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signed by Mr Jordi AYET PUIGARNAU, Director

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To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of
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AND THE COUNCIL on the implementation of Directive 2009/81/EC on
public procurement in the fields of defence and security, to comply with
Article 73(2) of that Directive

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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND
THE COUNCIL**

**on the implementation of Directive 2009/81/EC on public procurement in the fields of
defence and security, to comply with Article 73(2) of that Directive**

{SWD(2016) 407 final}

1. INTRODUCTION

Directive 2009/81/EC (the Directive) lays down rules for awarding public contracts in the fields of defence and security, following competitive tendering procedures based on the principles of transparency and equal treatment.

This report, required under Article 73(2) of the Directive, sets out the main findings of a review of its implementation and, based on those, presents proposals for the way forward. The accompanying Staff Working Document (SWD) contains the detailed evaluation of the Directive.

The review evaluates the Directive's functioning and, to the extent possible given the short time that has elapsed since the transposition deadline and the even shorter time since actual transposition by Member States, its impact on the defence market and industrial base¹. It has been based on the following main sources: the Tenders Electronic Daily database (OJ/TED), an internet-based public consultation and consultation meetings with Member States and stakeholders, Eurostat data and IHS Jane's defence database².

2. BACKGROUND

The main specific problem that led to the Commission's proposal and then the adoption of the Directive in 2009 was that Member States exempted – in particular on the basis of Article 296(1)(b) TEC (now Article 346(1)(b) TFEU) – almost automatically the procurement of military equipment from EU public procurement rules. The main cause of the problem was deemed at the time to be that EU public procurement rules failed to address the specific needs of defence and sensitive security procurement.

In 2011-2015, the overall value of defence procurement expenditure by the 28 EU Member States and EEA countries ranged between EUR 81 to 82 billion per year³. The Directive's main objective is to ensure that defence and sensitive security procurement in that market is carried out under EU rules based on competition, transparency and equal treatment. The Directive seeks to achieve this by providing tailor-made rules for such procurement, and thus limit the use of exemptions, in particular those under Article 346 TFEU, to exceptional cases. In this way, the Directive aims at supporting the establishment of an open and competitive European defence equipment market (EDEM) and, in turn, strengthening the competitiveness of the European defence technological and industrial base (EDTIB).

¹ As required by Article 73(2) of the Directive, the evaluation mainly focuses on the defence market and industrial base, although the Directive also applies to sensitive security procurement.

² For more details on the evaluation methodology, please see Section 4. and Annex III of the SWD.

³ This is the general government expenditure on military defence consisting of gross fixed capital formation and intermediate consumption, irrespective of whether the Directive is legally applicable to specific purchases. For more details, please see Section 2.1.1. of the SWD.

3. IMPLEMENTATION

3.1. Transposition

Overall, Member States' transposition of the Directive was considerably delayed. The deadline set was 21 August 2011. Only 3 Member States notified complete transposition by that date. 19 Member States had done so by March 2012. By May 2013, they had all notified complete transposition.

The Commission has not identified fundamental problems in terms of national transposition measures' conformity with the Directive, i.e. there are no problems that would jeopardise the overall functioning of the Directive. However, for a limited number of the Directive's provisions, certain issues need to be clarified⁴.

Before the Directive's adoption, 18 Member States maintained offsets regulations systematically (i.e. for all contracts or those above a certain value) requiring compensation from non-national suppliers when purchasing defence equipment from them. These regulations were clearly incompatible both with the EU treaties and with the correct transposition and application of the Directive. Member States have now either abolished or revised their offsets regulations. The remaining regulations provide that offsets/industrial return can only be required, following a case-by-case analysis, if the conditions of Article 346 TFEU are met. Nevertheless, there is still the question of how to ensure that, in concrete procurement practice, the use of offsets/industrial return requirements complies with the strict conditions for the application of Article 346 TFEU.

