Article 346 TFEU: The point of intersection between legal ambition and political will regarding the Defence Procurement Directive (2009/81/EC)?

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Summary

The European defence industry contributes to enable Member States of the European Union to care for the security and defence of European citizens. In order to safeguard the Member States’ ability to tend to their essential security interests, Article 346 TFEU was adopted. This Article provides Member States with the possibility to withhold information and take measures which they consider necessary to protect these interests, without having to obey EU law. However, Member States frequently exempted procurement of military equipment on the basis of Article 346 TFEU from EU public procurement rules. The Court of Justice of the European Union held already in 1986 in Case C-222/84 Johnston that the grounds of exemption from Treaty rules provided for in Article 346 TFEU should be interpreted narrowly. This problem contributed to the Commission’s proposal of a new Directive and later to the adoption of the Defence Procurement Directive in 2009.

This thesis examines the scope of application of Article 346 TFEU in order to determine when a Member State is allowed to derogate from Treaty rules on the basis of its essential security interests. Article 346 TFEU contains a secrecy exemption and an armaments exemption, Article 346(1)(a) and (b) respectively. This thesis further examines the current legal situation of Article 346 TFEU, including intensity of the Court’s scrutiny, proportionality, burden of proof and procedural requirements. Letter (a) and (b) has been seen to affect each other, which provides for the possibility of even more guidance by the Court in the pending Case C-187/16 Commission v. Austria.

The Defence Procurement Directive applies to contracts awarded in the field of security and defence when certain provisions such as Article 346 TFEU are not applicable. Nevertheless, the Defence Procurement Directive contains several grounds of exemption. This thesis focuses on three of these; security of supply, security of information and government-to-government contracts. Furthermore, the previously common practice of Member States to use offsets has been investigated. Lastly, the thesis’ analysis examines whether or not the European defence market will turn into a competitive market, presents observations of Case C-187/16 Commission v. Austria, and analyses the scope of Article 346 TFEU.
Preface


Mamma och pappa, för er villkorslösa kärlek, skjuts till (för det mesta rätt) flygplatser och för att ni helt enkelt alltid finns där för mig: stort tack. Många är ni som förtjänar en plats här. För att vända på Winston Churchills bevingade uttryck: “never was so much owed by so few to so many”.

Bryssel, mars 2018
Hanna Engström
## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CSDP</td>
<td>Common Security and Defence Policy</td>
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<td>EDA</td>
<td>European Defence Agency</td>
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<td>EDAP</td>
<td>European Defence Action Plan</td>
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<td>EDF</td>
<td>European Defence Fund</td>
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<td>EDIDP</td>
<td>European Defence Industrial Development Programme</td>
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<td>EDRP</td>
<td>European Development and Research Programme</td>
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<td>EU</td>
<td>European Union</td>
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<td>EUGS</td>
<td>EU Global Strategy on Foreign and Security Policy</td>
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<td>PADR</td>
<td>Preparatory Action on Defence Research</td>
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<td>PESCO</td>
<td>Permanent Structured Cooperation on security and defence</td>
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<td>TEU</td>
<td>Treaty of the European Union</td>
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<td>TFEU</td>
<td>Treaty of Functioning of the European Union</td>
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1 Introduction

1.1 Background

The prime contractors of the European defence market are France and the United Kingdom. They have the largest defence industries and are followed by Germany, Italy, Sweden and increasingly Spain. The Commission reported that 87% of European defence production is concentrated in these six countries.\(^1\) The European defence industry is a significant industrial sector, the turnover of 2014 was EUR 97.3 billion and it employs 500 000 people directly and 1.2 million indirectly. When looking at the public procurement of the defence industry, the market can be divided into two categories: that of armaments and that of security. The armaments market is mainly centred around ministries of defence as purchasers, whilst the security market covers all contracting entities. This thesis will focus on the armament section. The armaments market is of considerable significance, with the EU Member States spending EUR 194 billion on defence in 2010. The then 27 Member States spent 3.2 per cent of their total government expenditure on defence, according to Stockholm International Peace Research Institute.\(^2\) However, the defence budgets of the EU Member States have steadily decreased, at times drastically, since the end of the Cold War. The overall EU defence spending declined from €251 billion to €194 billion between 2001 and 2010. This severely affects the industries that develop equipment for armed forces, resulting in cutbacks in existing and planned programmes. Especially investment in defence research and development (R&D) is affected, which is of crucial importance for developing capabilities of the future.

