determination no less than 30 days before contract award.¹⁵⁰⁹ Thirdly, if required by the Head of an Agency, the contracting officer must prepare a justification to support the written determination.¹⁵¹⁰ Finally, the D&F must not be made on a class basis.¹⁵¹¹

Again, this exception is extremely broad. In terms of its effect on foreign contractors, this exception has been used to justify the purchase of foreign aircraft,¹⁵¹² as well as to restrict competition to U.S. firms where the contract was performed in a foreign country.¹⁵¹³ In 2003, the DoD cited this exception under FAR 6.302-7, to preclude other nations joined in the U.S. coalition in Iraq from competing for certain Iraqi reconstruction contracts. This controversial decision raised questions as to whether the exercise of sole source authority in this instance violated U.S. obligations under the WTO GPA.¹⁵¹⁴

¹⁵⁰⁶ For discussion of this exception, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 318, 319-320

¹⁵⁰⁷ FAR 6.302-7(b)

¹⁵⁰⁸ FAR 6.302(c)(1)(i) and (ii); DFARS 206.302-7

¹⁵⁰⁹ FAR 6.302(c)(2)

¹⁵¹⁰ FAR 6.302(c)(3)

¹⁵¹¹ FAR 6.302(c)(4)

¹⁵¹² See *Sikorsky Aircraft Corp.*, Comp. Gen. Dec. B-403471, 2010 CPD ¶ 271 cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055), 319

¹⁵¹³ See *Zublin Del., Inc.*, Comp. Gen. Dec. B-227003.2, 87-2 CPD ¶ 149 cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055), 319

¹⁵¹⁴ See J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 319-320; C Pitchas, 'World Trade Organisation/United States: award of prime contracts for infrastructure reconstruction in Iraq - an assessment under the WTO Agreement on Government Procurement' (2004) 3 PPLR, 85

It is recalled from Chapter 2, Section 2, that EU law does permit restrictions on free movement, *inter alia*, on grounds of “public policy”. However, any measure taken is subject to a strict proportionality assessment. It is further recalled that Member States have been more inclined to simply invoke Article 346 TFEU. A general public interest exception does not feature in the Defence Provision Directive.

The overall significance and ability of this exception to impact on foreign contractors should not be overstated. For Fiscal Year 2012, there has been a reported 0.19% use of this exception.¹⁵¹⁵

9. Conclusions

This Chapter has demonstrated that, by their terms, the CICA exceptions permitting non-competitive procurement are extremely broad. As indicated, certain exceptions correspond with the circumstances permitting use of the negotiated procedure without publication under the Defence Procurement Directive. To this extent, these exceptions appear to be standard features common to both the U.S. and EU procurement systems.

However, as indicated in Chapter 8, similarities and differences reflect the historical political and economic circumstances of each procurement system. In the U.S., legal institutions reflect the priority accorded to the protection of broadly defined national interests. In the EU, legal institutions are intended to equalize national and foreign

¹⁵¹⁵ By dollar value this equaled \$286,213,609.99 of dollars not competed. See http://www.usaspending.gov/pie-summarytabular?q=node%2F91&tab=By+Agency&fromfiscal=yes&carryfilters=on&typeofview=detailsummary&fiscal_year=2012&maj_contracting_agency=9700&maj_contracting_agency_name=Department+of+Defense&cdtype=0&page=1&rp=15&sortname=sum&sortorder=desc&dtype=NonComp accessed 20 September 2013.

competition and which is reflected in the generally more circumscribed exceptions contained in the Defence Procurement Directive.

In terms of discerning the effect of these exceptions on foreign competition, the research findings were necessarily limited by the absence of empirical data. Anecdotal evidence from GAO and other reports appears to indicate certain issues. Firstly, whilst the reports indicate general compliance with FAR J&A requirements, certain issues have been raised in relation to their use. Further, the fact that existing J&A requirements are generally met does not address the question of whether or not these requirements are effective. Secondly, issues have been raised concerning the effect of sole source contracting in limiting competition. Prime examples include the use of framework contracting.

To date, there have been no significant attempts to re-assess the CICA exceptions.¹⁵¹⁶ This Chapter recognizes the fact that the CICA exceptions do not constitute detailed means for regulating foreign competition. Notwithstanding, they exercise an important “gate-keeper” function in deciding the level of permissible competition. This includes the fundamental decision of whether foreign competition is permitted. To this extent, there is a transatlantic interest in ensuring that such exceptions operate effectively. A brief comparison of the CICA and EU exceptions indicate certain incidents of comparison as well as contrast which provoke interesting

¹⁵¹⁶ See, for example, a 1993 speech given by the then deputy DoD Inspector General: “We have not seen any analyses or demonstration of a problem that supports moving away from full and open competition or eliminating the seven exemptions to competition.” Prepared statement of Derek J. Vander Schaaf, deputy DoD inspector general to the House Small Business Committee on Thursday August 03 1995, entitled: “Debunking Acquisition Reform Myths” <<http://www.defense.gov/speeches/speech.aspx?speechid=948>> accessed 20 September 2013

debate regarding the definition, function, use and accountability for use of exceptions in defence procurement.

This thesis now turns to the final substantive Chapter of this Part which examines U.S. foreign acquisition law.

U.S. Foreign Acquisition Law

1. Introduction

It is recalled from Chapter 3 that the Defence Procurement Directive attempts to expressly exclude certain forms of international contracting from its scope of application through Articles 12 and 13 and which is, therefore, a field of activity regulated by the Member States subject only to their obligations to ensure conformity of action with EU law. Similarly, the U.S. regulates the conduct of its procurement relations with foreign contractors through its provisions on “foreign acquisition” contained in FAR Part 25 and DFARS Subpart 225.

This Chapter will examine key aspects of U.S. foreign acquisition law. Having outlined the main provisions, this Chapter will focus on offsets in foreign military sales and the reciprocal defence procurement memoranda of understanding (“RDPs”) in light of the significance recently attributed to these instruments by U.S. legal commentary in response to the Defence Procurement Directive.

2. U.S. Foreign Acquisition Law: International Contracting

Before examining offsets and the RDPs, it is first necessary to place U.S. foreign acquisition law in context not least because U.S. law prescribes “buy national” laws

and domestic sources restrictions which apply specifically to foreign contractors. As will be discussed in Section 4, signatories to the RDPs qualify for a waiver of these and other requirements. Importantly, however, these restrictions remain *prima facie* applicable to EU Member States which are not signatories to the RDPs unless they can secure a waiver by other means.

2.1. Domestic Source Restrictions and the Buy American Act

It is generally agreed that measures conferring a competitive advantage on domestic industries constitute a barrier to national procurement markets.¹⁵¹⁷ Such measures can take the form of “buy national” laws and policies. Whilst there is little statistical or other empirical evidence to substantiate their effect, research on discriminatory procurement and international trade suggests that “home biased” procurement practices are endemic and substantially affect trade flows, particularly in the manufacturing sectors.¹⁵¹⁸ With regard to EU Member States, the Fortresses and Icebergs Study has confirmed that most of the major defence trading Member States studied do not have explicit domestic content laws.¹⁵¹⁹ This is likely due, in part, to the fact that the application of such practices within the EU would constitute quantitative restrictions or measures of equivalent effect which are prohibited under EU law unless justified.¹⁵²⁰ As will be discussed in Section 4 below, even if Member States were to engage such practices, it is open for the U.S. to contend that such

¹⁵¹⁷ S Arrowsmith, *Government Procurement in the WTO* (n 77) 13-19

¹⁵¹⁸ S J Evenett and B Hoekman (ed.) *The WTO and Government Procurement* (Edward Elgar 2006) 356-73; *Fortresses and Icebergs*: (Vol. I) (n 12) 269

¹⁵¹⁹ *Fortresses and Icebergs*: (Vol. II) (n 12) 342 (with regard to France); 388 (with regard to Germany); 431 (with regard to Italy); 479 (with regard to Poland); 518 (with regard to Romania); 554 (with regard to Sweden); 608-9 (with regard to the UK)

¹⁵²⁰ Article 34 (ex Article 28 TEC) and Article 35 (ex Article 29 TEC). See Case 249/81 *Commission v. Ireland* [1982] ECR 4005; Case 222/82 *Apple and Pear Development Council v KJ Lewis Ltd* [1983] ECR 4083. See generally L W Gormley, *EU Law of Free Movement of Goods and Customs Duties* (n 96) 420 para 11.25 and para 11.27 and cases cited therein

treatment would be inconsistent with the guarantees provided in the RDPs.¹⁵²¹ The Fortresses and Icebergs Study nevertheless indicates the insistence of providing national content or value by a number of other means; these include partnering or teaming with indigenous firms or providing offsets.¹⁵²² The issue of offsets was examined in Chapter 7 and will be discussed in more detail in Section 3 below.

U.S. law stands in sharp contrast in this regard.¹⁵²³ U.S. law expressly mandates domestic preferences in order to protect domestic production and industries. In light of its historical significance, this Chapter focuses exclusively on the Buy American Act (“BAA”).¹⁵²⁴ However, other important domestic source restrictions include the so-called “Berry Amendment” which prohibits the DoD from acquiring listed items which are not grown or produced in the U.S and which has included speciality metals.¹⁵²⁵ Importantly, the specialty metals restriction does not apply to “qualifying countries” which include signatories to an RDP.¹⁵²⁶

The BAA was originally enacted in 1933 during the Great Depression in order to create and preserve jobs for American workers.¹⁵²⁷ The BAA is one of the most

¹⁵²¹ This has, at least, been confirmed by Germany. See *Fortresses and Icebergs*: (Vol. II) (n 12) 388

¹⁵²² *ibid*

¹⁵²³ For a useful overview of the issues presented by U.S. domestic preferences generally, see P H Wittie, ‘Transnational concerns: domestic preferences’ (n 1056)

¹⁵²⁴ 41 U.S.C. §§ 10a-10d, as amended

¹⁵²⁵ 10 U.S.C. § 2533a. For a useful discussion of the Berry Amendment and specialty metals restriction, see V B Grasso, ‘The Specialty Metal Provision and the Berry Amendment: Issues for Congress’ (Congressional Research Service) 22 March 2007 <<http://www.hsdl.org/?view&did=715821>> accessed 20 September 2013; V B Grasso, ‘The Specialty Metal Clause: Oversight Issues and Options for Congress’, (Congressional Research Service) July 2012 <<http://www.fas.org/sqp/crs/misc/RL33751.pdf>> accessed 20 September 2012

¹⁵²⁶ Qualifying Countries are listed at FAR 252. 225.7012

¹⁵²⁷ 41 U.S.C. §§ 10a-10d, as amended. The original enactment is contained in Ch. 212, 47 Stat. 1520, 72nd Congress, 2nd Session. (1933). The Act has only been substantively amended four times in succeeding years. See, P.L. 100-418, Title VII; 102 Stat. 1545, 100th Congress, 2nd Session (1988), P.L. 103-355, 108 Stat. 3346-7, 103rd Congress, 2nd Session (1994), codified at 41 U.S.C. 10a., P.L. 104-201, § 827, 110 Stat. 2611 104th Congress, 2nd Session (1996), codified at 41 U.S.C. 10b-3, and P.L. 110-28, Title VIII, § 8306, 121 Stat. 112, 211, 110th Congress, 1st Session (2007), codified at 41 U.S.C. 10a(b)

important components of the FAR and DFARS Parts on foreign acquisition.¹⁵²⁸ An often stated objective of the Act is to protect domestic labour by restricting the U.S. government from purchasing supplies for use within the U.S. that are not “domestic end products”.¹⁵²⁹ The nationality of the contractor is not considered when determining if a product is of domestic origin.¹⁵³⁰ The BAA is implemented in FAR Part 25 and DFARS 225.1.

For unmanufactured articles or supplies acquired for use in the U.S., the BAA requires that they must have been “mined” or “produced in the U.S.”¹⁵³¹ By contrast, a manufactured article will be deemed a “domestic end product” if the cost of the components mined, produced or manufactured in the U.S. exceeds 50 percent of the cost of all its components.¹⁵³² In implementation of the BAA, FAR 25.105 provides that if there is a domestic offer that is not the low offer, and the restrictions of the BAA apply to the low offer, the contracting officer must determine the reasonableness of the cost of the domestic offer. This requires the application of a price differential to the foreign offer.¹⁵³³ However, DFARS 225.105(b) requires the application of a 50% differential to DoD procurements.

¹⁵²⁸ The Buy American Act is mentioned expressly in FAR Subparts: 25.1 (Buy American Act – Supplies); 25.2 (Buy American Act – Construction Materials) and 25.6 (American Recovery and Reinvestment Act – Buy American Act – Construction Materials) and DFARS Subpart 225.1 (Buy American Act supplies) and 225.2 (Buy American Act – Construction Materials). For general commentary, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1614-1624

¹⁵²⁹ FAR 25.001

¹⁵³⁰ See, *E-Systems, Inc.*, 61 Comp. Gen. 431 (1982); and *Patterson Pump Co.*, B-200165, 80-2 CPD ¶ 453 (1980)

¹⁵³¹ 41 U.S.C. §8302(a)(1)

¹⁵³² 41 U.S.C. §8303(a)(2)

¹⁵³³ The differential is applied only to the bid price for material to be delivered under the contract, not the total contract price. See *Allis-Chalmers Corp. v. Freidkin*, 635 F.2nd 248 (3rd Cir. 1980) cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1622

There are a number of exceptions to the BAA. Firstly, the BAA does not apply to procurements to which application would be inconsistent with the public interest.¹⁵³⁴ As will be discussed below, as a result of memoranda of understanding and other international agreements, the DoD has determined it inconsistent with the public interest to apply restrictions of the BAA and the Balance of Payments Program¹⁵³⁵ to the acquisition of qualifying country end products.¹⁵³⁶ Signatories to the RDPs constitute “qualifying countries” for this purpose.¹⁵³⁷ It is possible for a public interest exception to be applied and an individual waiver secured in certain circumstances.¹⁵³⁸ DFARS 225.103(B) also provides that it is inconsistent with the public interest to apply the BAA to procurements covered by the WTO GPA to end products that are substantially transformed in the United States. Secondly, the BAA does not apply to products determined not to be reasonably available in commercial quantities and of satisfactory quality.¹⁵³⁹ Thirdly, the BAA does not apply if the cost of the lowest priced domestic product is unreasonable.¹⁵⁴⁰ A system of price

¹⁵³⁴ 41 U.S.C. §8302(a)(1)

¹⁵³⁵ The Balance of Payments Program restricts, *inter alia*, the purchase of supplies that are not domestic end products, for use outside the United States. See DFARS 225.7501

¹⁵³⁶ DFARS 225.103 (a)(i)(A). See *Self-Powered Lighting v. United States*, 492 Supp. 1267 (S.D.N.Y. 1980), where the court ruled that an MoU created a blanket exemption for all UK defence products and *American Hosp. Supply, Equipping & Consulting*, Comp. Gen. Dec. B-221357, 86-1 CPD ¶ 70, where GAO found proper use of an exemption under an MoU with Italy. These exemptions also extend to non-defence products procured by the DoD. See *Allis-Chalmers Corp. v. Arnold*, 619 F.2d 44 (9th Cir. 1980) and *Air Plastics, Inc.* Comp. Gen. Dec. B-199307, 80-2 CPD ¶ 141 (exemption for Denmark by MoU), cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1623