3.2. Use of the Directive

Upon entry into force, **uptake of the Directive** was almost immediate and **has shown a clear upward trend**. Since its transposition by Member States, the value of defence and security contracts awarded under the Directive has increased more than tenfold. The **total value of defence and security contracts awarded under the Directive in 2011-2015 was around EUR 30.85 billion**⁵. Defence and security procurement contracts have been also awarded under the civil procurement Directives, accounting for another EUR 8 billion, to arrive at a total of nearly EUR 39 billion in 2011-2015 of contracts awarded under EU procurement rules.

However, **the use of the Directive across Member States remains uneven**. Contracts awarded by UK authorities accounted for over half of the value of contracts awarded under the Directive in the five-year period of the review (nearly EUR 17 billion). France, Poland, Germany and Italy, which are among the Member States with the highest defence procurement expenditure, followed in the ranking. Between 2011 and 2015, no contract award notice under the Directive was published by contracting authorities from six Member States: Cyprus, Greece, Ireland, Malta, Luxembourg and Spain⁶. Differences

⁴ For more details, please see Section 5.1.2. of the SWD.

⁵ Since a significant share of contract award notices does not include the final value of the contract, 30.85 billion EUR is the minimum value of all contract awards under the Directive. If the missing information is imputed using average contract values, this value is estimated to increase to roughly 34.55 billion EUR.

⁶ These countries have published a number of contract award notices with a defence-related subject-matter under the civil procurement Directives. For more details, see Section 5.3.1.1. of the SWD.

across Member States are significant also when the value of contracts awarded under the Directive is compared with the available budgets (defence procurement expenditure). This indicator shows differences ranging, for instance, from Lithuania (38.4 %), Slovakia (36.4 %), the UK (17.7 %), France (10.3 %), to the Netherlands (1.3 %), Sweden and Austria (1 %).

Regarding use of procedures, it is important to note that those with prior advertising and a call for competition accounted for 60 % of the number of contract award notices and 76 % by value. The negotiated procedure without publication of contract notice accounted for 38 % and 23 %, respectively.

Estimates on the division between defence and security contracts show that the vast majority were defence purchases. Sensitive security contracts accounted for just 7 % of the number of notices and 3 % of their value.

4. OUTCOME OF THE EVALUATION

The Directive has been evaluated against five criteria: effectiveness, efficiency, relevance, coherence and EU added value.

4.1. Effectiveness

The essential element of the evaluation is to assess whether – and to what extent – the Directive has achieved its objectives.

4.1.1. Competition, transparency and non-discrimination in the European Defence Equipment Market (EDEM)

The Directive's main objective is to help establish an open and competitive EDEM, by making sure that public contracts in the fields of defence and sensitive security are awarded through competitive and fair procurement procedures.

In the (baseline) period 2008-2010, the average yearly value of defence and security procurement published EU-wide amounted to EUR 2.9 billion and roughly 3.3 % of the total defence procurement expenditure⁷. After the Directive became applicable, the average yearly value of defence and security procurement published EU-wide was roughly EUR 6.2 billion or 7.8 billion if defence and security purchases under the civil procurement regime were added. This equals, respectively, **between 7.6 % or 9.5 % of the total value of defence procurement expenditure in the reference period.**

The above shows that the Directive has led to **a more than twofold increase** in the value of defence and security contracts published EU-wide and awarded, in competition, under rules based on transparency and equal treatment. However, as pointed out above, **the degree of application of the Directive**, and therefore of the increase in competition, transparency and non-discrimination, **remains uneven across Member States.**

Despite the positive trend in increased volumes of public procurement carried out under EU rules, the evaluation has found that **a very significant share of defence**

⁷ This included contracts published in the OJ/TED under the civil procurement Directives and contracts published on the Electronic Bulletin Board (EBB) of the European Defence Agency (EDA).

procurement expenditure is still made outside the Directive. In particular, the **Directive was used to a very limited extent for the procurement of high-value, strategic, complex defence systems**⁸. However, there have been some recent examples of tenders for complex defence systems launched under the Directive⁹.

Regarding cross-border procurement penetration, the evaluation has found **that around 10 % of the value of contracts awarded under the Directive has been won directly by foreign companies**¹⁰. When comparing the findings with the baseline period (despite some methodological discrepancies), it appears that, since the Directive became applicable, direct cross-border procurement in the EU has remained at similar levels compared to the overall defence procurement expenditure.