As illustrated, the industry plays a significant role in the wider European economy. It generates innovation, high-end engineering and technologies which have had indirect effects in sectors such as electronics, civil aviation and space. The Commission, which is responsible for upholding the EU treaties, implementing decisions and proposing legislation, therefore considers the defence sector essential in order for Europe to remain a world-leading centre for manufacturing and innovation. Consequently, it is a part of the Europe 2020 Strategy for smart, sustainable and inclusive growth to strengthen the competitiveness of the defence sector. Moreover, the defence

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\(^1\) Commission ‘Communication on the Results of the Consultation Launched by the Green Paper on Defence Procurement and on Future Commission Initiatives’ (Communication) COM (2005) 626 final.

sector provides Europe with capacity to protect its citizen, value and interests and to assume responsibility of its own security. For this purpose, it is necessary to maintain a certain degree of strategic autonomy by ensuring security of supply, operational sovereignty and access to critical technologies. In addition, defence companies in Europe have battled the shrinking defence budgets with an increase in exports. However, this results in transfer of technology, intellectual property rights and production outside of the EU which will affect the competitiveness of the European Defence Technological and Industrial Base (EDTIB) in the long run.  

The EU has a vast set of public procurement rules, requiring publication of contract opportunities and prescribing certain award criteria etc. in order to open up the public procurement markets of the Member States to the Internal Market. Article 346 TFEU provides the Member States with the possibility to go outside of EU rules to protect their essential security interest. However, what was originally supposed to be a restrictively used ground for exemption, Article 346 TFEU ended up being frequently used by Member States, which brought most armament and related services outside of the EU’s trade, competition and procurement rules. As a result, 28 different defence markets emerged, consequently leading to reduced levels of innovation and competitiveness, higher prices, duplication and reduced transparency. In addition, protectionism and inefficiency characterised the defence markets, and the industry is still rated as one of the three most corrupt business sectors in the world in Bribe Payer’s Index of Transparency International. There is a traditional unwillingness to open defence markets to suppliers from other Member States, as highlighted in COM (2013) 542 final, at 41 and 53. For example, 80 % of defence equipment expenditure was spent on exclusively national procurement projects and only 13 % on purchases from other Member States.

The Commission highlights that when spending more is difficult, spending better is a necessity. Assisting with this, the European Defence Agency (EDA) promotes and facilitates integration between Member States within the EU’s Common Security and Defence Policy (CSDP) since its establishment in 2004. The CSDP comprises the defence and crisis management structures and capabilities of the EU. The EDA and the European External Action Service (EEAS), which is the diplomatic service and foreign and defence

ministry of the EU, together form the Secretariat of the Permanent Structured Cooperation (PESCO). PESCO is a structural integration by 25 of the 28 national armed forces of the EU. These are cornerstones in facilitating European defence.

1.2 Purpose and question formulations

The purpose of this thesis is to analyse the scope of the exemption ground in Article 346 TFEU. If the Article does not apply, defence procurements are required to be conducted within the framework of the Defence Procurement Directive (2009/81/EC). Moreover, there are several grounds for exemption in the Directive. This thesis will focus on the exemptions of security of supply, security of information and government-to-government contracts. Furthermore, the possibility to use offsets in defence procurement will be examined. Three questions will be answered in the thesis in order to fulfil this purpose in the ultimate way. Article 346(1)(a) TFEU allows Member States of the European Union to go outside of Treaty rules by setting forth that no Member State is obliged to supply information that is contrary to the essential interests of its security. In addition, Article 346(1)(b) TFEU ensures that a Member State is entitled to take measures that it considers necessary for the protection of the essential interests of its security. Therefore, the first question is:

i. What is the scope of a Member State’s essential security interest regarding security of supply, security of information, government to government procurements and offsets, and is that scope defined identically in Article 346(1)(a) and 346(1)(b) TFEU?

The second question aims to further define the scope of Article 346 TFEU by investigating which kind of measures and information that have been allowed by the Court of Justice of the European Union, the Commission etc., and which measures that have been considered to fall outside the scope of application of the Article. Therefore, the second question is:

ii. What is the scope of the terms “information” and “measures” used in Article 346 TFEU concerning security of supply, security of information, government-to-government contracts and offsets?