¹⁵³⁷ 225.872-1. The following constitute “qualifying countries”: Australia, Belgium, Canada, Czech Republic, Denmark, Egypt, Federal Republic of Germany, Finland, France, Greece, Israel, Italy, Luxembourg, Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey and the UK

¹⁵³⁸ For instance, according to DFARS 225.103(a)(ii), a public interest exception may be appropriate in the following circumstances: (1) if accepting the low domestic offer will involve substantial foreign expenditures, or accepting the low foreign offer will involve substantial domestic expenditures; (2) to ensure access to advanced state-of-the-art commercial technology; or (3) to maintain the same source of supply for spare and replacement parts (i) for an end item that qualifies as a domestic end product; or (ii) in order not to impair integration of the military and commercial industrial base. *ibid*

¹⁵³⁹ 41 U.S.C. §8302(a)(2)(B); FAR 25.103(a). See *Midwest Dynamometer & Eng’g Co.*, Comp. Gen. Dec. B-252168, 93-1 CPD ¶ 408 cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1622-1623

¹⁵⁴⁰ 41 U.S.C. § 8302(a). For general commentary, see J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1622

differentials has been established for use in making this determination.¹⁵⁴¹ Fourthly, the BAA does not apply to procurements of products for use outside the United States.¹⁵⁴² Finally, the BAA does not apply to information technology determined to be a commercial item.¹⁵⁴³

For many years, the BAA has been the subject of intense scrutiny, not least because of claims regarding the potential for protectionist measures to threaten bilateral and multilateral trade agreements concluded between the U.S. and other countries.¹⁵⁴⁴ It is beyond the scope of this Chapter to engage an analysis of the BAA in full. For present purposes, it is necessary to focus, to the extent possible, on discerning the effect of the BAA with regard to the position of foreign contractors in defence procurement and which will be examined in Section 4 below. However, the position with regard to non-signatory EU Member States is even more difficult to discern. For instance, all of the countries examined for the purposes of the Fortresses and Icebergs Study are RDP signatories with the exception of Romania. The Study indicates that Romania “greatly desires such agreements”.¹⁵⁴⁵ However, it is not clear whether it is to be inferred that Romania has been subject to significant restrictions in application of the BAA. It has been argued that a 50% price differential “severely inhibits a programme manager’s ability to choose from a globally competitive market

¹⁵⁴¹ Executive Order 10582, 19 Fed. Reg. 8723 (1954). These differentials have been codified in FAR 25.105

¹⁵⁴² 41 U.S.C. §8302(a)(2)(A). See *Systems & Def. Servs. Int’l*, Comp. Gen. Dec. B-254254.2, 94-1 CPD ¶ 91; *Maremont Corp.*, 55 Comp. Gen. 1362 B-186276, 76-2 CPD ¶ 181 cited in J Cibinic Jr, R C Nash Jr and C R Yukins, *Formation of Government Contracts* (n 1055) 1623

¹⁵⁴³ FAR 25.193(e)

¹⁵⁴⁴ See for instance, J A Howell, ‘The Trade Agreements Act of 1979 Versus The Buy American Act: The Irresistible Force Meets the Immovable Object’ (2005-2006) 35 Pub Cont LJ 495; S L Schooner and C R Yukins, ‘Public Procurement: Focus on People, Value for Money and Systemic Integrity, Not Protectionism’, The George Washington University Law School Public Law and Legal Theory Working Paper No.460, 87; S L Schooner and C R Yukins, ‘Tempering ‘Buy American’ In the Recovery Act – Steering Clear of a Trade War’ (2009) 51(10) Government Contractor 1; J S Smyth, ‘The Impact of the Buy American Act on Program Managers’ (1999) Acquisition Review Quarterly, 263

¹⁵⁴⁵ *Fortresses and Icebergs*: (Vol. II) (n 12) 506. According to the Study, there is no indication at present that the U.S. is seeking to negotiate an RDP, in particular, citing problems with Romania’s compliance with EU and international norms regarding transparency, corruption and organized crime

for defence goods.”¹⁵⁴⁶ Again, however, it is not clear the extent to which non-signatory EU Member States are disproportionately affected as compared to other foreign countries.¹⁵⁴⁷

2.2. International Trade Agreements

In addition to domestic source restrictions, FAR 25.4 and DFARS 225.4 also stipulate the policies and procedures applicable to acquisitions that are covered, *inter alia*, by the WTO GPA. However, FAR 25.4 does not apply to acquisitions of arms, ammunition or war materials, or purchases indispensable for national security or for national defence purposes.¹⁵⁴⁸

The most important provisions of the FAR and DFARS for the purposes of the present Chapter concern the categories of other international agreement. FAR 25.8 specifies the general provision relating to treaties and agreements between the U.S. and foreign governments. DFARS 225.8 contains a number of supplementary provisions. The main provisions relate to cooperative projects under NATO and the RDPs. The RDPs will be examined separately in Section 4 below.

With regard to NATO, U.S. law prescribes specific rules relating to cooperative procurement projects. For the purposes of DFARS, a “cooperative project” means a “jointly managed arrangement” which is described in a written agreement between the parties and undertaken to further the objectives of standardization, rationalization,

¹⁵⁴⁶ J S Smyth, ‘The Impact of the Buy American Act on Program Managers’ (n 1544) 268-269

¹⁵⁴⁷ As will be discussed in Section 4.7 below, it should also be borne in mind that it has been reported that even the BAA waivers under the RDPs have not been fully applied in all circumstances and it is not possible to fully discern the effect of the BAA waivers in practice

¹⁵⁴⁸ FAR 25.401(a)(2)

and interoperability of the armed forces of NATO member countries.¹⁵⁴⁹ The relevant agreement must provide for: (i) one or more of the other participants to share with the U.S. the cost of research and development, testing, evaluation, or joint production (including follow-on support) of certain defence articles; (ii) concurrent production in the U.S and in another member country of a defence article jointly developed; or (iii) acquisition by the US of a defence article or defense service from another member country.¹⁵⁵⁰ In terms of the authority delegated under this provision, Departments and Agencies may enter into cooperative project agreements with NATO or with one or more NATO members.¹⁵⁵¹ This includes the authority to enter into contracts or incur other obligations on behalf of other participants,¹⁵⁵² and to solicit and award contracts to implement cooperative projects.¹⁵⁵³

A waiver of certain laws and regulations may be obtained if the waiver: (1) is required by the terms of a written cooperative project agreement; (2) will significantly further NATO standardization, rationalization and interoperability and (3) is approved by the appropriate DoD official.¹⁵⁵⁴

In addition, DFARS allows the Director of DPAP to authorize the direct placement of

¹⁵⁴⁹ DFARS 225.872(a)(1) and (2)

¹⁵⁵⁰ DFARS 225.872(a)(3)

¹⁵⁵¹ pursuant to DoDD 5530.3, International agreements. See DFARS 225.871-3

¹⁵⁵² 225.871-3(a)(2)

¹⁵⁵³ 225.871-3(a)(2) and 225.871-3(a)(3)

¹⁵⁵⁴ 225.871-3(b). Under 225.871-4(a) (statutory waivers), for contracts or subcontracts placed outside the United States, the Deputy Secretary of Defense may waive any provision of law that specifically prescribes— (1) Procedures for the formation of contracts; (2) Terms and conditions for inclusion in contracts; (3) Requirements or preferences for— (i) Goods grown, produced, or manufactured in the United States or in U.S. Government-owned facilities; or (ii) Services to be performed in the United States; or (4) Requirements regulating the performance of contracts. (b) There is no authority for waiver of— (1) Any provision of the Arms Export Control Act (22 U.S.C. 2751); (2) Any provision of 10 U.S.C. 2304; (3) The cargo preference laws of the United States, including the Military Cargo Preference Act of 1904 (10 U.S.C. 2631) and the Cargo Preference Act of 1954 (46 U.S.C. 1241(b)); or (4) Any of the financial management responsibilities administered by the Secretary of the Treasury. (c) To request a waiver under a cooperative project, follow the procedures at PGI 225.871-4. (d) Obtain the approval of the Deputy Secretary of Defense before committing to make a waiver in an agreement or a contract

subcontracts with particular subcontractors. Directed subcontracting is not authorized unless specifically addressed in the cooperative project agreement.¹⁵⁵⁵ The Subpart further states that in some instances, it may not be feasible to name specific subcontractors at the time the agreement is concluded. However, the agreement must clearly state the general provisions for work sharing at the prime and subcontract level.¹⁵⁵⁶

The above provision evidences a considerable degree of flexibility to enable cooperation within NATO, including without regard to competitive contracting. It is recalled from Chapter 3, Section 5 that the Defence procurement Directive does not regulate cooperative procurement and simply provides one of a possible number of legal bases to exclude NATO procurement.¹⁵⁵⁷

FAR 25.9 also contains specific provisions on customs and duties. DFARS 225.900 provides that the DoD will issue duty-free entry certificates for qualifying country supplies (end products and components). For the purposes of DFARS 225.003 a qualifying country means a country with a RDP.

3. Offsets in Foreign Military Sales

Chapters 3 and 7 briefly examined foreign military sales primarily from the perspective of the recipient. As indicated, the U.S. operates a Foreign Military Sales

¹⁵⁵⁵ 225.871-5(a)

¹⁵⁵⁶ 225.871-5(b). For additional information on cooperative project agreements, see PGI 225.871-5

¹⁵⁵⁷ See Articles 12(a) and (c) discussed in Chapter 3, Sections 3 and 4, respectively

("FMS") programme in which it provides requested items to requesting Governments. This exchange is substantially one way. Section 22 of the Arms Export Control Act 1976 authorizes the DoD to enter into contracts for resale to foreign countries or international organizations.¹⁵⁵⁸ The policies and procedures concerning acquisition under FMS are regulated in DFARS 225.73.¹⁵⁵⁹

It is beyond the confines of this thesis to engage a detailed discussion of FMS contracting. It is recalled from Chapter 9, Section 2.1.1 that one of the criticisms that has arisen from U.S. Reports on competition in procurement concerns the extent to which FMS are seen as reducing competition in procurement.¹⁵⁶⁰ CICA permits other than full and open competition in such an instance.¹⁵⁶¹ In particular, FMS customers can request a subcontract to be placed with a particular firm.¹⁵⁶² Further, whilst U.S. law regulates customer involvement to a certain extent, contracting officers have discretion to permit FMS customers to be involved in contract negotiations.¹⁵⁶³ The extent to which such contracting processes may impact on competition has not been extensively researched. However, in accordance with the focus of Part I of the thesis, this Chapter is confined to an examination of related offset agreements.

As indicated in Chapter 3, Section 6, a legitimate sale may often be accompanied by an offset agreement. Chapter 7, Section 4.2.2 examined the problematic relation of the sale and offset and its implications for third countries. As this Section will discuss,

¹⁵⁵⁸ 22 U.S.C. 2762

¹⁵⁵⁹ DFARS 225.7300(b) provides that it does not apply to: (1) FMS made from inventories or stocks; (2) Acquisitions for replenishment of inventories or stocks; or (3) Acquisitions made under DoD cooperative logistic supply support arrangements

¹⁵⁶⁰ United States Government Accountability Office, *Defense Contracting: Actions Needed to Increase Competition* (n 1163) 15

¹⁵⁶¹ 10 U.S.C. 2304(c)(4). Implemented in DFARS 225.7304 in accordance with FAR 6.302-4

¹⁵⁶² DFARS 225.7304

¹⁵⁶³ DFARS 225.7304

U.S. law similarly differentiates a legitimate sale from an offset agreement accompanying the sale. However, the U.S. is similarly ambivalent with regards to the legal and policy distinctions it draws between legitimate sales and offset agreements which, in the views of one U.S. legal commentator, has given a “false impression of an absence of offset arrangements in FMS transactions”.¹⁵⁶⁴

Annual monitoring of the impact of offsets on the U.S. defence industrial base dates as far back as 1984.¹⁵⁶⁵ According to the Bureau of Industry and Security (“BIS”), from 1993-2010 52 U.S. firms reported entering into 763 offset-related defence export sales contracts worth \$111.59 billion with 47 countries, with associated offset agreements valued at \$78.08 billion.¹⁵⁶⁶

3.1. U.S. Government Policy: “Hands Off(sets)”

U.S. Government policy on offsets states that the government considers offsets¹⁵⁶⁷ to be “economically inefficient and trade distorting.”¹⁵⁶⁸ The U.S. prohibits any U.S.

¹⁵⁶⁴ M J Nackman, ‘A Critical Examination of Offsets in International Defense Procurements: Policy Options for the United States’ (n 971) 529

¹⁵⁶⁵ In 1984, Congress amended the Defense Production Act to require the President to submit an annual report to Congress on the impact of offsets on the U.S. defense industrial base. See Pub. L. 98-265, April 17, 1984, 98 Stat. 149. In 1992, Congress amended the DPA and directed that the Secretary of Commerce function as the President’s Executive Agent in this regard. See Pub. L. 102-558, Oct. 28, 1992, 106 Stat. 4198. See also Part IV of Exec. Order No. 12919, 59 Fed. Reg. 29525 (June 3, 1994). Section 723 of the DPA authorizes the Secretary of Commerce to develop and administer the regulations necessary to collect offset data from U.S. firms. The Secretary of Commerce has delegated this authority to the Bureau of Industry and Security (“BIS”). BIS published its offset reporting regulation in 1994. See 59 Fed. Reg. 61796, December 2, 1994, codified at 15 C.F.R. § 701. BIS amended its offset regulation in 2009. See 74 Fed. Reg. 68136, December 23, 2009, codified at 15 C.F.R. § 701. For a useful historical discussion of U.S. initiatives in offset reporting, see M J Nackman, ‘A Critical Examination of Offsets in International Defense Procurements: Policy Options for the United States’ (n 971) 524

¹⁵⁶⁶ U.S. Department of Commerce Bureau of Industry and Security, Offsets in Defense Trade, Sixteenth Study, Conducted Pursuant to Section 723 of the Defense Production Act of 1950, as Amended, January 2012, 3 citing Table 2-1: ‘Summary of Defense Export Sale Contract Values with Related Offset Agreements, 1993-2010’ (Source: BIS offset database) <http://www.bis.doc.gov/index.php/forms-documents/doc_view/396-offsets-in-defense-trade-sixteenth-study> accessed 20 September 2013

¹⁵⁶⁷ The U.S. Defense Offsets Disclosure Act of 1999 Pub. L. 106-113, section 1243(3) defines the term “offset” as: “the entire range of industrial and commercial benefits provided to foreign governments as an inducement or condition to purchase military goods or services, including benefits such as coproduction, licensed production, subcontracting, technology transfer, in-country procurement, marketing and financial assistance, and joint

government Agency from encouraging, entering directly into, or committing U.S. firms to any offset arrangement in connection with the sale of defence articles or services to foreign governments.¹⁵⁶⁹ To this extent, companies retain responsibility for determining whether to undertake, negotiate and implement offset agreements.¹⁵⁷⁰ Accordingly, as DPAP observes, the DoD has implemented a “hands off” approach to offsets.¹⁵⁷¹ This position is formalised in legal terms by DFARS 225.7303-2(3)(ii) which provides that: “the U.S. Government assumes no obligation to satisfy or administer the offset requirement or to bear any of the associated costs.”¹⁵⁷² This extends to a policy of providing no involvement with the negotiation of the offset agreement itself between the company and the FMS customer, and no role in judging the merits of these agreements.¹⁵⁷³ In addition, the Letter of Offer and Acceptance (“LOA”) between the U.S. Government and the FMS customer and the resulting contract, *inter se*, do not include any of the terms of the offset (even though the LOA and contract may include costs associated with the offset).¹⁵⁷⁴ Notwithstanding, it has been observed that whilst discussions will only take place directly between the purchasing country and contractor outside U.S. Government control, the implication is that the U.S. will have some knowledge of any proposal.¹⁵⁷⁵ U.S. commentary has

ventures.”