Direct cross-border procurement occurs when companies operating from their home market bid and win contracts for tenders launched in another Member State. Cross-border procurement also occurs indirectly through subsidiaries (e.g. the subsidiary bids for tenders in a different country from that of its headquarters or parent company). Based on a comparison of winning companies with the SIPRI list of Top100 defence companies¹¹, the total value of **indirect cross-border awards in 2011-2015 equalled roughly 40 % of the total value of contracts awarded under the Directive (12.44 billion EUR)**. The number and value of indirect cross-border contracts in practice could be larger as the indirect cross-border wins of smaller companies (not present on the SIPRI list) were not captured by this estimation.

Finally, another factor to assess the functioning of the market is the practice of offsets/industrial return. Based on industry's feedback and data published by the U.S. Department of Commerce¹², it can be concluded that: Member States still seem to use to some extent offsets/industrial return requirements (presumably relying on Article 346 TFEU); the frequency of such requirements seems to have marginally decreased; and there appears to be a trend to move away from indirect non-military offsets. It should be added that some industry stakeholders expressed concerns about uncertainties concerning the practical use of offset requirements in certain Member States.

Therefore, it can be concluded that **the objectives of the Directive have only partially been achieved: it led to an initial increase in competition, transparency, and non-discrimination** in Europe's defence procurement market, but **much more progress in Member States' consistent use of the Directive is needed** to achieve fully those objectives.

⁸ For more details, please see Section 6.1.2. of the SWD.

⁹ The most prominent example is the contract notice published by the German authorities in July 2015 for the procurement of multi-purpose combat ships.

¹⁰ The proportion of "direct cross-border procurement" under the civil procurement Directives in 2007-2009 was 3.5 % in terms of value.

¹¹ The SIPRI Top 100 arms-producing and military services companies in the world excluding China, December 2015, <http://books.sipri.org/files/FS/SIPRIFS1512.pdf>.

¹² The annual report on "Offsets in Defense Trade", <https://www.bis.doc.gov/index.php/other-areas/strategic-industries-and-economic-security-sies/offsets-in-defense-trade>. For more information, see Section 6.1.1.4. of the SWD.

Several factors are thought to have contributed to the uneven and partial use of the Directive and, in turn, affected the achievement of the Directive's objectives. A relatively short time (2-3 years) elapsed between actual transposition by Member States and the last year covered in the evaluation (2015). If the upward trend in the use of the Directive continues, its impact will become more visible in the next few years. There may also still be limited awareness of the Directive's rules among Member States' authorities. A related factor is probably a still too broad interpretation of possible exemptions, including under Article 346 TFEU. Moreover, a significant share of defence procurement expenditure may have been spent on contracts awarded in the framework of cooperative programmes started well before the adoption of the Directive. Finally, the financial crisis may have led to the cancellation or postponement of new major procurement projects to be implemented under the Directive.

4.1.2. Rules adapted to defence procurement

The Directive aims to ensure there is competition, transparency and equal treatment, while it also lays down provisions adapted to the specific needs of defence procurement and safeguarding Member States' security interests. The most relevant provisions here are those on exclusions (i.e. provisions excluding certain contracts from the scope of the Directive in particular circumstances that are specific to defence procurement) and the provisions on security of information and security of supply.

As regards the exclusions, in the light of the consultations with Member States and stakeholders, it can be concluded that **their wording does not need to be amended. However, it may be useful to provide guidance** on the application of some of these provisions. Several Member States mentioned in particular that clarifications on Article 12(c) on international organisations would be useful. Some industry stakeholders expressed concerns about the application of certain exclusions, especially Article 13(f) on government-to-government sales, and called for guidance and enforcement on this aspect.

It can also be confirmed that **the provisions on security of information are appropriate. No specific problem has been identified with regard to the provisions on security of supply.** It is clear, however, that these latter provisions only address part of a much more complex problem and cannot, by themselves, be sufficient to fully guarantee Member States' security of supply.