By answering these questions, the scope of Article 346 TFEU in relation to the Defence Procurement Directive will be thoroughly investigated. Furthermore, the Commission have stated in its report on the implementation of the Defence Procurement Directive that it is continuously satisfied with the
text of the Directive and does not aspire to further change it. However, there is consensus between the Commission and doctrine regarding the implementation of the Defence Procurement Directive. Interestingly, even though the uptake of the Directive has shown a steady upward trend since it entered into force in 2011, neither is pleased with the present effect of the Directive. Consequently, the third question is:

i. Why has the Defence Procurement Directive not had the desired effect, and what measures are the Commission taking to adjust this?

1.3 Method and material

The method that has been used is the European legal method. The European legal method refers to the approach used to deal with EU legal sources. EU law sources are used in this paper due to the fact that the addressed issues are regulated at EU level, and that the current legal situation will be investigated on an EU level. Moreover, EU legal practice from the European Court of Justice (and the Tribunal) has been applied in this paper. Furthermore, EU case law is binding and directly applicable in all Member States and contributes inter alia to clarify how the provisions of the Treaty and the Defence Procurement Directive should be interpreted. In addition to EU legislation (ie, Directives and Treaties) and case law, Communications and Guidance Notes from the Commission will also be used in this paper. Such instruments are not legally binding but should be taken into consideration since they have a significant normative effect in practice. Even though EU law is said to lack the equivalence of Swedish preparatory works, some of the reports that resulted in the adaption of the Directive have been used to get a picture of the background to the adoption of the Defence Procurement Directive.

Furthermore, doctrine has been used as it is a widely accepted source of law. Although doctrine is the lowest legal source, it can still contribute to legal developments through the internal logic of the arguments put forward by the

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7 Ibid.
11 Fredric Korling and Mauro Zamboni 2013, "Juridisk metodlära ", (Lund Studentlitteratur AB, 2013)
author (or authors).\textsuperscript{12} EU legal doctrine has been used, as well as articles. The most comprehensive and relevant doctrine in the field of defence procurement in the EU is Professor Martin Trybus's work, "Buying Defence and Security in Europe", which has been studied. Regarding sources, the OSCOLA system for citation of legal authorities has been used.

1.4 Delimitations

First, this thesis will be limited to legislation on an EU level and will focus on the scope of Article 346 TFEU. The scope of this Article is general in the sense that the Member States themselves are allowed to define what constitutes their essential security interests, however all exemptions from Treaty rules are to be interpreted narrowly as established by the Court. The field of national security and defence procurement is wide, which is why this thesis will not go further into the area of Intra-Community transfers, exports and standardisations, where there are defence specific regulations. Neither will this thesis explore the European armaments law and policy that applies outside of the Internal Market, or NATO, EDA and OCCAR.

OCCAR is an international organisation which focuses on the through life management of cooperative defence equipment programmes, and NATO is an intergovernmental military alliance between some North American countries and several European countries. These organisations affect the defence market on an international level as well as on a European level, but due to the legal nature of this thesis, priority has been given to legal provisions either in the Defence Procurement Directive or in the Treaty.

Moreover, the Defence Procurement Directive contains several provisions and exemptions, but this thesis will focus on security of supply, security of information and government-to-government specifically. National law will not be included in this thesis, nor will review and remedies in the Defence Procurement Directive be further developed. In addition, the armaments market will be in focus, in favour of the security market. Export control will not be further addressed either.

1.5 Current state of research

There is plenty of research material such as doctrine regarding Article 346 TFEU, the exemptions of security of supply, security of information, 

\textsuperscript{12} Jan Kleineman, "Rättsdogmatisk metod" (Lund Studentlitteratur 2013).
government-to-government procurements and offsets. Yet, although there is case law regarding Article 346 TFEU from the Court, the amount is limited which is often mentioned in doctrine. Moreover, the Commission have released several Guidance Notes relating to Article 346 TFEU and the aforementioned exemptions from the Defence Procurement Directive. Furthermore, an implementation report on the Directive has been released by the Commission, and several Communications, Working Papers, Green Papers, press releases etc. regarding the defence sector.