¹⁵⁶⁸ Presidential Policy on Offsets in Military Exports, Statement by President Bush’s Press Secretary 16 April 1990 <http://www.acq.osd.mil/dpap/paic/attachments/offsets/presidential_policy_on_offsets_in_mil_exports.pdf> accessed 20 September 2013

¹⁵⁶⁹ *ibid.* Implemented in DFARS 225.7306

¹⁵⁷⁰ *ibid.*

¹⁵⁷¹ Defense Procurement and Acquisition Policy Office, Offsets of Foreign Military Sales, FMS Offsets and Other Issues Affecting FMS Procurements, Frequently Asked Questions (FAQs) <http://www.acq.osd.mil/dpap/cpic/ic/offsets_of_foreign_military_sales.html#_ftn1%23_ftn1> accessed 20 September 2013

¹⁵⁷² DFARS 225.7303-2(a)(3)(ii)

¹⁵⁷³ *ibid.*

¹⁵⁷⁴ The FMS agreement is documented in a Letter of Acceptance. DFARS 225.7301(a) in accordance with DoD 5105.38-M, Security Assistance Management Manual

¹⁵⁷⁵ M J Nackman, ‘A Critical Examination of Offsets in International Defense Procurements: Policy Options for the United States’ (n 971) who observes at 527: “The U.S. Government supposedly remains blissfully ignorant of the fact of their existence. Yet it is no secret which countries have offset requirements, as the offsets are

suggested that, to this extent, the DoD “turns a blind eye” to offsets in FMS and in doing so implicitly endorses the practice despite the U.S.’ official position.¹⁵⁷⁶

3.2. Offsets in Transatlantic Defence Trade

Chapter 7 has provided the context for understanding the significance attributed to offsets within the EU. In terms of the extent of U.S. involvement in offset practices within the EU, according to a 2010 BIS report, in 2009, U.S. firms reported entering into 17 new offset agreements with EDA members valued at \$670 million.¹⁵⁷⁷ EDA members accounted for 30.36 % of the new offset agreements reported by U.S. firms in 2009 based on quantity and 9.95% based on value.¹⁵⁷⁸ In addition, U.S. firms reported 230 offset transactions with EDA members with an actual value of \$1.11 billion, and an offset credit value of \$1.44 billion.¹⁵⁷⁹ The EDA members accounted for 34.64% of all offset transactions reported by U.S. firms in 2009 based on quantity and for 31.62% of the overall offset transaction value.¹⁵⁸⁰

Within the U.S., it is generally well reported that U.S. prime contractors readily identify the benefits of offsets as an important point of leverage into foreign defence markets as well as supporting the U.S. defence industries base.¹⁵⁸¹ However, it has been suggested that the views of subcontractors are often overlooked.¹⁵⁸² A principal

ultimately later disclosed to the U.S. Government as part of an annual reporting requirement to BIS [footnote omitted], shortly after the DCSA news release is published [footnote omitted].”

¹⁵⁷⁶ *ibid*

¹⁵⁷⁷ BIS, ‘Offsets in Defense Trade Sixteenth Study’ (n 1566) 6

¹⁵⁷⁸ *ibid*

¹⁵⁷⁹ *ibid*

¹⁵⁸⁰ *ibid*

¹⁵⁸¹ *ibid*

¹⁵⁸² See M J Nackman, ‘A Critical Examination of Offsets in International Defense Procurements: Policy Options for the United States’ (n 971) 523. See also G Ianakiev, ‘The United States and the “Offsets in Defence Trade”

concern relates to sales with direct offset requirements. These are said to displace U.S. subcontractors with foreign sources on export versions of initial systems designed by those subcontractors, in turn, resulting in the disclosure of intellectual property and other technical “know-how” which enables foreign sources to become competitors.¹⁵⁸³

Another important observation indicates the relative lack of clear offset tracking even in the U.S. where U.S. law imposes a number of statutory requirements in this regard.¹⁵⁸⁴ The upshot is that the U.S. is still “studying” the effects of offsets and that before any substantive policies can be adopted, there needs to be greater transparency in reporting their use.¹⁵⁸⁵ This current emphasis on monitoring is broadly consistent with EU policy in the field.¹⁵⁸⁶

However, it is also important to emphasise that whilst the U.S. does not formally endorse offset policies in the way that has otherwise been explicit in EU Member States through dedicated offset laws and practices, the U.S. nevertheless actively seeks domestic content and workshare from foreign contractors on major programmes.¹⁵⁸⁷

Issue’ (2006) *Proceedings of the 10th Annual International Conference on Economics and Security* 308 <http://www.city.academic.gr/special/events/economics_and_security09/2006/11-lanakiev.pdf> accessed 20 September 2013

¹⁵⁸³ M J Nackman, ‘A Critical Examination of Offsets in International Defense Procurements: Policy Options for the United States’ (n 971) 522

¹⁵⁸⁴ *ibid*, 521 and 523

¹⁵⁸⁵ *ibid* 524

¹⁵⁸⁶ See for instance, the discussion of the EDA Offset Code in Chapter 7, Section 4

¹⁵⁸⁷ An example in this regard would have been the KC-X aerial refueling tanker contract discussed in Chapter 9, Section 3.3. See also *Fortresses and Icebergs: (Vol. II)* (n 12) 674

3.3. U.S. Offset Reform

Of specific relevance to the present thesis, U.S. legal commentary has examined possible options for offset reform. For instance, it has been observed that the U.S. cannot simply prohibit U.S. companies from participation in offsets through regulation, although a legal (as opposed to political) assessment in favour or against this position has not been advanced.¹⁵⁸⁸ More emphatically, it has been identified that this would “prove crippling” in the international defense trade market and that, rather, a global prohibition is needed.¹⁵⁸⁹ Again, this is broadly correspondent with the EDA’s commitment to a global reduction of offset use through progressive elimination.¹⁵⁹⁰ However, the reality is that offsets are culturally engrained in the procurement practices of the most developed defence nations as well as many of the emerging economies.

One suggestion that has been identified as a “deceptively appealing option”, might be to require offsets in U.S. defense procurements from foreign contractors, with a view to “driving the WTO to eliminate the offset prohibition loophole altogether”.¹⁵⁹¹ However, it has been acknowledged that such a shift would harm the U.S.’ closest defense partners in the transatlantic defence industry, incentivizing them to move toward more protectionist measures at a time when they are “beginning to move away from them”.¹⁵⁹² It has also been suggested that efforts could be made to standardize the defence trade offset practice by pushing for additions to the WTO

¹⁵⁸⁸ M J Nackman, ‘A Critical Examination of Offsets in International Defense Procurements: Policy Options for the United States’ (n 971) 528

¹⁵⁸⁹ *ibid*

¹⁵⁹⁰ See Chapter 7, Section 4

¹⁵⁹¹ Nackman, ‘A Critical Examination of Offsets in International Defense Procurements: Policy Options for the United States’ (n 971) 528

¹⁵⁹² *ibid*

GPA, thereby at least making the practice more predictable with the ultimate goal of eradicating the practice entirely.¹⁵⁹³ To this extent, an emphasis on short to medium term management (including through the use of legal institutions) as opposed to absolute prohibition may be the most pragmatic solution as a means of progressively phasing offsets practices out.

As indicated in the Introduction, a legal analysis of offset practices in the transatlantic defence market would necessitate a thesis in its own right. The objective of this thesis is served by highlighting the extent to which ambivalent EU and U.S. attitudes to offsets has required a mediated and compromised legal position. Offsets and related practices should be a high priority for future legal research examining transatlantic defence procurement.

4. Reciprocal Defence Procurement MoU's

It is apposite that the substantive Part of this thesis should conclude with a discussion of the RDPs in light of repeated references made to these instruments in previous Chapters. Specifically, in response to what has been identified as a “seemingly perpetual European gripe with what is perceived to be a protectionist U.S. defense procurement policy” it has been proposed that:

[r]evamping the RDPs with more stringent procedural requirements aimed at fairly competing more U.S. defense contracts could appease America's

¹⁵⁹³ M J Nackman, 'A Critical Examination of Offsets in International Defense Procurements: Policy Options for the United States' (n 971) 528-529, although the form and content of these “additions” is not specified

wary European allies and nip any “buy European” inclination in the bud”.¹⁵⁹⁴

In particular, it has been suggested that the absence of significant transparency requirements, or any detailed positive rules governing how procurements are to be conducted is a “lost opportunity to say the least”.¹⁵⁹⁵ In addition, as will be discussed below, U.S. legal commentary has also suggested the need for reform of the review provisions.¹⁵⁹⁶ This analysis pre-empts the fact that certain of the RDPs are intended to terminate in 2015, provoking a necessary discussion of their renewal, reform or replacement.¹⁵⁹⁷

4.1. Background

RDPs are currently in effect between the U.S. and 21 countries.¹⁵⁹⁸ Sixteen of those countries are EU Member States.¹⁵⁹⁹ This group comprises all of the EU’s major defence producers. One of those countries (Turkey) is an EU accession candidate

¹⁵⁹⁴ D B Miller, ‘Is it Time to Reform Reciprocal Defense Procurement Agreements?’ (n 31)

¹⁵⁹⁵ *ibid*

¹⁵⁹⁶ Developments, ‘Transatlantic Procurement Outlook is Mixed, Panelists Say’ (2009) 51(42) Government Contractor ¶ 393, 2 (summary of comments at a George Washington University Law School Colloquium)

¹⁵⁹⁷ For instance, the US-UK RDP (inclusive of its annexes) will terminate on 1 January 2015. Further, if either Government considers it necessary for “compelling national reasons” to discontinue its participation under the RDP before the date of termination, an immediate consultation must take place to determine “such actions” as may be necessary to alleviate problems that may result from termination. See Memorandum of Understanding Between the Government of the United States and the Government of the United Kingdom of Great Britain and Northern Ireland Relating to the Principles Governing Cooperation in Research and Development, Production, Procurement And Logistics Support of Defense Capability, December 16 2004, Section 6 (6.2) <[http://www.acq.osd.mil/dpap/Docs/paic/MOU-United%20Kingdom%20\(Dec%202004\).pdf](http://www.acq.osd.mil/dpap/Docs/paic/MOU-United%20Kingdom%20(Dec%202004).pdf)> accessed 20 September 2013

¹⁵⁹⁸ These countries comprise: (1) Australia; (2) Austria; (3) Belgium; (4) Canada; (5) Denmark; (6) Egypt; (7) Finland; (8) France; (9) Germany; (10) Greece; (11) Israel; (12) Italy; (13) Luxembourg; (14) Netherlands; (15) Norway; (16) Portugal; (17) Spain; (18) Sweden; (19) Switzerland; (20) Turkey; (21) UK. The DPAP provides links to the RDPs and their accompanying annexes and amendments <http://www.acq.osd.mil/dpap/cpic/ic/reciprocal_procurement_memoranda_of_understanding.html> accessed 20 September 2013

¹⁵⁹⁹ (1) Austria; (2) Belgium; (3) Czech Republic; (4) Denmark; (5) Finland; (6) France; (7) Germany; (8) Greece; (9) Italy; (10) Luxembourg; (11) Netherlands; (12) Poland; (13) Portugal; (14) Spain; (15) Sweden; (16) UK

and NATO member State. It follows that twelve EU Member States are not RDP signatories.¹⁶⁰⁰ Most of those non-signatories have limited or substantially no defence capabilities.¹⁶⁰¹ A number of the RDPs were concluded in the 1970's,¹⁶⁰² reflecting a Cold War concern of the U.S. to signal collaboration with its allies.¹⁶⁰³ The recent signature of RDPs with Eastern European States such as Poland and the Czech Republic may signal a different contemporary relevance to the RDPs, although, as will be discussed, this is certainly not reflected in the generic terms of the latest RDPs which substantially replicate their predecessors.

The common objectives shared by the RDPs is to: (a) make the most cost-effective and rational use of the resources allocated to defence; (b) promote the widest possible use of standard or interoperable equipment and (c) develop and maintain an advanced technology capability for the North Atlantic Alliance.¹⁶⁰⁴

Before examining their provisions in full, certain fundamental observations can be made. Firstly, the RDPs also identify principles relating to RDT&E, logistics support, quality assurance and security of supply and information. The generality of their scope therefore constitutes a significant limitation on their ability to exercise a discrete and dedicated procurement function. This perception is perhaps evidenced by the fact that certain signatories have viewed the RDP's primarily as "national

¹⁶⁰⁰ These Member States are: (1) Bulgaria; (2) Croatia; (3) Cyprus; (4) Estonia; (5) Hungary; (6) Ireland; (7) Latvia; (8) Lithuania; (9) Malta; (10) Romania; (11) Slovakia; (12) Slovenia

¹⁶⁰¹ Romania is arguably the exception in this regard and is reflected by its coverage in the Fortresses and Icebergs Study. However, as indicated in Section 2.1 (n 1545) the U.S. has no present intention to enter into an RDP with Romania

¹⁶⁰² For a useful historical overview of attitudes towards the RDPs during this period and efforts aimed at reform in this regard, see United States General Accounting Office, European Initiatives: Implications for U.S. Defense Trade and Cooperation (n 60) 36-44

¹⁶⁰³ Prior to this date, certain countries had maintained understandings relating to reciprocal defence procurement

¹⁶⁰⁴ See for example, the U.S.-UK RDP (n 1597)

security agreements”.¹⁶⁰⁵ Secondly, whilst U.S. legal commentary highlights the importance of the RDPs to transatlantic defence trade, as indicated, the U.S. has signed RDPs with non-European, non-NATO countries.¹⁶⁰⁶ Therefore, in the further pursuit of transatlantic defence cooperation, it is by no means clear that the U.S. would be prepared to sign RDPs with all EU Member States or with the EU in place of its Member States.¹⁶⁰⁷ Finally, most importantly, it should be observed that the neither the US-Poland or US-Czech Republic RDPs (both of which were signed after transposition of the Defence Procurement Directive) contain any reference to the Directive.