4.1.3. Impact on the European Defence Technological and Industrial Base (EDTIB)

The analysis conducted on the state of Europe's defence industry, based on the available data, shows that **it is difficult to conclude that overall the EDTIB has fundamentally changed** in the period 2011-2015 as a result of the introduction of the Directive. In fact, there are a number of factors that could affect the EDTIB, such as changes in Member States' budgets, the emergence of new competitors on non-EU countries' markets, and technological developments, with a more efficient European market being one of them. Given the long life-cycle of defence products, all these factors are likely to take several years to bring about changes in the EDTIB. Therefore, **it is impossible to establish any causal link yet between the effects of the Directive and developments in the EDTIB**, only five years after the transposition deadline. Significant delays in transposition and the still partial uptake by Member States must also be taken into account.

4.1.4. *The situation of SMEs*

Smaller companies can access the public procurement market by bidding and winning public contracts or by obtaining subcontracts from the successful tenderer (subcontracting).

To estimate the share of contracts awarded to SMEs under the Directive, the evaluation looked at a sample of winning firms and checked the presence of SMEs¹³. This analysis showed that **27.9 % of contracts included in this sample had been awarded to SMEs**. In terms of market share, these contracts accounted for **6.1 % of the total value of contracts in the sample**. Therefore, SMEs appear to be less successful in winning contracts under the Directive than in general EU public procurement, where the share is 56 % in number of contracts and 29 % by value. This difference may be explained by the specific nature of the defence procurement market.

Stakeholders' perceptions of the Directive's impact on SMEs is rather mixed. Many do not see a significant impact (positive or negative). Overall, stakeholders seem to consider that, while no fundamental change in the situation of SMEs in the defence sector has occurred in recent years, these companies face some additional difficulties. According to stakeholders, these are, however, most likely due to factors such as reductions in national defence budgets rather than to the Directive.

According to the traditional approach to subcontracting, the successful tenderer is free to decide about letting subcontracts to other firms. **In around 10 % of contract award notices under the Directive, the contracting authorities stated that some share of the awarded contract is likely to be subcontracted to third parties**. In terms of value, these contracts accounted for 42 % of overall procurement under the Directive, nearly EUR 13 billion. If a value of 30 % is used as proxy for the subcontracted share of these contracts, the total value of this **subcontracting would be around EUR 3.8 billion**. This represents an estimation of business opportunities for SMEs and sub-suppliers to be freely selected by the successful tenderer (main contractor).

The specific **subcontracting provisions of the Directive** allow the contracting authority to require the successful tenderer to subcontract a share of the contract to third parties via competitive tendering, following the rules specified in Articles 50 to 53. These provisions **have clearly not been used by Member States' authorities**: the number of published subcontract notices is negligible. The negative assessment of the effectiveness of the Directive's provisions on subcontracting is confirmed by the Member States, the EDA, and industry. Based on their input, the main reasons why these provisions have not been used appear to be: i) Member States have no incentive to use these provisions, because they do not guarantee the involvement of local companies; ii) these provisions seek to open supply chains for the award of specific contracts, while supply chains are established long before, especially in defence; iii) using this form of competitive subcontracting would raise several legal and administrative problems.

Since the subcontracting provisions merely lay down options for Member States and contracting authorities, the fact that they have not been used does not prevent the use of the Directive or undermine its functioning. However, the aim of providing, through

¹³ For more details, see Section 6.1.4.5. and Annex III of the SWD.

legislative measures, additional opportunities to sub-suppliers and SMEs by injecting competition into the supply chains of prime contractors has not been achieved.

4.2. Efficiency

To assess the Directive's efficiency, the evaluation looked at the costs stemming from its application, and at how they compare to the benefits.