Concerning future related issues like the Commission initiated European Defence Fund (EDF) on the other hand, which is meant to work as an incentive to cross border cooperation in the defence industry in order to increase competition and decrease fragmentation, there is not much legal research to be found. This can be explained by the fact that the EDF consists of a Communication and a proposal for a European Defence Industrial Development Programme (EDIDP) Regulation. If the European Parliament and the Council decide to adopt the Regulation in early 2018, the Development Programme will be operational in early 2019.

1.6 Outline

In Chapter 2, the legal framework concerning Article 346 TFEU will be laid out. Relevant case law will be presented to further carve out the scope of these provisions, as well as Communications and Guidance Notes from the Commission. The scope of application of Article 346 TFEU will be investigated in order to determine when a Member State is allowed to derogate from Treaty rules on the basis of its essential security interests. Article 346 TFEU contains a secrecy exemption and an armaments exemption, Article 346(1)(a) and (b) TFEU respectively. Furthermore, Article 346(2) TFEU refers to a list of the products to which the provisions of paragraph 1(b) apply. Firstly, the relevance of this list will be investigated. Secondly, relevant case law is examined to further define the current legal situation of Article 346(1)(b) TFEU. This includes intensity of the Court’s scrutiny, proportionality, burden of proof and procedural requirements. Thirdly, Article 346(1)(a) TFEU will be looked into as well as the pending Case C-187/16 Commission v. Austria.

In Chapter 3, the exemptions in the Defence Procurement Directive (security of supply, security of information and government-to-government), and the possibility to use offsets will be investigated. The Defence Procurement Directive applies to contracts awarded in the field of security and defence when certain provisions such as Article 346 TFEU are not applicable.
Nevertheless, the Defence Procurement Directive contains several grounds of exemption. This thesis focuses on three of these; security of supply, security of information and government-to-government contracts. Furthermore, the previously common practice of Member States to use offsets will be investigated.

In Chapter 4, an analysis will be conducted. The scope of Article 346 TFEU and the potential impact of the pending case Commission v. Austria will be analysed. Finally, it will be discussed whether or not the European defence market will turn into a competitive market.
The Defence Procurement Directive, just like all directives, is a piece of secondary EU law. The purpose of this is to provide a more detailed interpretation of primary law, such as Article 346 TFEU, and further expand and provide depth to it. Secondary legislation is initiated by the Commission after consultations with stakeholders, and then passed by the Council which represents the Member States, and the European Parliament, where the members are directly elected. Their limits are set by the TFEU. The primary legislation regulating the European Union was unanimously formed by the Member State governments, and ratified by the parliaments of each Member State or by referenda. It constitutes the foundation of the Defence Procurement Directive, and defines its limitations. The Directive touches upon several dimensions of the TFEU, including competition (anti-trust) such as merger control, State aid and exports outside of the Union (export control) and intra-Community trade with armaments as well as other security sensitive goods.

In Article 3 TFEU, it is stated that the EU has exclusive competence to “establish competition rules necessary for the functioning of the Internal Market”. Furthermore, Article 4 TFEU stipulates that there is a shared competence between the EU and Member States in the principle area of the Internal Market. Exclusive competence means Member States are no longer able to legislate in a specified area. When Member States have a shared competence, they are allowed to legislate in an area as long as the EU does not legislate in that field. Consequently, following the Defence Procurement Directive, the Member States action in this area is pre-empted. In addition, Article 4(3) TFEU embodies the principle of solidarity, which entails the obligations of Member States to “assist each other in carrying out tasks which flow from the Treaties” in full mutual respect. Moreover, the Preamble of the Directive refers to present Articles 62 (on services), 53(1) (on establishment) and 114 (the general Internal Market legal base) TFEU as legal basis for the Directive, which together with Articles 18 TFEU prohibit protectionist behaviour by Member States against each other.

Articles 28-37 TFEU establish the free movement of goods, which was widely defined in *Arts Treasures* as “products which can be valued in money
and which are capable of forming the subject of commercial transactions”. This clearly includes armaments and the products on the Council’s list of 15 April 1958, which will be discussed below. The prohibitions in Articles 34 and 35 TFEU, which concern quantitative restrictions on imports and exports, and all measures having equivalent effect, are not absolute. Restrictions violating these Articles can be justified by grounds of exemption in Article 36 TFEU, the most relevant basis in this case being the one of public security. However, such justifications cannot “constitute a means of arbitrarily discrimination or a disguised restriction on trade between Member States”. Furthermore, Articles 45(3), 52(1) and 65(1) TFEU holds that public security can be used to justify a derogation. Moreover, the concept of public security is defined widely and covers all aspects of security, internal and external, including national security. In contrast, the exemption in Article 346 TFEU relate to a narrower concept of security, which is pointed out by Advocate General Sir Gordon Slynn in Campus Oil.