4.2. Main Provisions

The RDPs vary in their content according to the specific circumstances of the country concerned. Perhaps unsurprisingly, the most comprehensive in terms of content is the US-UK RDP which, for ease of exposition, will be the subject of analysis and whose provisions broadly correspond with those of other RDPs concluded before the Defence Procurement Directive.¹⁶⁰⁸ It should be observed at the outset that the main text is relatively short. More substantial provision is made in Annexes accompanying the main text. For instance, the US-UK RDP contains 7 Annexes. In light of the focus

¹⁶⁰⁵ United States General Accounting Office, International Procurement: NATO Allies' Implementation of Reciprocal Defense Agreements (Report to Congressional Committees) GAO/NSIAD-92-126, March 1992, 2 <<http://www.gao.gov/assets/220/215699.pdf>> accessed 20 September 2013

¹⁶⁰⁶ The latest proposal has concerned the possibility for the conclusion of an RDP with Argentina

¹⁶⁰⁷ In the political sphere, any such possibility could mean that the U.S. would, to some extent, lose the political control and flexibility which it currently has in conducting its transatlantic defence trade relations bilaterally with individual Member States

¹⁶⁰⁸ The UK is also a useful candidate for analysis in light of the fact that, as will be discussed in Part III, the U.S. has concluded a bilateral defence trade treaty with the UK albeit with regard to the export and transfer of defence articles

of U.S. legal commentary on the procurement aspect, this Chapter focuses on Annex I which stipulates the procedures implementing the RDP.¹⁶⁰⁹

4.2.1. Field and Scope of Application

Concerning the field of application, the U.S.-UK RDP is broadly defined and non-specific. The RDP covers the acquisition of defence capability by the US DoD and UK Ministry of Defence through both research and development and procurement of defence equipment, supplies and services.¹⁶¹⁰ However, the RDP does not cover construction contracts.¹⁶¹¹ Concerning the personal scope of application, the RDP refers to both Government-to-Government and Government-to-industry procurement.¹⁶¹² It follows that the RDP does not cover industry-industry procurement. It should be observed, however, that the RDP does not explicitly differentiate between each form.

4.2.2. Principles Governing Reciprocal Defence Purchasing

The RDP makes a number of general statements regarding the intention of signatories to facilitate the “mutual flow” of defence procurement, aiming at long term “equitable balance” in exchanges.¹⁶¹³ The stated objective is the intention for each

¹⁶⁰⁹ The other Annexes are: Annex II (concerning mutual acceptance of testing and evaluation); Annex III (concerning reciprocal audits of contracts and subcontracts); Annex IV (concerning logistics support of defence equipment); Annex V (concerning quality assurance); Annex VI (on security of supply) and Annex VII (concerning exchange of technical information)

¹⁶¹⁰ Section 1 (1.1.)

¹⁶¹¹ Section 1 (1.2.)

¹⁶¹² Section 2 (2.4.1.). See also Section 4 on industrial involvement

¹⁶¹³ Section 2 (2.1.) The reference to “equitable balance” is very similar to the term “equitable return” which is sometimes used to refer to industrial return and global balance strategies. Within the terms of the RDP, however, the reference most likely simply refers to the need for steady defence trade flows between the U.S. and UK

Government to provide firms of the other country with treatment “no less favourable” than that accorded to domestic enterprises.¹⁶¹⁴ The RDP enumerates the following principles in this regard.

4.2.2.1. Identification of Defence Items

The RDP provides that the Governments will identify and nominate for consideration defence items believed to be suitable to satisfy their respective requirements.¹⁶¹⁵ In this regard, the Governments will decide the purchases to which the RDP will apply and whether the items may be procured on a Government-to-Government or Government-to-industry basis.¹⁶¹⁶ Further, the RDP also provides that each Government will adopt qualified defence items that have been developed or produced in the other country, in the interests of standardization and the utilization of scarce resources, to the extent practicable.¹⁶¹⁷ On current understanding, neither Government has adopted a specific list including qualifying categories of such items.¹⁶¹⁸ Similarly, neither Government has designated specific procedures for use in this regard.

4.2.2.2. Regular Discussion of Adverse Effects of Offsets and Other Policies

The RDPs do not contain any substantial provisions specifically related to offsets or countertrade. A recent exception is the U.S.-Czech RDP which expressly provides

¹⁶¹⁴ Section 2 (2.3.)

¹⁶¹⁵ Section 2 (2.4.1.). See also Annex I, Section 2 (2.1) and Annex I, Section 3 (3.3.3.)

¹⁶¹⁶ Section 2 (2.4.1.)

¹⁶¹⁷ Section 2 (2.4.2.). See also Annex I, Section 2 (2.1.)

¹⁶¹⁸ For example, there is no list equivalent to the EU 1958 list, on which see Chapter 2, Section 2.2

that the RDP does not regulate offsets.¹⁶¹⁹ The basis for this inclusion is not clear. Notwithstanding, the RDPs generally identify a requirement to regularly discuss measures to limit the “adverse effects” of offsets.¹⁶²⁰ However, whilst the possibility for “discussion” may exist, there is no designated forum within the framework of the RDP which is dedicated to focusing on the use of the RDPs to limit offsets and related practices.

4.3. Implementing Procedures: Procurement

Annex 1 contains a number of Sections, two of which refer to “General Procedures” and “Procurement Procedures” and both of which refer specifically to procurement. The Annex is intended to give effect to a general principle of “transparency and integrity” in the conduct of procurements.¹⁶²¹ In turn, a number of more specific principles are enumerated which are discussed below. It should be observed that at the time of their initial adoption the Department of Commerce recommended that the Annexes should include provisions conforming closely to the then GATT Government Procurement Code so as to ensure specificity and enforceability.¹⁶²² However, the DoD rejected the recommendation on the basis that such provisions were “too cumbersome”, would “eliminate the flexibility required on such procurements” and would, fundamentally, limit the nations’ sovereign right to regulate defence trade for national security reasons.¹⁶²³

¹⁶¹⁹ Agreement Between The Government of the United States of America and The Government of the Czech Republic Concerning Reciprocal Defence Procurement Agreement, 18 April 2012, Article III <<http://www.acq.osd.mil/dpap/Docs/mou-czech.pdf>> accessed 20 September 2013

¹⁶²⁰ *ibid*

¹⁶²¹ Section 2.4.4

¹⁶²² United States General Accounting Office, International Procurement: NATO Allies’ Implementation of Reciprocal Defense Agreements (n 1605) 8

¹⁶²³ *ibid*

4.3.1. General Procedures

The Section on General Procedures contains a number of discrete references to procurement as follows.

4.3.1.1. Obtaining Information About Possible Procurement

The RDP provides that it will be the primary responsibility of industry to obtain procurement information and to respond to requests for proposals in accordance with nationally prescribed procurement procedures and regulations.¹⁶²⁴ Further each Government will, consistent with normal practice and procedures, ensure that responsible Government authorities will assist sources from the other country by responding promptly to requests for appropriate information.¹⁶²⁵

Importantly, however, as will be discussed below, the RDP does not identify any specific requirements to assist foreign sources in obtaining information about possible procurements beyond that which is ordinarily provided.¹⁶²⁶

According to one U.S. legal commentator, an important objective of transparency requirements is “informational utility”; in this regard, the current lack of access to

¹⁶²⁴ Annex 1, Section 2.2

¹⁶²⁵ This information concerns: [2.3.1] plans and programs for production, logistics support and acquisition of defence equipment and defense services; [2.3.2.] requirements for the qualification of sources; [2.3.3.] specifications, quality assurance standards and other appropriate documentation

¹⁶²⁶ The fact that industry is primarily responsible for finding business opportunities was identified a point of criticism in the 1992 GAO Report. See United States General Accounting Office, International Procurement: NATO Allies' Implementation of Reciprocal Defense Agreements (n 1605) 5

procurement information on the part of prospective suppliers has been identified as a specific deficiency under the RDPs.¹⁶²⁷

4.3.1.2. Full and Equitable Consideration to All Qualified Sources

One principle identified by the RDP is that “full and equitable consideration” will be given to all qualified sources.¹⁶²⁸ This also extends to sources applying for qualification.¹⁶²⁹ “Full and equitable consideration” is not defined except to the extent that consideration must be in accordance with the policies and criteria of the purchasing agencies (in the case of qualified sources) and the laws, policies, regulations and procedures of the purchasing Government. This also includes relevant and applicable European Union regulations.¹⁶³⁰

It is inferred that it is this principle on which U.S. observers seek to rely in arguing that U.S. economic operators should be accorded treatment equal to that of EU economic operators both in terms of being invited to participate in contract award procedures and in substantive treatment once admitted.¹⁶³¹

¹⁶²⁷ D B Miller, ‘Is it Time to Reform Reciprocal Defense Procurement Agreements?’ (n 31); The fact that industry is primarily responsible for finding business opportunities was identified as an issue in the 1992 GAO Report. See United States General Accounting Office, International Procurement: NATO Allies’ Implementation of Reciprocal Defense Agreements (n 1605) 5

¹⁶²⁸ Section 2 (2.4.4.(ii)). Annex I, Section 2(2.4)

¹⁶²⁹ *ibid*

¹⁶³⁰ *ibid*

¹⁶³¹ For a discussion in this regard, see Chapter 4, Section 3

4.3.1.3. Satisfaction of Requirements

The U.S.-UK RDP further provides that offers will be required to satisfy requirements including performance, quality, supportability, delivery and cost.¹⁶³² Specifically, it provides that in preparing invitations for bids and requests for proposals, and in evaluating offers, full consideration will be given to potential NATO savings and/or increased NATO combat capability expected to result from procurement items that are standardized or interoperable with those of the Allies, where applicable and consistent with national laws and regulations.¹⁶³³ These considerations are similar to those contained under the most economically advantageous tender principles in the Defence Procurement Directive, in particular, the reference to “interoperability”.¹⁶³⁴

4.3.1.4. Offers Evaluated Without Application of Price Differentials under Buy National Laws

The most often-cited provision of the RDPs concerns that which ensures that offers of defence items developed and/or produced in the other country will be evaluated without applying price differentials under ‘Buy National’ laws and regulations and without applying the cost of import duty.¹⁶³⁵

It is recalled from Section 2.1 that certain provisions of the RDP’s have been incorporated into U.S. law and implemented by the DFARS 225.872 entitled

¹⁶³² Section 2 (2.4.4.(iii)); Annex I, Section 2(2.5)

¹⁶³³ *ibid*

¹⁶³⁴ Article 47(1)(a), although this provision does not explicitly refer to NATO

¹⁶³⁵ Annex I, Section 2(2.6). Section 2(2.7) further provides that: “[c]onsistent with national laws and regulations and, in the case of HMG relevant and applicable European Union regulations, provision will be made for duty-free certificates and related documentation.”

“[c]ontracting with qualifying country sources”. Before examining these provisions, it is important to observe that DFARS 225.872 does not apply, *inter alia*, to acquisitions of supplies restricted by: (1) U.S. National Disclosure Policy;¹⁶³⁶ (2) U.S. defense mobilization base requirements,¹⁶³⁷ except for quantities in excess of that required to maintain the defense mobilization base; (3) other U.S. laws or regulations;¹⁶³⁸ and (4) U.S. industrial security requirements. Therefore, procurement in accordance with the RDPs is precluded to the extent of any prior determination on one of the grounds listed.

In the event that the above do not apply, DFARS 225.872-1(a) and (b) give specific legal effect to the principle that offers or proposals must be evaluated on the basis of non-discrimination on the grounds of place of manufacture, without applying price differentials under ‘Buy National’ laws and regulations. It is recalled that DFARS identifies a list of “qualifying countries”.¹⁶³⁹ These include States with which the DoD has signed an RDP.¹⁶⁴⁰

However, it is important to observe that the waiver does not have automatic application for Austria and Finland, which can only be exempted on a purchase-by-purchase basis.¹⁶⁴¹ Further, the statutory waiver is not absolute. The waiver can be rescinded where the Secretary of Defense determines that a foreign country has discriminated against certain types of products produced in the U.S. and covered by

¹⁶³⁶ DoD 5230.11, Disclosure of Classified Military Information to Foreign Governments and International Organizations

¹⁶³⁷ This refers to purchases under the authority of FAR 6.302-3(a)(2)(i). For a discussion of this exception, see Chapter 10, Section 4

¹⁶³⁸ This includes the annual DoD Appropriations Act

¹⁶³⁹ See DFARS 225.872-1(a)

¹⁶⁴⁰ This waiver also has a statutory basis in § 10a 41 U.S.C.; FAR 25.103(a); and 19 U.S.C. §2512(b)(3)

¹⁶⁴¹ DFARS 225.872-1(b)

the agreement.¹⁶⁴² In addition, the waiver does not limit the Secretary of Defense's authority to restrict acquisitions to domestic sources or reject an otherwise acceptable offer from a qualifying country source when considered necessary for national defence reasons.¹⁶⁴³

A full waiver for all signatory RDP would be a necessary equalising measure under reformed RDPs.

4.3.1.5. No Substantive Authorisation to Export Defence Items

Finally, the RDP is not intended to, and does not, create any substantive authority to authorize the export of defence items, including technical data, controlled on the UK Military List or the U.S. Munitions List.¹⁶⁴⁴ Further, any export subject to the UK Export Control Act or U.S. Arms Control Act and the ITAR must be compliant with such Acts and such Regulations.¹⁶⁴⁵ However, as will be discussed in Part III, the U.S. and UK have sought to mitigate the effect of certain export control laws through a recently adopted U.S.-UK defence trade cooperation treaty.

4.4. Procurement Procedures

As indicated, the Annex contains a specific section on "Procurement Procedures". It is recalled from Chapter 3, Section 3.2 that whilst commentators have generally

¹⁶⁴² 41 U.S.C. §10b(2)(a)(1)

¹⁶⁴³ DFARS 225.872-1(c)

¹⁶⁴⁴ Annex I, Section 2.8

¹⁶⁴⁵ *ibid.* For a discussion of ITAR in light of the adoption of the Defence Procurement Directive and ICT Directive, see Chapter 5

assumed the automatic exclusion of the RDPs from compliance with the Defence Procurement Directive under Article 12(a), according to the Guidance Note on defence and security specific exclusions, the wording of Article 12(a) appears to require 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.¹⁶⁴⁶ Therefore, this Section will examine whether the RDPs meet these requirements.

4.4.1. Publication of Contract Notices in a Generally Available Periodical

Annex I provides that each Government will publish or will have published a notice of proposed purchases in a generally available periodical, in accordance with national rules or practices, to the extent practicable.¹⁶⁴⁷ In this regard, the RDPs do not specify available periodicals, leaving a range of possibilities.¹⁶⁴⁸ Further, the RDP does not identify circumstances in which it would not be practicable to publish a notice. Issues relating to information access will be specifically considered below.

4.4.2. Content of Notices

The Annex provides that the notice will contain: the subject matter of the procurement; time limits set for the submission of offers or requests to participate in the bid invitation process and addresses to which offers or requests to participate

¹⁶⁴⁶ Guidance Note, Defence- and security- specific exclusions, 2, point 3, para 2

¹⁶⁴⁷ Annex I, Section 4(4.1)

¹⁶⁴⁸ United States General Accounting Office, International Procurement: NATO Allies' Implementation of Reciprocal Defense Agreements (n 1605) 7

should be sent.¹⁶⁴⁹ However, the Annex does not specify a minimum content of details relating to subject matter or specific time limits for submission.

4.4.3. Content of Invitation to Tender

The Annex also provides that contracting authorities will provide copies of invitations to tender/solicitations for proposed purchases in accordance with national rules or practices.¹⁶⁵⁰ These must contain the following: the nature and quantity of the items supplied; whether the procedure is by sealed bids or negotiation; the criteria on which the award is to be based, such as by lowest bid price or otherwise; any delivery date; the address and closing date for submitting bids as well as the language(s) in which they must be submitted; the address of the contracting authority; any economic and/or technical requirements, financial guarantees and information required from suppliers; and the amount and any terms of any sum payable for tender/solicitation documents.¹⁶⁵¹ Again, however, the RDPs do not identify a set of procurement procedures or specify key requirements such as those relating to qualitative selection or award.

4.4.4. Publication of Invitations to Tender in Adequate Time

The RDP provides that any invitation to tender will be published in “adequate time” to enable interested suppliers to signify their interest and will allow adequate time for

¹⁶⁴⁹ Ibid

¹⁶⁵⁰ Annex I, Section 4(4.2.)