The total costs of procurement procedures carried out under the Directive are estimated to be approximately EUR 89.6 million in 2011-2015 (EUR 27.6 million for contracting authorities and nearly EUR 62 million for all businesses, including the unsuccessful ones). These costs are not only those directly resulting from the Directive's obligations, but could include other cost elements, which cannot be disentangled, such as "business as usual cost" or costs resulting from national legislation¹⁴. **When compared to the total value of awarded contracts (EUR 30.85 billion in 2011-2015), the costs of procedures account for around 0.3 % of the contract value.**

The perception of a number of stakeholders (including the majority of business respondents to the online survey) is that the costs have increased under the Directive. However, this perception emerges when the Directive's costs are compared to a previous situation where defence procurement was not subject to competitive rules. It also results from consultation meetings that industry stakeholders do not believe that it would be possible to achieve the Directive's objectives with significantly less regulation.

As regards the cost-benefit analysis, the Directive would be likely to generate savings of roughly EUR 770 million, if a conservative assumption of 2.5 % savings was used, based on the 2011 evaluation of the civil procurement Directives. **Therefore the savings generated by the Directive are likely to exceed, by nearly a factor of nine, the costs of the procedures for public authorities and firms**¹⁵.

During the consultations, stakeholders were also asked to give an overall assessment on the Directive's efficiency by comparing the costs and benefits of carrying out (for contracting authorities) or participating in (for businesses) procurement procedures under the Directive. Among contracting authorities, the perception is largely positive, while the perception of business respondents is more critical. As it results from consultation meetings, businesses seem to consider that the costs of participating in procurement procedures under the Directive outweigh the benefits not because of the Directive itself, but rather due to the limited uptake and inconsistencies in applying its rules.

The Directive imposes information obligations about award procedures essentially on contracting authorities, and not on businesses. These obligations are the basis of EU public procurement rules and do not differ from those under the civil procurement Directives. Therefore, the evaluation concluded that the administrative burden stemming from the Directive's rules is negligible.

Although the stakeholders' views about efficiency are not entirely positive, the Commission concludes, especially in the light of costs and savings' estimations, that the

¹⁴ For more details on costs estimations and on related methodological issues, please see Section 6.2.1. and Annex III of the SWD.

¹⁵ For more details on savings estimations, please see Section 6.2.2. of the SWD.

Directive is broadly efficient but that further progress is needed to ensure a more consistent and increased use of the Directive by Member States.

4.3. Relevance

The Commission considers that **the Directive's objectives are still fully relevant**. As shown above, significant progress towards these objectives has been made, but much more is needed. **The whole rationale and needs that led to the adoption of the Directive remains relevant. All of this is supported by a broad consensus among Member States and stakeholders.**

The new developments that occurred after the adoption of the Directive – the deteriorating security situation, budgetary constraints, emerging consensus on the need for strategic autonomy and more cooperation, the new legal framework for civil procurement – do not question the relevance of the Directive's objectives.

4.4. Coherence

The evaluation looked at the internal consistency between the different provisions of the Directive, and their consistency with legislative or policy instruments in related areas.

The Commission has not identified internal coherence problems concerning the Directive's provisions, neither has any such issue emerged from the consultations.

The Directive's consistency with the framework of EU public procurement law has also been analysed. The Commission finds that there are no problems of coherence with the other instruments of EU public procurement law, including the new civil procurement Directives. In this context, the question of whether (some of) the innovations introduced by the new civil procurement Directives should be rolled over to the (defence procurement) Directive attracted particular attention from Member States and stakeholders, which have rather mixed views on the issue. The Commission observes that **the innovations of the new civil Directives do not create coherence problems with regard to the existing text of the (defence procurement) Directive.**

The Commission finds that there are no inconsistencies between the provisions of the Directive and those of Directive [2009/43/EC](#) on intra-EU transfers of defence-related products¹⁶. Member States' and stakeholders' have highlighted that the implementation of the latter is an important factor for the full uptake of the Directive.

In recent years, Member States, EU institutions and stakeholders have stressed the need to strengthen European defence cooperation, including in the field of procurement. The Directive recognises the importance of this aspect and seeks to enable Member States to pursue cooperative procurement in different forms. Based on discussions with Member States experts, the stakeholders' consultations, and a specific contribution from the European Defence Agency (EDA), it can be concluded that **the Directive does not hinder cooperative procurement**. However, it is important to encourage Member States' authorities to make full use of the available flexibility under the Directive to pursue cooperative procurement.