2.1 Grounds for exemption in Article 346 TFEU

The purpose of Article 346 TFEU is to give the Member States the possibility to care for the essential interests of their security, and balance that with the maintenance and promotion of the Internal Market. The Article reads 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

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

Ultimately, this Article represents the borderline between the Internal Market and the Member States competence regarding national security. It determines the substance of the Defence Procurement Directive, and sets the limits of the scope of application of it.

2.2 Narrow interpretation

In Case 222/84 Johnston, the Court expressed that Article 346 TFEU is one of the limited amount of articles which the Treaty provides for grounds of derogations applicable in situations that may involve public safety, and that these articles “deal with exceptional and clearly defined cases. Because of their limited character, those articles do not lend themselves to a wide interpretation”. This paragraph has been continuously repeated by the Court, in Case C-187/01 Dory in 2001 and in the eight Military Exports Cases in 2009-2010, and suggests a narrow interpretation of Article 346 TFEU. Furthermore, the Court have clarified in C-294/05 Commission v. Sweden that “although it is for the Member States to take appropriate measures to ensure their internal and external security, it does not follow that such measures are entirely outside the scope of Community law”. Moreover, the Court held in the same case that the derogations provided for in Article 346 TFEU must, in respect of derogations from fundamental freedoms, be interpreted strictly, confirming the narrow interpretation of the Article. Furthermore, the measure must be necessary to counter a real, specific and serious risk to the security interest concerned.


18 Ibid, para. 44.

On the other hand, there are cases which seem to have deviated from this position. In Case T-26/01 *Fiocchi Munizioni v. Commission*, the Tribunal stated that the regime established by Article 346 TFEU is intended to “preserve the freedom of action of the Member States in certain matters affecting national defence and security”, and concluded that since the Article is among the Treaty’s “general and final provisions…it has, for the activities which it covers and on the conditions which it sets forth, a general effect, capable of affecting all the ordinary legal provisions of the Treaty, including those on the competition rules”. Moreover, the Tribunal puts forward that Article 346(1)(b) TFEU “confers on the Member States a particularly wide discretion” regarding the assessment of measures they consider necessary for the protection of the essential interests of their security. However, this is to be understood as giving the Member States a wide range in areas of applicability regarding article 346(1)(b) TFEU, not as standing in conflict with the narrow interpretation of the Article (see Chapter 2.2.1.3).

In the pending Case C-187/16 *Commission v. Austria*, Advocate General Kokott acknowledges this paragraph in her Opinion. She precedes by reminding the Court of its reasoning in Case C-157/06 *Commission v. Italy*, where the Court stated that the provisions in Article 346 TFEU do not make it possible for Member States to derogate from their duties under EU law based on no more than reliance on their essential national security interests. Furthermore, in *Military Export* the Court ruled that the secrecy exemption in Article 346(1)(a) TFEU only can be invoked on a case-by-case basis. In *German Export*, the Court ruled on this to apply to the exemption as a whole. According to Trybus, professor in EU Law at Birmingham University and an expert in the field of EU defence procurement, this indicates that national codes derogating from Treaty rules on the basis of Article 346(1)(b) TFEU, such as in *Commission v. Italy*, would be deemed illegal.

### 2.2.1 The armaments exemption of Article 346(1)(b) TFEU

The armaments exemption in Article 346(1)(b) TFEU allows a Member State...
“to take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production or trade in arms, munitions and war material”.

The following section will further interpret this part of Article 346 TFEU.

### 2.2.1.1 The 1958 list of armaments in Article 346(2) TFEU

Article 223(2) EEC (which is now Article 346(2)), obliged the Council to produce a list of what constitute such “arms, munitions and war material”. According to Trybus, the list is to be understood as an integral part of Article 346(1)(b) TFEU although the legal status is unclear. Since the list is a separate part of the TFEU, amendments are subject to a unanimous decision of the Council. The list was produced in 1958, and there has been no amendments since then. For a long time, the list was unpublished and the level of secrecy differed between Member States. Some kept it strictly confidential, and the Commission and others provided copies of it to anybody interested. The list was finally published in academic publications in the 1980s and 1990s. Consequently, it was easier for Member States to abuse Article 346 TFEU by extending the Article to concern products which were not on the list, due to the difficulty of holding them accountable for violations when the extent of the provision was unknown.