¹⁶⁵¹ Ibid

response consistent with user requirements.¹⁶⁵² However, the RDP does not identify specific time limits in this regard. It is recalled from Chapter 9, Section 3.1 that a particular issue identified for foreign contractors accessing the U.S. market concerned the date of RFP release and the limited time available to prepare and submit a proposal.

4.4.5. Notification of Outcome

With regard to post award considerations, the RDP provides that tenderers/offerors will be promptly notified as to the outcome of the tender/solicitation process.¹⁶⁵³ However, again no time limit for notification is specified.

4.4.6. Reasons for Non-Award

The RDP also provides that, on request, a supplier will be provided with “pertinent information” concerning the reasons why he was not allowed to participate in a procurement or was not awarded a contract.¹⁶⁵⁴ However, the U.S.-UK RDP does not specify a minimum content or type of information to be provided. In the more recent U.S.-Poland RDP, some attempt has been made to strengthen this provision. For instance, in addition to the provision of pertinent information, this RDP provides that:

¹⁶⁵² This is not the only reference to “adequate time” in the RDP. The RDP provides that in meeting their procurement requirements, the Governments will ensure, as far as practicable, that the industries of each country are afforded adequate time to be able to participate in the production and procurement processes. See Annex I, Section 3(3.3.3.)

¹⁶⁵³ Annex I, Section 4(4.4)

¹⁶⁵⁴ Annex I, Section 4(4.5.)

Upon request, the procuring Party shall provide additional information to any unsuccessful offeror dissatisfied with the explanation for rejection of its offer or that may have further questions about the award of the contract. The additional information shall, consistent with the procuring Party's laws, regulations, policies, procedures, and international obligations, include information on the characteristics and the relative advantages of the offer selected.¹⁶⁵⁵

This provision appears to go a step further in its attempt to ensure transparency and, to a lesser extent, accountability in providing the possibility for requests for additional information. Further, provision appears to extend beyond a minimum content of information to include "characteristics" and "relative advantages of the offer". The inference is that this should be equivalent to that provided to domestic contractors on request, subject to any other applicable national laws e.g. relating to disclosure of sensitive data.

This also appears to be further reinforced by a provision in the U.S.-Poland RDP which identifies a requirement to have published procedures for the hearing and review of complaints arising in connection with any phase of the procedure process to ensure "to the greatest extent possible" that complaints "shall be equitably and expeditiously resolved".¹⁶⁵⁶ By contrast, the U.S.-UK RDP merely requires that the

¹⁶⁵⁵ Memorandum of Understanding Between The Government of the United States of America and The Government of the Republic of Poland Concerning Reciprocal Defense Procurement 27 August 2011, Article V(5) <<http://www.acq.osd.mil/dpap/Docs/mou-poland.pdf>> accessed 20 September 2013

¹⁶⁵⁶ Article V(6)

Governments will “maintain” and “exchange pertinent information on these procedures”.¹⁶⁵⁷

4.4.7. Absence of A Distinct Set of Rules Specifically Concerning Award

In light of the above, it is arguable that the RDPs do not satisfy the purported criteria necessary to legitimate exclusion under the Defence Procurement Directive. As U.S. legal commentary has itself observed, the RDPs’ most stringent procedural requirement is a relatively slight list of information required to be included in solicitations.¹⁶⁵⁸ Further, the RDPs simply make reference to procedures under national law. It is important to observe, however, that the Guidance Note which purports to identify “specific procedural rules” as a criterion is not a legally binding interpretation of EU law.

Fundamentally, it is not clear why a Member State even needs to rely on Article 12(a) in order to exclude contracts awarded in accordance with an RDP. The question is: what is the purpose of the exclusion? Generally, the purpose is to provide flexibility in procurements conducted according to a discrete set of procurement rules which are tailored to the specific objectives of the international agreement, or international organisation concerned. However, the RDPs only provide guarantees of non-discrimination and equal treatment in accordance with the laws, policies, regulations and procedures of the purchasing Government. This also includes relevant and applicable European Union regulations. The RDPs do not provide for more favourable treatment to be accorded to U.S. economic operators, nor necessarily

¹⁶⁵⁷ Annex I, Section 4(4.6.)

¹⁶⁵⁸ D B Miller, ‘Is it Time to Reform Reciprocal Defense Procurement Agreements?’ (n 31) 102

provide a substantial means to circumvent the provisions of the Defence Procurement Directive.

The logical result on the Guidance Note's interpretation is that if the international agreement or arrangement does not contain specific procedural rules, the contract must be awarded in accordance with the Directive. However, this does not affect the fact that the U.S. economic operator is provided with the guarantee under the RDP in any event, namely equal treatment in accordance with EU law, because the Directive is without prejudice to a Member State's decision as to whether or not to permit third countries to participate in contract award procedures.

It is suggested that the RDPs need to be revised in order to clarify precisely what function they are intended to serve with regard to non-discrimination and equal treatment in light of the Defence Procurement Directive. The reference to "European Union Regulations" may have referred to the Public Sector Directive (and, possibly, in consideration of WTO GPA obligations under the Directive).¹⁶⁵⁹ However, the Defence Procurement Directive does not expressly regulate third country participation. The RDPs themselves envisage that amendments can be made in order to take account of any such changes.¹⁶⁶⁰ Similarly, as indicated in Chapter 2, Section 3 the wording of Article 12(a) itself also requires clarification.

¹⁶⁵⁹ For a brief discussion in this regard, see Chapter 4, 2.2

¹⁶⁶⁰ For instance, the U.S-UK MoU states the following in the introduction: "The Governments intend the understanding of this MOU to strengthen the North Atlantic Alliance. In so doing, the Governments recognize the efforts of European governmental defense cooperation organizations to enhance collaboration on defense capability programs by more comprehensive and systematic arrangements among the individual member nations. They, therefore, understand that in the event of a possible conflict between understandings entered into between one of these organizations and the USG, and this MOU, the signatories hereto will consult with a view to amending this MOU."

4.5. Reform of Procedural Requirements: Transparency and Accountability

It is recalled that U.S. legal commentary has criticized the RDPs because they do not govern how procurements are to be conducted.¹⁶⁶¹ Whilst not unequivocal, this criticism could refer to the absence of specific rules e.g. identifying discrete procedures for the award of contracts. This gives rise to a question as to whether the RDPs should specify their own procedures. It is submitted that this would never be a viable option, not least because it would raise issues of compatibility with existing procedures and potential duplication. Essentially, the RDPs are not intended to regulate procurement *per se* but are rather focused on guarantees in relation to market access.

4.5.1. Standards of Competition

In light of the above, it is suggested that the RDPs should focus on promoting non-discrimination, equal treatment, transparency and accountability objectives. For instance, it may be possible to better regulate access to competition (e.g. comparable to the function of CICA) which then informs the decision on the choice of appropriate national procedure.¹⁶⁶² This might be achieved, *inter alia*, by setting minimum standards on the publication of reasons justifying the level of competition sought.

¹⁶⁶¹ D B Miller, 'Is it Time to Reform Reciprocal Defense Procurement Agreements?' (n 1594)

¹⁶⁶² For instance, it is recalled that CICA requires full and open competition, full and open competition after the exclusion of sources and other than full and open competition. The exclusions and exceptions require determinations and findings and justifications and approvals. By contrast, the Defence Procurement Directive simply provides that Member States may select the procedure which they seek to use. However, the exercise of this discretion remains substantially unregulated, or at least, unaccountable at the point of selection

4.5.2. Transparency Through Publication

According to one U.S. legal commentator, an important objective of transparency requirements is “informational utility”. In this regard, the current lack of access to procurement information on the part of prospective suppliers has been identified as a specific deficiency under the RDPs.¹⁶⁶³ It is recalled that the RDPs do not make any detailed provision for the content of notices, contents of invitation to tender and do not specify time frames or time limits for publication of tenders. Further, notices must simply be published in a non-specific periodical and only to the extent practicable. Whilst this thesis does not specifically advocate any particular reform proposal, no consideration has been given, for example, to possibilities for a designated “Transatlantic Defence and Security Contract Portal”¹⁶⁶⁴ for government to industry and/or industry to industry procurement for contracts above a certain threshold determined to be of “transatlantic interest”.¹⁶⁶⁵

4.5.3. Limitations on “National Security Exceptions”

Related to the issue of better regulating access to competition, it has been suggested that there should be “limited exceptions for national security concerns”. In particular, it has been observed that achieving the optimal balance between procedural

¹⁶⁶³ See citations at n1267 above

¹⁶⁶⁴ For instance, in 2010, the EU set up a TransAtlantic IPR Portal. The US-EU Intellectual Property Rights Working Group developed the joint portal as a collaborative effort to strengthen IPR protection globally through support for U.S. and European small- and medium-sized enterprises. The United States and the European Union established the IPR Working Group in 2005 and is under the umbrella of the Transatlantic Economic Council (“TEC”). See FAQ, http://ec.europa.eu/enterprise/initiatives/ipr/faq/index_en.htm.

¹⁶⁶⁵ The present author draws on the notion of contracts of “clear cross border interest” as that concept is developing under EU law for the purposes of determining the application of the EU procurement Directives and EU procurement principles

requirements and national security exemptions will be the decisive issue in drafting language for the RDPs.¹⁶⁶⁶

A number of observations have been made in this regard. It has been observed in relation to the application of WTO GPA award procedures and the permissible justifications for limited tendering, that the WTO GPA seems to preclude derogation from non-discrimination commitments for the purpose of pursuing national industrial policies.¹⁶⁶⁷ It has been suggested that strict adherence to this prohibition in the RDPs would be unwise and that to be “politically feasible” and “militarily prudent”, revised RDPs will need to permit defence procurement agencies to limit tendering to domestic firms under certain defined circumstances.¹⁶⁶⁸

It has been stated that determining what circumstances warrant invoking such an exception would be critical.¹⁶⁶⁹ It has been proposed that “emergency” or “short-term military supply necessity” should certainly warrant limited tendering.¹⁶⁷⁰ However, it has also been observed that:

[w]hether and to what extent RDP parties would be willing to expressly permit limiting tendering to domestic suppliers for long-term defense industrial base protection will pose a more difficult task, and this issue will

¹⁶⁶⁶ *ibid*

¹⁶⁶⁷ D B Miller, ‘Is it Time to Reform Reciprocal Defense Procurement Agreements?’ (n 31) citing at fn81 Arrowsmith, *Government Procurement in the WTO* (Kluwer Law International, 2003) (n 77) 344-5

¹⁶⁶⁸ D B Miller, ‘Is it Time to Reform Reciprocal Defense Procurement Agreements?’ (n 31) *ibid*

¹⁶⁶⁹ *ibid* fn82

¹⁶⁷⁰ *Ibid*

be the critical battleground in crafting the language of such an exception.¹⁶⁷¹

It is interesting to observe that a provision in the EDA Code of Conduct on Defence Procurement is cited as an example of a narrow exception. The exception states that participating Member States:

may exceptionally need to proceed with specific procurements without competition, in cases of pressing operational urgency; for follow-on work or supplementary goods and services; or for extraordinary and compelling reasons of national security.¹⁶⁷²

It has been suggested that while the exception will be open to exploitation by RDP parties seeking to skirt their obligations, the memorialization of a strict exception, coupled with provisions requiring justification for its invocation, may discourage would be abusers by raising the reputation cost of non-compliance.¹⁶⁷³ In particular, specific reliance is placed on the notion that Governments raise their “reputational stake” when they commit to international agreements, decreasing, however slightly, the chances of abuse and that because the RDPs operate on the principle of reciprocity, a strictly defined exception will make non-compliant behaviour easier to identify, increasing the exposure of bad faith actors to retaliatory measures by RDP counterparts.¹⁶⁷⁴

¹⁶⁷¹ *ibid* fn83

¹⁶⁷² Miller, *ibid*, fn83 citing the EDA Code of Conduct on Defence Procurement

¹⁶⁷³ *ibid*

¹⁶⁷⁴ *ibid*

It is beyond the intended aims of this thesis to proffer an alternative draft of such an exception. However, it is not clear why such commentary has not similarly drawn on the provisions of the Defence Procurement Directive concerning the circumstances permitting the use of the negotiated procedure without publication.¹⁶⁷⁵ It is recalled from Chapter 10 that whilst still relatively broad, at the very least, by their terms, these provisions are more restricted in their application than certain of the CICA exceptions to full and open competition under U.S. law.

Further, the above proposal rightly separates the issue of whether a defence industrial base ground should even be included from the issue of the form and extent that any such exception could take. It is recalled from Chapter 10, Section 4.1 that it is at least arguable as to whether or not there should be a free-standing industrial mobilization ground and, if so, its precise scope. However, as indicated above, it is further necessary question precisely what purpose the exception should serve.¹⁶⁷⁶ This is quite apart from the fundamental issue as to precisely what interests should legitimately be protected by industrial mobilization. This is necessary in order to avoid industrial mobilization becoming a residual “catch-all category” open to indiscriminate use.

In addition, whilst the above U.S. legal commentary recognizes the corresponding need for justification procedures, no attempt has been made to identify the form and content of such procedures. For example, as became apparent from the analysis undertaken in Chapter 10, it might be possible to include justification and approvals

¹⁶⁷⁵ Article 28

¹⁶⁷⁶ For instance, it is recalled that industrial mobilization can take a number of specific forms. In statutory form, it enables the exclusion of certain sources (but otherwise full and open competition). It also acts as an exception precluding full and open competition. It also serves a discrete function in precluding application of the Buy National waiver in otherwise competitive procurement under the RDPs

procedures as standard and/or notification requirements of use and/or intention to use as a grounds for limiting competition in both the U.S. and EU. It is not clear how a strictly defined exception will make non-compliant behaviour easier to identify in the absence of dedicated reporting, monitoring and review mechanisms which have not been prioritised in the case for reform.

Finally, whilst it is agreed that the “memorialization” of one or more exceptions coupled with provisions requiring justification for its invocation may discourage would-be abusers, it may be questioned whether the so-called “reputational cost” of non-compliance will be sufficient to act as an effective deterrent.¹⁶⁷⁷

Whilst this thesis does not advocate any one specific measure to either reform existing exceptions, stipulate new exceptions or otherwise improve transparency and accountability requirements pertaining to their use, the above provides a basis for thinking more critically about whether it is possible to develop common definitions of the exceptions, justifications, approvals, notification requirements and reporting mechanisms.

4.6. Review and Dispute Settlement

It is recalled that the recent U.S.-Poland RDP attempts to provide a more formal commitment to transparency in the provision of post-award information. However, a

¹⁶⁷⁷ Whilst it is recognized that “naming and shaming” can be a useful tool within procurement communities, the experience of the voluntary EDA regime discussed in Chapter 7 indicates that absent adequate enforcement, the institution of specific provisions alone is unlikely to deter non-compliance

more fundamental issue concerns the absence of the provision of a review mechanism. The U.S.-UK RDP provides as follows:

Any difference of view regarding the interpretation or application of the MoU will be resolved by consultation between the two Governments and will not be referred to a national or international tribunal or third party for settlement.¹⁶⁷⁸

It is necessary to consider review procedures in more detail.