¹⁶ See Section 6.4.2. of the SWD.

4.5. EU added value

The Directive has led to an increase in the value of defence contracts published EU-wide and awarded through fair and competitive tendering procedures. The estimates done for the cost-benefit analysis also show that the Directive is likely to have generated savings significantly exceeding the costs of running the procedures for public authorities and businesses. If the uptake of the Directive further increased in the future, these results seem likely to be even more pronounced.

The same results could not be achieved through action by Member States which would inevitably result in different regimes increasing regulatory complexity and causing unnecessary obstacles to cross-border activities. With no specific EU regime for defence and sensitive security procurement, the increase in the use of transparent, fair and competitive tendering procedures, and the corresponding decrease in the use of exemptions, would not continue and might even be reversed.

Therefore, the **Directive has a clear EU added value and continues to comply with the principle of subsidiarity.**

5. CONCLUSIONS AND WAY FORWARD

Following the evaluation, and in general concurrence with Member States' and stakeholders' inputs, the **Commission believes that overall the text of the Directive is fit for purpose, that the Directive is broadly on track towards meeting its objectives** and that an amendment of the Directive is not necessary. Nevertheless, as shown above, and considering the short period of time that has elapsed since the actual transposition of the Directive, there is a **strong need to focus on its effective implementation, in order to improve its effectiveness and in turn, its efficiency.** This requires, among other things, a stable legal framework. Even if a legislative proposal could lead to a few marginal improvements to the text, at this stage it would not help with progression towards achieving the Directive's objectives. **Therefore, the Commission has decided not to put forward a legislative proposal with this report.** However, a number of proposals for the way forward, based on the conclusions of the evaluation, are made below.

There were no fundamental problems identified regarding the Directive's transposition into national legislation. However, there are certain issues to be clarified on the transposition of a limited number of provisions of the Directive:

- The Commission will contact the Member States concerned to solve these outstanding issues and seek any clarifications needed.

The Directive has led to an initial increase of competition, transparency, and non-discrimination in Europe's defence procurement market, and to a corresponding decrease in the use of exemptions. However, a very significant share of defence procurement expenditure is still done outside the Directive. The Directive was used to a very limited extent for procuring high-value, strategic, complex defence systems. In addition, the degree of application of the Directive remains uneven across Member States, leading to additional costs for industry. Furthermore, Member States still seem to use – at least to a certain extent – offsets/industrial return requirements (presumably relying on Article 346 TFEU). Industry stakeholders expressed concerns about the uncertainties concerning the use of these requirements.

In this context, the Commission will take the following actions:

- Provide guidance on the interpretation/application of specific provisions of the Directive concerning exclusions. The adoption of a Commission notice providing guidance on government-to-government contracts is a first step in this direction. The Commission will also consider developing further guidance on the use of offsets/industrial return requirements.
- Develop the dialogue with Member States and stakeholders on applying the Directive. Advanced consultations between Member States and the Commission may be particularly useful with regard to major defence procurement projects.
- Publish periodic statistical reports (scoreboards) on Member States' use of the Directive.
- Start infringement procedures, where serious breaches of EU law are identified with regard to specific defence procurement cases. The focus should especially be on cases of non-application of the Directive and on related market distortions such as offsets/industrial return requirements.

The subcontracting provisions of the Directive have not been used and are considered ineffective:

- The Commission will revise the guidance on the subcontracting provisions in order to increase flexibility for Member States' procurement authorities, thereby providing the incentive for them to use these provisions and, more in general, enabling them to drive competition into supply chains.

The Directive does not hinder cooperative procurement. However, to encourage Member States' authorities to fully use the flexibility existing under the Directive:

- The Commission will provide guidance to clarify the whole range of options for cooperative procurement.

The Commission will produce additional or revised guidance on all these issues in close cooperation with Member States and in consultation with stakeholders.

Finally, the European Defence Action Plan proposals aimed to foster cross-border market access for sub-suppliers and SMEs are also expected to help improving the levels of cross-border penetration and of SMEs participation in defence contracts.