The list is still not officially published, however the Council published an “Extract of Council Decision 255/58 of 15 April 1958” in 2008. Recital 10 in the Commission’s Guidance Note on the Defence Procurement Directive sets out that this is the relevant version. Furthermore, recital 10 in the Defence Procurement Directive confirms that the list is “generic and to be interpreted in a broad way in the light of the evolving character of technology, procurement policies and military requirements which lead to the development of new types of equipment” which was also the position of the Commission in its Guidance Note from 2006 on Article 296 EC (present day Article 346 TFEU). Nevertheless, the list is still to be interpreted narrowly because it provides an exemption to Treaty rules, and an extensive interpretation would risk to undermine the functioning of the Internal Market as stated by the Court in Johnston.

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27 Commission, ‘Guidance Note on Article 296 EC’ (Guidance Note), 2006, p. 5.
Moreover, Trybus argues that the list is exhaustive and constitutes a limitation of Article 346(1)(b) TFEU due to the wording of Article 346(2) TFEU which “clearly limits the application of Article 346(1)(b) TFEU to goods on the list”.

This is confirmed in the judgement T-26/01-Fiocchi Munizioni v. Commission, where the Tribunal concludes that it is clear from the wording of the Article that Article 346(1)(b) TFEU is “not intended to apply to activities relating to products other than the military products identified on the Council’s list of 15 April 1958”.

2.2.1.2 Armaments intended for specifically military purposes: Agusta and Finnish Turntables

Materials that can be used for both military and civil purposes usually falls outside the scope of the list, because of its limitations. These goods are often referred to as “dual use goods” or “soft defence material”, and can for example be transport aircraft, cross-country vehicles and tents. The Court have dealt with the point of intersection in several cases, and thereby crystallizing the scope of the Article. In addition, it should be pointed out that products considered to have a military purpose which are not represented on the 1958 list, are not covered by Article 346(1)(b) TFEU and consequently will have to be exempted by the public security exemption in Article 36 TFEU. In the Italian cases Agusta and Commission v. Italy, the Court addressed the question whether it is sufficient for an item to be on the 1958 list, or if additional requirements has to be met in order to rely on the derogation ground in Article 346 TFEU.

In Agusta, the Italian Republic excluded supplies of light helicopters for the use of police forces and the national fire service from Treaty based procurement rules by relying on Article 296(1)(b) EC (present day Article 346 TFEU), since the helicopters were dual-use items. The Commission argued that Italy did so unrightfully, since the helicopters were to be used essentially civilian and therefore not normally in military operations, and brought actions under what is now Article 258 TFEU against Italy. The fact that the helicopters had to have certain characteristics similar to those of military helicopters was not sufficient for them to be equated with military supplies, and consequently the Commission deemed them to be intended for a possible dual use. The Court initially reminded the parties of its previous

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31 Case C-337/05, Commission v. Italy [2008] ECLI:EU:C:2008:203
32 Case C-157/06, Commission v. Italy [2008], ECLI:EU:C:2008:530
case law, according to which provisions that enable derogations from the Treaty in connection with public procurement shall be interpreted strictly. Moreover, the burden to prove such exceptional circumstances that can justify an exemption relies with the party seeking to apply the derogation. In addition, although Member States are allowed to take measures in order to protect their essential security interest according to Article 296(1)(b) EC, these measures must not alter the conditions of competition in the Internal Market regarding products which are not intended for specifically military purposes.

The Court stated that it is clear from the wording of Article 296(1)(b) EC that in order for products to be exempted from Treaty rules on the grounds of the Article, they have to be intended for specifically military purposes. Accordingly, if the military purpose is hardly certain, the purchase in question needs to correspond with the rules governing the award of public contracts. The Court concluded that items that are clearly for civilian use, which only has a potential military use, cannot be exempted on the base of Article 296(1)(b) EC. The Court mirrored this judgement in the case Commission v. Italy a couple of months later, where the Commission sought a clarification from the Court that Italy had failed its obligations under EU law by adopting a national code.