4.6.1. Consultation

It is observed that “consultation” is not defined. An important question is whether consultation is an adequate and effective means of redress. For instance, U.S. legal commentary has specifically identified the provision of informal consultation (as opposed to a reference to a specific bid protest forum) as a limitation of the RDPs.¹⁶⁷⁹ More formal protest fora aside, in light of the emphasis placed in the U.S.-Poland RDP on “equitable” and “expeditious” resolution, it is suggested that greater consideration could be given, in the first instance, to whether existing consultation mechanisms could be improved.¹⁶⁸⁰ In any event, it is possible to suggest that, signatories, in fact, currently exceed this level of provision through a designated national Ombudsman.

¹⁶⁷⁸ Section 6(6.4.)

¹⁶⁷⁹ Developments, ‘Transatlantic Procurement Outlook is Mixed, Panelists Say’ (n 1596), Statement of C R Yukins at 2

¹⁶⁸⁰ This would depend on a host of factors. For instance, there may be issues regarding disclosure, anonymity etc which may militate against any possibility of a formal consultation mechanism which could, for example, require the production of written records and statements identifying the basis for any grievance and any resolution procedure adopted

4.6.2. Ombudsman

According to the U.S. DPAP, if a foreign company does not fully understand contracting rules and regulations or considers that it was unfairly excluded from defence procurement, it may contact the DoD Ombudsman.¹⁶⁸¹ Similar Ombudsmen exist in EU Member States.¹⁶⁸²

In 1991 the DoD designated a senior level acquisition official to serve as an Ombudsman to deal with issues raised by foreign governments relating to the RDPs.¹⁶⁸³ At the time, the DoD encouraged other RDP signatories to adopt similar procedures. However, according to a contemporary 1992 GAO Report, certain officials stated that an Ombudsman was unnecessary.¹⁶⁸⁴ Further U.S. defence industry representatives questioned the need for an Ombudsman for large U.S. defence firms but that smaller U.S. firms seeking business in Europe might benefit from such provision.¹⁶⁸⁵ The GAO Report also expressly recommended their continued use.¹⁶⁸⁶ However, there is substantially no information relating to the functions and processes of national Ombudsman in this field. It is clear that they do

¹⁶⁸¹ For more information, see DPAP, DoD Ombudsman, <http://www.acq.osd.mil/dpap/cpic/ic/dod_ombudsman.html> accessed 20 September. The website does not provide any related information or guidance in relation to the conduct of the DoD Ombudsman's functions

¹⁶⁸² See for example the Delegation Generale Pour L'Armement <<http://www.defense.gouv.fr/dga/>> accessed 20 September 2013

¹⁶⁸³ National Defense Authorization Act for Fiscal Year 1991 Public Law 101-510; 104 Stat. 1693

¹⁶⁸⁴ United States General Accounting Office, International Procurement: NATO Allies' Implementation of Reciprocal Defense Agreements (1605) 11

¹⁶⁸⁵ *ibid*

¹⁶⁸⁶ *ibid*

not function in the same way as an Ombudsman would ordinarily function (i.e. as a point of redress which may be exhausted before recourse to judicial review).¹⁶⁸⁷

Notwithstanding, again, it is possible to consider ways in which national Ombudsman procedures could be improved as an alternative to more substantial forms of redress. At the very least, there should be greater transparency with regard to the role and extent of the Ombudsman's function.

4.6.3. National and International Tribunals

The express exclusion of recourse to international tribunals and third party dispute settlement is understandable, in particular, in light of the possibility for questions to arise regarding the subjection of the State to jurisdiction.¹⁶⁸⁸ Such mechanisms are likely more suitable for use in disputes between private contractors.

However, it is not clear whether "tribunal" includes a court. It is submitted that the above provision in its current form does not necessarily preclude determinations being made in judicial proceedings which implicate references to the RDPs.¹⁶⁸⁹

¹⁶⁸⁷ A number of factors may preclude recourse to such Ombudsman. For instance, foreign contractors may not be well accustomed to such procedures. Further, it may not be clear to contractors what potential benefit is to be derived by contacting an Ombudsman. In addition, for large defence firms, an Ombudsman is unlikely to be perceived as an effective means of redress for high value, complex procurements which necessitate the expenditure of significant resources and expertise in detailed review as well as the availability of remedies. Importantly, contractors may also be reluctant to complain in light of the potential for disclosure of the complaint to prejudice their chances of future awards

¹⁶⁸⁸ On the relevance of international arbitration in procurement generally, see M Audit, *Contrats Publics et Arbitrage International* (Bruylant 2011)

¹⁶⁸⁹ It is recalled from Chapter 4, Section 3.1.1 that the UK refers to the possibility of procurers being subject to implied contractual obligations to consider a tender fairly when it considers a tender from a third country. If litigated, it is conceivable that U.S. contractors could argue that they should receive equal treatment in accordance with the Directive and which is reinforced by the guarantee provided under the RDPs

As indicated above with regard to the use of the Ombudsman, in the early 1990s it was observed that EU and U.S. firms rarely used European contract grievance procedures.¹⁶⁹⁰

4.7. Reform of Review and Remedies

In addition to improvements in transparency requirements, one eminent U.S. legal commentator has also identified that if U.S. vendors fear discrimination under the Defence Procurement Directive, they may press for broader remedies under the RDPs.¹⁶⁹¹ More specifically, it has been suggested that one of the interesting questions would be whether or not the RDPs could “cross-reference” the bid-protest fora that are allowed under the GPA or Defence Procurement Directive.¹⁶⁹²

It is beyond the scope of this thesis to propose a model for dispute settlement of transatlantic defence procurement issues. Nevertheless, it is possible to identify a number of core issues in consideration of any such proposal. Firstly, the WTO GPA presently excludes defence procurement from its scope. In any event, as the same U.S. legal commentator has identified elsewhere, one of the structural issues that U.S. policy makers face in seeking to improve the effectiveness of the WTO GPA (as well as other trade agreements) concerns its enforceability in U.S. bid protest forums, in particular the GAO.¹⁶⁹³ An unresolved issue is whether, as a practical matter, foreign contractors will be able to enforce their rights under the various free trade

¹⁶⁹⁰ GAO, International Procurement: NATO Allies' Implementation of Reciprocal Defense Agreements (n 1605)

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¹⁶⁹¹ C Yukins, 'The European Defence Procurement Directive: An American Perspective' (n 311) 5

¹⁶⁹² Developments, 'Transatlantic Procurement Outlook is Mixed, Panelists Say' (n 1596), Statement of C R Yukins at 2

¹⁶⁹³ Yukins and Schooner, 'Incrementalism: Eroding the Impediments to A Global Procurement Market' (n 29) 18

agreements to trade in the U.S. procurement market without suffering discrimination. The same is arguably the case with regard to foreign contractors in the courts of EU Member States.

Secondly, the Defence Procurement Directive only refers to the fact that Member States determine whether or not to permit third countries to participate in contract award procedures. The Directive is silent on the issue of any corresponding provision of review and remedies. Further, the Directive's review procedures do not apply to contracts excluded pursuant to Articles 12 and 13.¹⁶⁹⁴

Thirdly, such provisions are only useful if foreign contractors are inclined to seek forms of administrative and judicial review in practice, something which, as indicated above, is not certain.

Whilst the above has emphasised legal redress, it is possible to consider whether alternative forms of redress could be suitable. For instance, dispute settlement procedures exist under the North American Free Trade Agreement ("NAFTA").¹⁶⁹⁵ Further, NATO has specific competition advocates which provide informal avenues for appeals and settlement of disputes without recourse to litigation.¹⁶⁹⁶ Recently, the European Space Agency ("ESA") has created a Procurement Review Board with specific competences to review contract awards as well as award limited remedies by way of damages.¹⁶⁹⁷ This thesis does not necessarily advocate the adoption of

¹⁶⁹⁴ Article 55 (1)

¹⁶⁹⁵ For details, see <http://www.naftanow.org/dispute/default_en.asp> accessed 20 September 2013

¹⁶⁹⁶ For instance, see: <<http://www.nspa.nato.int/en/organization/procurement/competition.htm>> accessed 20 September 2013

¹⁶⁹⁷ I am grateful to Professor Martin Trybus for this observation

independently appointed “transatlantic competition advocates”, “transatlantic defence trade Ombudsman” or a “Transatlantic Defence Procurement Review Board”. Nevertheless, alternative means of redress ought to be given due consideration in any future research agenda in addition to the “cross-referencing” of existing bid protest for a as currently proposed.

4.8. Effect of the Reciprocal Defence Procurement MoU’s in Practice

As one U.S. legal commentator observes, the practical effect of the RDPs is difficult to determine.¹⁶⁹⁸ This is historically due, in part, to the fact that for many years information relating to waivers of the BAA was unavailable.¹⁶⁹⁹ As will be discussed below, there now exists some statistical data on use of the waivers. However, it is also important to emphasise that whilst the BAA waiver is a significant feature of the RDPs, it should not be the exclusive focus in determining its effect.

4.8.1. Waivers of The Buy American Act

According to the 2012 Report to Congress on purchases from foreign entities in FY 2011, 2,645 waivers were granted to Qualifying Countries totalling \$1.1 billion dollars.¹⁷⁰⁰ This represented 9.1% of the total \$12.4 billion in DoD purchases from foreign entities that were not subject to the BAA.¹⁷⁰¹ To this extent, the waiver is a substantially effective provision. Whilst acquisition officials have identified that

¹⁶⁹⁸ D B Miller, ‘Is it Time to Reform Reciprocal Defense Procurement Agreements?’ (n 31) 98

¹⁶⁹⁹ *ibid*

¹⁷⁰⁰ Report to Congress on Department of Defense Fiscal Year 2011 Purchases From Foreign Entities, Under Secretary of Defense for Acquisition, Technology and Logistics (n 1175) 1 (source FPDS-NG)

¹⁷⁰¹ *ibid*

obtaining approval for a waiver can cause delays, the waiver generally allows foreign goods to compete with U.S. goods on a “reasonably competitive basis”.¹⁷⁰²

4.8.2. General(ised) Trends

Notwithstanding the above, whilst the RDPs were the subject of focus by the GAO in the early 1990s, there has been substantially no official analysis of the functioning of the RDPs in recent years. In 1991, the GAO reported that in light of DoD estimates of a “significant decline” in the U.S. defence trade advantage with its European allies, government and industry observers began to question the “continued usefulness” of the RDPs.¹⁷⁰³ A 1992 GAO Report indicated that, from a European perspective, according to the views of some States, the RDPs had helped to achieve more balance in defence trade.¹⁷⁰⁴ However, it also identified that most countries said that despite the RDPs, their contractors had limited access to the U.S. defence market citing “numerous legislative and regulatory restrictions”, in particular, identifying the fact that the RDPs did not waive speciality metals restrictions, set asides for small businesses and national mobilization restrictions which were otherwise applicable.¹⁷⁰⁵ This continues to be asserted in the EU U.S. Barriers to Trade Reports.¹⁷⁰⁶ By contrast, from a U.S. perspective, it was identified that the RDPs were probably less advantageous to the U.S. but that it was not possible to quantify the extent to which the RDPs have enabled access of U.S. contractors to the

¹⁷⁰² J S Smyth, ‘The Impact of the Buy American Act on Program Managers’ (n 1544) 269-271

¹⁷⁰³ United States General Accounting Office, European Initiatives: Implications for U.S. Defense Trade and Cooperation (n 60) 2-3

¹⁷⁰⁴ United States General Accounting Office, International Procurement: NATO Allies’ Implementation of Reciprocal Defense Agreements (n 1605) 3

¹⁷⁰⁵ *ibid* 4

¹⁷⁰⁶ United States Barriers To Trade and Investment Report for 2008 (European Commission) July 2009, 16 <http://trade.ec.europa.eu/doclib/docs/2009/july/tradoc_144160.pdf> accessed 20 September 2013

European defence market.¹⁷⁰⁷

To this extent, a recurrent theme which has emerged since the 1990s is a general failure on the part of the signatories to develop on the initial implementing Annexes and to monitor the potential for the RDPs to extend beyond waivers of the BAA.

5. Conclusions

This Chapter has sought to reinforce the analysis in Chapter 7 by highlighting the significance of offsets as a priority issue for transatlantic focus. Importantly, consistent with the underlying philosophy of this thesis, U.S. legal commentary has observed the importance of studying regulatory behaviour and practice before proposing extensive reform through the use, *inter alia*, of legal institutions such as treaties. In the short-to-medium term, it may be possible to consider proposals for an instrument such as an MoU which could, at the least, bring U.S. and EU offsets onto a transparent transatlantic agenda. Whilst such an instrument would inevitably lack the degree of specificity and enforceability that could otherwise be accorded through an international treaty, such a proposal could become a feasible interim measure.

This Chapter has also identified the importance which has been attributed to the RDPs in light of the adoption of the Defence Procurement Directive. As indicated, the RDPs serve an important function in one particular respect, namely providing authorization for a BAA waiver. However, a cursory analysis identified significant limitations of the provisions. Whilst U.S. legal commentators have made reference to

¹⁷⁰⁷ United States General Accounting Office, International Procurement: NATO Allies' Implementation of Reciprocal Defense Agreements (n 1605) 4-5

strengthening procedural and remedial provision under the RDPs, such commentary has not explicitly identified whether the RDPs should continue to operate as such or whether they should be replaced by trade agreements or other arrangements which confer rights that are legally enforceable under national law. At the very least, the above analysis has exposed the extent to which legal discourse increasingly draws on the relevance of legal processes and institutions (e.g. transparency requirements and remedial provision by reference to existing procurement regimes) in positing cases for reform of transatlantic defence procurement.

This Chapter concludes the analysis of U.S. federal defence procurement law.

PART III

CABLES AND BRIDGES ACROSS THE ATLANTIC

Conclusions

1. Introduction

In accordance with the aims, objectives and research questions identified in Chapter 1, this thesis has subjected the core legal regimes which regulate defence procurement in the European Union and the United States of America to critical analysis. This final Chapter draws the threads of analysis together in order to extrapolate key areas of short-term, mid-term and long-term priority focus for the purposes of examining the existing and potential role of legal institutions in the regulation of transatlantic defence procurement.

It is recalled that a major U.S. study relied on the figurative depiction of “fortresses” and “icebergs” to depict transatlantic defence trade dynamics. This Chapter adopts its own depiction of “cables” and “bridges”. On August 16, 1858, the first transatlantic telegraph cable transmitted a communication from Her Majesty Queen Victoria to U.S. President James Buchannan.¹⁷⁰⁸ President Buchanan’s statement that the communication should serve as an instrument destined to diffuse law and that its communications shall be held sacred in passing to their places of destination (with a question as to such possibility even in the event of hostilities) is apposite in the

¹⁷⁰⁸ For a useful history, see J S Gordon, *A Thread Across the Ocean: The Heroic Story of the Transatlantic Cable* (Harper Perennial 2003); see also C G Hearn, *Circuits in the Sea: The Men, the Ships, and the Atlantic Cable* (Westport, Conn: Praeger 2004)

context of a discussion of transatlantic defence procurement where issues of trust and security are at the core transatlantic relation.

In this instance, cables are lines of communication that should be opened between lawyers and the acquisition communities in the EU and U.S. on defence procurement issues. Through an informed dialogue, these messages can be relayed to legislators and policy-makers tasked with ensuring that the foundations of the EU and U.S. legal regimes are capable of bearing the changes in regulatory and competitive dynamics that are likely to result from increased defence trade legislation. In turn, this will provide the bases on which to assess the possibilities for building bridges across the Atlantic in the form of more coordinated transatlantic regulation. For ease of reference, an Annex is appended to the thesis which provides a breakdown of short-term, medium-term and long-term research agendas which correspond with a progressive assessment of the existing legal position towards a basis for reform.

In considering the research findings set out below, it is worth bearing in mind, as a frame of reference, three key elements identified by one eminent U.S. legal commentator as necessary for successful transatlantic defence cooperation. These are: (1) a mature system of procurement rules on open competition and transparency; (2) an assurance of non-discrimination against foreign contractors and (3) a bid protest or remedy forum.¹⁷⁰⁹

¹⁷⁰⁹ 'Transatlantic Procurement Outlook is Mixed, Panelists Say', Recorded Comments of C R Yukins (n 1596) Statement of C R Yukins, 2

2. Cables: Priority Focus in the Short-Term

2.1. Role of Security and Other Exceptions in Transatlantic Defence Procurement

Chapter 2 identified Article 346 TFEU as the archetypal example of the extent to which security exceptions can condition regulatory approaches to defence procurement. The EU institutions have sought to limit the theoretical and practical scope of Article 346 TFEU through a limited interpretation and the adoption of a Defence Procurement Directive defined by reference to its terms. This has been achieved, primarily, through the portrayal (by the Commission and EU legal commentators) of a consistent body of case law confirming the *fact* that the legitimate scope of Article 346 TFEU is limited. On this basis, there have been calls for a “new” interpretation of Article 346 TFEU and the “europeanisation” of essential security interests. However, Chapter 2 also identified that this has precluded an enquiry which focuses more precisely on what the legitimate scope of Article 346 TFEU actually is. A reorientation of the analysis in this regard challenges reified conceptions of the perceived *accepted* and *acceptable* role of Article 346 TFEU. A broader analysis questioned whether a Member State could invoke Article 346 TFEU where third country considerations are implicated. Such analysis is necessitated by the need to discern whether Article 346 TFEU could continue to have a legitimate role in transatlantic defence procurement even if its role has been limited in the field of European defence procurement. This imperative is confirmed, for example, by the fact that NIAG has recommended the need for “legally acceptable interpretations”.¹⁷¹⁰

To this extent, a key finding of the Chapter is a need to fundamentally assess the

¹⁷¹⁰ NATO NIAG High Level Advice Study No 154, Developments in Europe to Reform Export Control and Defense Procurement Processes and Implications and Opportunities Resulting, Particularly with Regard to Multinational Programs Supporting NATO Capabilities and Interoperability’ (n 60)

conceptual bases of security exceptions as well as the extent to which those exceptions are culturally determined by the “structural biases”¹⁷¹¹ of interested actors involved in their interpretation. Future research should focus on the question of precisely what legitimate role broadly defined security (and other) exceptions do and should have in transatlantic defence trade.

2.2. Compatibility of International Obligations in Transatlantic Defence Procurement

Chapter 3 examined the Defence Procurement Directive’s provisions on excluded contracts. At a general level of analysis, it was emphasized that the Directive’s scope is limited in significant respects. Articles 12 and 13 intend to exclude the most institutionally, organizationally, politically and economically complex forms of procurement. However, at a more critical level of analysis, the exclusions reveal considerable legal uncertainty. The exclusions are broad and non-specific. The legal bases for exclusion are not entirely clear. Yet, legal certainty is necessary for Member States and the U.S. to ensure the legitimate exercise of procurement competences whilst maintaining full compliance with their international obligations. As indicated, at present, the Defence Procurement Directive does not provide an adequate mechanism to police the boundary between legitimate and illegitimate exclusion. A more fundamental observation is that those same forms of procurement are likely to continue to operate in circumstances which are either unregulated, subject to regulation that is not generally understood or enforced or which is misapplied, or ignored. Future research should focus on precisely how, and to what extent, Member States will utilize the exceptions as well as their corresponding and

¹⁷¹¹ The author loosely appropriates a term used in M Koskeniemmi, *From Apology to Utopia: The Structure of International Legal Argument* (Cambridge 2006) Epilogue

relative effect on intra-EU and third country procurement relations in the fields of excluded activity.

2.3. Third Country Relations in the Field of EU Defence Procurement

As indicated in Chapter 4, the EU has largely superseded Member States with regard to third country relations in the field of public procurement. By contrast, there is substantially no detailed research on access and treatment of third countries in the EU procurement market. Whilst the Defence Procurement Directive attempts to maintain a position of ostensible neutrality with regard to third countries, it is difficult to discern the potential effect of the Directive on the national regulatory and policy approaches of Member States. Although the thesis' findings were necessarily limited, it identified the possibility for considerable variability in national approaches to affect internal and external trade. Importantly, the Chapter also raised a more fundamental question regarding the extent to which the EU is likely to be able to continue to refrain from adopting a position with regard to third country access in the field of defence procurement. This forces difficult questions which strike at the heart of the appropriate and necessary division of Member State and EU competences. The thesis emphasized that third country relations in the field of defence procurement should be accorded concurrent priority in line with the focus that will inevitably be placed on the internal operation of the Directive. Given the fact that it is only now that EU third country initiatives are starting to develop in the field of public procurement, the EU should similarly focus at the outset on the third country dimension of defence procurement. Future research should focus on examining the *overall* coherence of EU public and defence procurement law with regard to third country relations, in

particular, based on an informed understanding of the legal position at the national level.

2.4. Discrimination and Discriminating under the Defence Directives

Chapters 5 and 6 examined the Defence Procurement Directive's provisions on security of supply and technical specifications. It must be acknowledged and emphasised that U.S. commentators are cautious to observe that the Defence Procurement Directive is not intended to discriminate against the U.S. and could produce positive effects (howsoever qualified and quantified). Notwithstanding, U.S. claims must be taken seriously. Fundamentally, the Defence Procurement Directive is not an instrument of transatlantic defence procurement liberalization. By definition and nature, its principal objective is to promote EU-wide competition in the first instance. Importantly, the Directive *itself* contains few references to third countries. Notwithstanding, the Chapter treated U.S. claims with regard to ITAR with the necessary level of credibility. However, it also sought to differentiate between possible interpretations of generally worded provisions and their potential effect in practice. The Directive legitimately distinguishes between discriminating and discriminatory factors. The assessment of ITAR *prima facie* falls under the former. Future research should focus on the extent to which the Defence Procurement Directive's provisions are applied in consideration of matters pertaining to third countries.¹⁷¹² As indicated, the manner in which the Guidance Notes attempt to distinguish EU economic operators from third countries is, at points, overly simplistic

¹⁷¹² This should be tied to the broader considerations outlined above in relation to Chapter 4

and perhaps reflects a deeper level of uncertainty regarding the EU's position with regard to third country involvement under the Directive.

2.5. Relevance of EU Governance to Transatlantic Defence Procurement: Offsets

If the preceding Chapters were unable to convince observers that the overall coherence of the EU defence procurement regime is not simply a matter for internal EU debate, Chapter 7 should confirm its importance as a matter of transatlantic concern. A casualty of the co-existence of supranational and intergovernmental defence procurement competences is the practice of offsets. The thesis has identified a number of instances of legal and practical uncertainty in the EU and U.S. which must be addressed. These issues are rendered even more acute in light of the close relation of offsets to government-to-government sales. Future research should seek to subject offsets (including related "compensation practices") to critical legal description and to test their compatibility with the full corpus of EU and international trade law. In addition, research should focus on the legalities of offset administration. A fundamental question concerns whether to legally prohibit offsets altogether, *prima facie* prohibit offsets without expressly regulating them but allow for their justification in exceptional circumstances, or permit offsets but regulate them with a view to progressively reducing and/or eliminating them.

2.6. Limits of Legal Institutions (and effects) and the Use of Discretions

Chapter 9 examined the extent to which national law in the U.S. enabled, restricted and precluded foreign participation in U.S. contracts as well as treatment once

admitted. The fundamental limitations of the analysis were immediately apparent. The Chapter drew on the limited available empirical evidence to examine certain ways in which it may be possible to discriminate against foreign contractors. As it was pointedly observed, it is not necessarily regulatory regimes which constitute the most significant impediment to transatlantic defence trade but rather the discretionary practices legitimated by procurement cultures. Whilst the research findings were limited, the analysis sought to draw on comparable means by which the Defence Procurement Directive seeks to address the kinds of issues identified, although it has been cautious to respect the theoretical and practical limitations of the comparative endeavour. At the least, questions arise as to whether it is possible to better regulate the exercise of discretions. In addition, a brief analysis of a major U.S. award revealed an alternative perspective on the difficulties faced by contracting officials concerned to ensure participation of foreign contractors. The Chapter also brought into focus a neglected area of research, namely access to and treatment of foreign contractors under national review systems.

Future research should focus on the ways in which legal requirements may be formulated so as to facilitate discrimination against U.S. and EU contractors e.g. through the drafting of requests for proposals in terms of specifications and other requirements.¹⁷¹³ Most importantly, as indicated in Chapter 10, this requires a fundamental re-assessment of the continued necessity for broadly worded provisions

¹⁷¹³ Although, it is accepted that this may be extremely difficult as a matter of practicality in light of the sensitive nature of defence contracting, the limited disclosure of documentation and the general reluctance to volunteer information on procurement practices

conferring significant discretions and whether these could be subject to greater accountability and transparency mechanisms.¹⁷¹⁴

2.7. Effects of Non-Competitive Contracting

Finally, Chapter 10 identified clear limitations of available legal commentary and empirical evidence on the issue of non-competitive contracting. On the one hand, sole source contracting is patently more defensible than blanket recourse to national security or industrial mobilization grounds if contracting authorities are tied up with proprietary data issues and a limited supply base. On the other hand, issues such as data retention and framework contracting (even if pursued on grounds of perceived economic efficiency) should not result in the comfort of recourse to a limited supply base. A limited national supply base in turn limits the global supply base at lower tiers. To this extent, open national competition in the U.S. is as much a transatlantic defence procurement objective as open access to foreign competition. Future research should focus on the broader effects of such practices beyond the national supply base.

3. Foot-Bridges: A Priority Focus in the Medium-Term

Whilst defence procurement is substantially excluded from the framework of international treaties, it is possible to discern a nascent state of *legalization* of

¹⁷¹⁴ For instance, to date, there has been little focus on the fact that exceptions such as Article 346 TFEU and the exceptions under the Defence Procurement Directive are not subject to any substantial form of detailed invocation or notification requirements in contrast to U.S. law which provides a system of determinations and findings and justifications and approvals.

transatlantic defence trade.¹⁷¹⁵ The 1979 Klepsch Report enhanced awareness of transatlantic defence procurement issues.¹⁷¹⁶ However, consideration of transatlantic defence trade as a legally regulated system(s) was confirmed in 1989 when William Taft, then U.S. Permanent Secretary to NATO¹⁷¹⁷ proposed a system modelled on the General Agreement on Tarrifs and Trade (“GATT”) to promote fair trade practices in defence trade.¹⁷¹⁸ The initiatives were never developed but the relevance of the possibilities for considering the use of legal institutions to regulate defence procurement on a transatlantic (as opposed to bilateral) basis are in the midst of resurgence. As indicated in this thesis, U.S. legal commentary has identified the possibility for reform of the RDPs by reference to, if not incorporation of, legal standards.

Further, in 2007, the U.S. and UK concluded a specific Defence Trade Cooperation Treaty (“DTCT”).¹⁷¹⁹ The Treaty only applies between the U.S. and U.K. which, for the purposes of the DTCT, constitute the “Approved Community”.¹⁷²⁰ The Treaty is intended to provide a comprehensive framework for “exports”¹⁷²¹ and “transfers”¹⁷²²

¹⁷¹⁵ By this term it is not mean that previously illegal forms of behaviour are legalized. Rather, the term connotes the sense of the increasing use and/or proposed use of legal institutions to regulate aspects of transatlantic defence trade

¹⁷¹⁶ E A Klepsch and T Normanton, Two-way Street – Klepsch Report: Europe-United States Arms Procurement (1979 Brassey’s London)

¹⁷¹⁷ And lest it be forgot, former U.S. Undersecretary of Defense

¹⁷¹⁸ For a useful overview in this regard, see J B Steinberg, ‘The Transformation of the European Defense Industry: Emerging Trends and Prospects for Future U.S.-European Competition and Collaboration, Prepared for the Under Secretary of Defense for Acquisition, RAND, 1992, 109-110

¹⁷¹⁹ Treaty between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America concerning defence trade cooperation: London and Washington, 21 and 26 June 2007, Cm 7213, September 2007. The DDTC was specifically implemented by the Security Cooperation Act of 2010 Pub. L. 111-266, Oct 8, 2010. The requirements under the Act were further implemented by the DFARS Subpart 225.79 – Export Control (added May 22, 2012)

¹⁷²⁰ Article 1(10). See also Articles 1(11) and 1(12). Article 4 defines the “United Kingdom Community”. Article 5 defines the “United States Community”. See also DFARS 225.7902-1, 225.7902-5(b) and 252.225-7047(a)

¹⁷²¹ Article 1(2) defines “Export” as: “the initial movement of Defense Articles from the United States Community to the United Kingdom Community.” See also DFARS 225.7902-1, 225.7902-5(b) and 252.225-7047(a)

¹⁷²² Article 1(9) defines “transfer” as: “the movement of previously Exported Defense Articles within the Approved Community”. See also DFARS 225.7902-1, 225.7902-5(b) and 252.225-7047(a)

of “defence articles”¹⁷²³ (whether classified or not) without a licence or other written authorization.¹⁷²⁴ Under the Treaty, instead of a U.S. exporter preparing and requesting Department of State approval of an export licence or other written authorization for a project, the exporter may export defence articles within the scope of the Treaty without such prior licences or written authorizations.¹⁷²⁵ Similarly, all defence articles exported pursuant to the Treaty may be transferred without prior written authorization of the U.S. Government.¹⁷²⁶ It is recalled that in 2009 the EU commissioned a study on *The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries*.¹⁷²⁷ The Study made one particular recommendation which has subsequently received specific endorsement by a 2011 NIAG Report.¹⁷²⁸ Specifically, it has been recommended that the DTCT licensing model should be used as a basis for the development of a “transatlantic general licence”. Whilst it is beyond the scope of this thesis to examine licensing regulation, in light of the analysis engaged in Chapter 5, there is a close relation between the fields of procurement and licensing and which is, itself, exemplified by the contemporaneous adoption of the Defence Procurement and ICT Directives. To this extent, there is a possibility for considering whether such initiatives could be developed in the field of defence procurement.

¹⁷²³ Article 1(1) defines “Defence Articles” as: “articles, services, and related technical data, including software, in tangible or intangible form, listed on the United States Munitions List of the International Traffic in Arms Regulations, as modified or amended.” See also DFARS 225.7902-1, 225.7902-5(b) and 252.225-7047(a)

¹⁷²⁴ Article 2 U.S.-UK DTCT

¹⁷²⁵ Article 6(1). In order to do so, the exporter must verify that: (i) the U.K. partner is on the list of approved companies/facilities i.e. a member of the Approved Community; (ii) the effort is in support of at least one of the 4 purposes indicated above; (iii) the defence article is not on the exempted technology list. Also in 22 CFR 126 Supplement No.1

¹⁷²⁶ Article 7(1)

¹⁷²⁷ ‘The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries’, Final Report, December 2009 (n 662), 4-5 and 89-98

¹⁷²⁸ “SMART DEFENCE, SMART TADIC”, 14 October 2011, North Atlantic Treaty Organisation and NATO Industrial Advisory Group High Level Advice Study No 154, Developments in Europe to Reform Export Control and Defense Procurement Processes and Implications and Opportunities Resulting, Particularly with Regard to Multinational Programs Supporting NATO Capabilities and Interoperability

These developments should also be considered within the broader context of current debates concerning whether or not to bring defence procurement within the scope of regimes such as the WTO GPA¹⁷²⁹ and UNCITRAL.¹⁷³⁰ The extent of any privileged transatlantic legal relations between the U.S. and EU in this regard would need to be factored into account.

3.1. Reciprocal Defence Procurement Memoranda of Understanding

As indicated in Chapter 11, Sections 4.5 and 4.7, U.S. legal commentary has proposed reform of the RDPs. However, such commentary has also identified the limits of offering specific numerical estimates of the economic benefits to be expected from the suggested changes.¹⁷³¹ Notwithstanding, it has been suggested that assuming the effectiveness of transparency provisions in reducing trade barriers, RDP signatories are likely to benefit from at least some reduction in defense costs.¹⁷³² In addition, it has been observed that the more detailed a trade agreement,

¹⁷²⁹ See for example, C Yukins, 'Barriers to International Trade in Procurement After the Economic Crisis, Part II: Opening International Procurement Markets: Unfinished Business' (n 459) Int'l 2-22. Whilst it has been suggested that the WTO GPA is not yet a ready means of achieving such uniformity, it has been suggested that it could be pointed in such a direction. In this regard, three specific developments have been identified. The first is the fact that, as recalled from Chapter 8, since 1984, the U.S. has had a unified civilian-defense procurement regime under the FAR. Secondly, it has been suggested that the adoption within the EU of the Defence Procurement Directive, in particular, has bolstered this trend. Thirdly, in 2010, the Working Group developing the revised UNCITRAL model procurement law has recommended a revised UNCITRAL model procurement law that would merge defence and civilian procurement, in particular, because developing nations saw unification as a means of reducing corruption in weaker defence procurement systems. *ibid*

¹⁷³⁰ See for example, Report of the United Nations Commission on International Trade Law, Forty-second session (29 June-17 July 2009), General Assembly, Official Records, Sixty-fourth session, Supplement No.17 <<https://cms.unov.org/.../GetDocInOriginalFormat.drxx?DocID...7d85>> accessed 20 September 2013. It is beyond the scope of this thesis to examine the UNCITRAL proposals in full. Suffice to state that there are a number of interesting proposals, one of which is to provide examples of situations intended to be covered by the notion of "essential national security". See 21-12 *ibid*

¹⁷³¹ It has been stated that given the complexity of modeling international trade flows, predicting, and measuring the behavioral effects of transparency requirements, it is doubtful that such estimates could be reliably made. See D B Miller, 'Is it Time to Reform Reciprocal Defense Procurement Agreements?' (n 31)

¹⁷³² *Ibid*

the less costly it is to monitor.¹⁷³³ An important question that will need to be confronted is precisely what is the continued function of the RDPs and is their function most effectively served in their current form?

3.2. Other Discrete Issues - Offsets

In addition to the issue of market access and treatment in defence procurement, as indicated in this thesis and particularised by way of illustration in the Annex, there are a range of other priority areas in the medium term. One significant issue concerns the question of U.S. export control reform, in particular, in relation to ITAR. In the medium term, this is likely to involve reform at the national level. Other possible alternatives may include the consideration of an MoU on offsets (and other possible counter-trade practices) and abatements. As indicated in Chapter 7, the EDA has identified the possibility for engagement with the U.S. on these issues. A specific “Transatlantic Offset and Countertrade Treaty” is an unlikely medium term prospect.

4. Suspension-Bridges: A Priority Focus in the Long-Term

In the long term, a fundamental issue concerns the continuing basis of engagement of the U.S. and Europe on defence procurement issues. Much will depend on whether the EU will develop a sufficiently robust defence identity such as to leverage its defence policy into the field of defence trade and convince Member States that it should exercise greater competences in the field of defence procurement. Further, much will also depend on any U.S. reorientation of its trade in defence strategies

¹⁷³³ Miller citing J Linarelli, ‘The WTO Transparency Agenda: Law, Economics and International Relations Theory’, in S Arrowsmith and M Trybus (eds.), *Public Procurement: The Continuing Revolution* (Kluwer Law International 2003) 57-60

away from Europe and towards other States. Both positions will also ultimately be influenced by the rate, and development, of emerging economies, in particular those with developing defence capabilities.

Whilst this thesis has advocated restraint against proposing grand designs for transatlantic legal institutions, it is possible to conceive of long term initiatives. Certain of these are particularised by way of illustration in the Annex and which may build on issues addressed as short and medium term priorities. These include: a Transatlantic Defence Procurement Treaty; a Transatlantic Defence Trade Cooperation Treaty; a Transatlantic Trade Treaty on Government Defence Sales, Offsets and Countertrade; a Transatlantic Defence Procurement Ombudsman or Review Board and a Transatlantic Defence Contract Portal.

Having provided the most rudimentary cartography of EU and U.S. defence procurement law, this thesis concludes with a final observation. The transatlantic telegraph suffered major failures on several occasions after first transmission. Through persistence and spirit of cooperation, it finally succeeded. Competition had its own distinctive part to play.¹⁷³⁴

¹⁷³⁴ It took the introduction in 1869 of competing French companies to dramatically reduce telegraph rates and improve viability

ANNEX

Summary of Options for Future Research

SHORT-TERM PRIORITIES

As indicated, this thesis would not advocate the use of treaty mechanisms to regulate specific aspects of transatlantic defence trade in the short term. There should be a more systematic and comparative focus on understanding the historical and current operation of legal institutions which operate within both the U.S. and the national legal systems of EU Member States. The following provides a non-exhaustive illustration of possible areas to examine:

1. Analysis of the role of security and other exceptions under EU and US law
 - a. How does the language of security exceptions compare (both within EU primary and secondary law and across national legal systems)?
 - b. What is the legitimate scope of application of security exceptions in the field of defence procurement?
 - c. What is their precise function (as distinct from their intended function)?
 - d. Do these exceptions effectively fulfill their intended or actual function?
 - e. Should these exceptions be deleted, retained or amended?
 - f. Should Article 346 TFEU be subject to a notification requirement (whether ex ante or, if not possible, ex post)?
 - g. Should the CICA exclusions and exceptions be amended?
 - h. What conditions could be placed on the use of exceptions e.g. as a matter of wording, justifications and approvals etc
 - i. How do national and EU courts approach issues of competence in the application of security exceptions (including as a matter of separation of powers)?

2. Analysis of the Defence Procurement Directive's provisions on excluded contracts
 - a. To what extent do the exclusions delimit and balance Member State and EU competences?
 - b. What is the legitimate scope of application of the exclusions?
 - c. How should the language of the exclusions be interpreted?
 - d. How are the exclusions applied in practice?
 - e. How do the exclusions affect the procurement relations between Member States and the relations of third countries, in particular the U.S.?
 - f. Should the exclusions be deleted, reformed or retained or amended?
 - g. Should the Directive include more effective mechanisms to ensure the justification, monitoring and policing of the use of exclusions?
 - h. To what extent, if at all, should co-operative and collaborative procurement within the EU be subject to more stringent legal requirements?

3. Analysis of EU law and third country relations in the field of defence procurement
 - a. How do Member States conduct their relations with third countries in the field of defence procurement?
 - b. What effect, if any, will the Defence Procurement Directive have on regulatory and policy approaches to third country relations, in particular with regard to the fact that Member States retain the power to decide whether or not to permit third countries to participate in contract award procedures?

- c. What effect will any regulatory and policy approaches have on third country relations in practice?
 - d. What effect will the variability of national laws and policies have on internal trade between Member States within the EU?
 - e. How does EU law apply to, and affect, third country access and treatment more generally with regard to free movement of goods, persons, establishment, competition law, merger control and foreign investment in the defence sector?
 - f. Should the EU accord equal priority to third country relations in the field of defence procurement (as it does to third country relations in public procurement) in its assessment and monitoring of the Directive's application (also in consideration of medium-term objectives identified below)?
4. Analysis of the application of the Defence Procurement Directive's provisions to, and in consideration of, third countries
- a. How should regulators approach the political and legal conceptualization of "security of supply" and "security of information"?
 - b. How will contracting authorities apply the Defence Procurement Directive in relation to third country economic operators invited to participate in contract award procedures?
 - c. How will contracting authorities apply the Defence Procurement Directive in relation to EU economic operators which rely on third country suppliers, or third country products?
5. Analysis of the application of the ICT Directive's provisions
- a. To what extent is the ICT Directive being used in conjunction with the Defence Procurement Directive?
 - b. To what extent does the regime impact on third countries (howsoever determined), in particular, in light of its *prima facie* exclusion of ITAR transfers?
 - c. Could the ICT regime provide a possible model for improving U.S.-EU export and transfers of defence material?
 - d. What impact (howsoever determined) will the ICT Directive have on issues regarding re-export of defence material?
6. Analysis of offsets and related compensation practices
- a. To what extent are offsets and offset-related practices (including e.g. *juste retour* compatible with EU law?
 - b. To what extent is the administration of offsets regulated?
 - c. Should offsets be prohibited under existing international procurement agreements?
 - d. Should offsets be regulated within international procurement agreements?
 - e. Should offsets be expressly prohibited as a matter of EU and US law?
 - f. Should offsets continue to be viewed as *prima facie* incompatible with EU law but subject to a more well-defined, regulated exception than Article 346 TFEU and the EDA procurement regime?
 - g. Should offsets be permitted but their management subject to more detailed regulation?
 - h. To what extent do legal regimes applicable to foreign military sales contracting affect national and foreign competition?
 - i. Should the EU and US regulate abatement practices? If so, how?

7. Exercise of discretions conferred by legal authorisations
 - a. In what ways is it possible for legal requirements pertaining to the definition of technical specifications and other requirements (e.g. relating to RFPs) to be utilized to discriminate against foreign contractors?
 - b. Could legal institutions better regulate the exercise of discretions?
 - c. To what extent can the exercise of any such discretions and their “effects” or “impacts” be measured (qualified and/or quantified)?

8. Use of Justifications and Approvals for use of exceptions
 - a. Should certain provisions of the Defence Procurement Directive be subject to more robust determinations and findings or justifications and approvals requirements equivalent to those applicable under U.S. law (e.g. to legitimate use of certain exclusions and use of the least competitive procedures)?
 - b. Should existing justification and approval provisions available under U.S. law be reformed?
 - c. Should Article 346 TFEU be subject to a justification and approvals requirement?

9. Sole Source Contracting
 - a. Research should focus on examining the extent to which sole source contracting precludes foreign competition (i.e. differentiating legitimate sole sourcing from instances in which foreign competition would otherwise be possible).
 - b. More extensive focus could be placed on the extent to which issues such as: protection of proprietary data; follow on work; framework contracting and grounds such as industrial mobilization are utilised.
 - c. Should broadly defined industrial mobilization grounds be subject to greater definition, conditions on their discrete use?

10. Small business contracting
 - a. How does small business contracting operate in the defence procurement context?
 - b. To what extent do small business policies and regulation impact (howsoever determined) on competition in the transatlantic defence market?
 - c. To what extent, if at all, could U.S.-EU small business initiatives be pursued in the field of defence procurement?

MEDIUM TERM PRIORITIES

As indicated, any medium-term priorities should be informed by an extensive and consolidated investigation and implementation of the short-term priorities. However, subject to the above considerations, in the medium-longer term, it may be possible to consider the following:

1. Reform of the RDPs

Form

- a. Should the U.S. conclude RDPs with non-signatory EU Member States?

- b. Could a “Transatlantic Defence Procurement Memorandum of Understanding” be adopted? This could be concluded between the U.S. and each individual Member State or, alternatively, by the EU on behalf of its Member States (but which would need to take account of any exercise of EU competence in the field of external relations).

Content

- c. Clarification of the legal position vis-à-vis the Defence Procurement Directive is necessary.
 - d. Should the scope of existing RDPs and future RDPs be confined to market access and equal treatment as opposed to the conduct of procurement and other issues?
 - e. Should the existing (or any proposed RDP) incorporate more substantial provision on transparency and accountability e.g. in relation to information requirements, review and remedies?
2. Offsets and counter-trade practices
- a. Should the U.S. and individual EU Member States (or the EU on behalf of its Member States) conclude a Memorandum of Understanding on offsets and countertrade practices and/or a Memorandum of Understanding on abatements?
3. Coverage of defence procurement in international agreements
- a. Should defence procurement be incorporated within the WTO GPA and UNCITRAL?
 - b. To what extent would this impact (howsoever determined) on discrete transatlantic defence procurement relations?
4. EU policy on third country access
- a. Whilst advocated as a short-medium term priority, should the EU adopt a discrete policy on third country access to the EU defence procurement?
 - b. To what extent should any such proposal be modelled on EU third country policy in the field of public procurement?
5. U.S. reform of U.S. export control policies and laws
- a. To what extent is strategic reform of U.S. policies and laws on export controls necessary?
6. “Transatlantic General Licences”
- a. To what extent should the U.S. and EU consider the possibility of adopting licensing schemes in relation to the export and transfer of defence material (and considering the issue of re-exports)?
 - b. Does the ICT regime provide a possible model for adaptation?

LONG-TERM PRIORITIES

As indicated, long-term priorities would ultimately depend both on the progress of issues addressed in the short-medium term and the broader political and economic contexts (which

may present any number of significant obstacles that could preclude the viability of any proposal identified below). Notwithstanding, in accordance with an identified state of nascent legalization identified in this thesis, it is possible to conceive of a transition from policy initiatives and instruments such as Memoranda of Understanding to more formalized transatlantic legal relations. Of course, these must, in any event, be supported by robust national and EU legal frameworks. The following provides a non-exhaustive illustration of the possibilities. It should be observed that this thesis does not necessarily commit to a particular view as to the viability or merits of any of the following:

1. Transatlantic Defence Procurement Treaty
 - a. Could this constitute a full scale market access agreement (equivalent to existing bilateral free trade agreements in the field of public procurement), concluded by the U.S. and the EU on behalf of its Member States and building on the experiences of the existing and proposed RDPs?
2. Transatlantic Defence Trade Cooperation Treaty
 - a. Could this constitute a full scale export and transfer licensing regime for defence material between the U.S. and EU, concluded by the U.S. and EU on behalf of its Member States and drawing on the experiences of the existing U.S.-UK DTCT?
 - b. Any such instrument would necessarily require compatibility with a Transatlantic Defence Procurement Treaty.
3. Transatlantic Trade Treaty on Government Defence Sales, Offsets and Countertrade
 - a. Could this constitute a full scale offsets, sales and counter-trade regime, concluded by the U.S. and EU on behalf of its Member States and drawing on the experiences of any offset and counter-trade RDP?
4. Transatlantic Defence Procurement Ombudsman or Review Board
 - a. Could a Transatlantic Defence Procurement Review Board be instituted to adjudicate complex contracts above a certain threshold determined to be of “transatlantic interest” (howsoever determined)
 - b. To what extent could existing review boards constituted under existing international organisations provide a model for any such Board?
5. Transatlantic Defence Contracts Portal
 - a. Could this cover government-to-industry, and industry-to-industry procurement?
 - b. To what extent could existing portals in the defence context provide a model for such a Portal?

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