The Court follow a clearly logical way in its reasoning. Many products are of dual use, and many of the European companies which produce armaments also manufactures civil products. Therefore, Trybus argues, taking measures to put armaments outside of Internal Market law can easily affect civil goods. In the following case C-615/10 Finnish Turntables, the Court again touched upon the issue of what constitutes a specifically military purpose, and further narrows the scope. The Finnish Defence Forces Technical Research Centre had not procured turntables on the basis of the Public Sector Directive, due assuming they were exempted from the Directive on the basis of Article 10 of that Directive and from the Treaty on the ground of the armaments exception in Article 346(1)(b) TFEU.

The Court set out that even if a product is on the Council list of 15 April 1958, and the product has technical applications for civilian use which are largely identical, it can only be considered to be intended for specifically military

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33 Case C-337/05, Commission v. Italy [2008] ECLI:EU:C:2008:203, para. 43 and 44.
34 Ibid, para. 46.
purposes within the terms of Article 346 TFEU “if such use is not solely that which the contracting authority intends to confer on it, but also (...) that which results from the intrinsic characteristics of a piece of equipment specially designed, developed or modified significantly for those purposes.”

The Court then established that the use of the word “military”, and the words “insofar as they are of a military nature” and “exclusively designed” used respectively in points 11, 14 and 15 of the list, indicate that the turntables must have a specifically military nature in objective terms. In addition, the Court noted that recital 10 in the preamble of the Defence Procurement Directive mentions the words “military equipment” and explained them to be understood as to cover products that later have been adapted to military purposes to be used as arms, munition or war material, even though they were first designed for civilian use. The Court finally concluded that the turntables are covered by point 15 read together with points 11 and 14 of the list.

Interestingly, in this case the Court takes on a relatively comprehensive analysis of Article 346(1)(b) TFEU compared to its previous rulings on the Article. The first part of the analysis investigates whether or not the product in question (the turntables) is on the 1958 list of armaments or not, and the second part examines if the national security interests of the Member State justify derogation. The judgement builds on the Agusta case and the hardly certain criterion, by clarifying that additional requirements need to be met if a product is clearly intended for military purposes but also has possibilities for essentially identical civilian purposes, in order for Article 346(1)(b) TFEU to be applicable. The Court further develops its reasoning by setting forth that the material in question has to be specifically designed, developed or through “substantial modifications” intended for military purposes “by virtue of its intrinsic characteristics”. According to Trybus, this is a high threshold since dual-use items on the 1958 list need to be specifically designed, developed and modified for military purposes.

However, in paragraph 46 of its judgement the Court concludes that dual-use items on the list can be exempted on the basis of Article 346(1)(b) TFEU if they have been “specially designed and developed, also as a result of substantial modifications” for specifically military purposes, by virtue to their intrinsic characteristics. In paragraph 40 of the same judgement, the Court clarifies this by referring to “intrinsic characteristics of a piece of equipment

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39 Ibid, para. 41.
specifically designed, developed or modified significantly for those purposes”. Consequently, this must be understood as the terms not being cumulative. Trybus further states that the Finnish Turntable judgement clarifies what was missing in the Agusta case by making the 1958 list a part of its analysis, whereas in Agusta the Court does not mention the list.41

To conclude the current legal situation regarding dual-use items, it is possible to exempt them from Treaty rules on the basis of Article 346 TFEU if certain conditions are met. The Advocate General in Case C-337/05 Commission v. Italy, on the contrary, interpreted the words “for specifically military purpose” to in itself preclude dual-use products.42 However, this was not brought up by the Court and in the light of Agusta and recently Finnish Turntables, the Court has made no indications to completely shut the door for dual-use products on the 1958 list.

2.2.1.3 General provision and wide discretion: Fiocchi Munizioni

As previously stated, all exemptions from Treaty rules must be interpreted narrowly according to the by the Court repeatedly referred to Johnston judgement.43 In Fiocchi Munizioni, an Italian manufacturer of arms and munitions made a formal complaint to the Commission due to Spain having granted subsidies to a Spanish undertaking owned by the state which produced arms, munitions and tanks as well.44 The Commission consequently initiated bilateral communications with Spain on the basis of Article 348 subparagraph 1 TFEU. Spain argued that the activities of the undertaking concerned were lawful on the basis of 346(1)(b) TFEU and recognized in Spanish law to be in the interest of the national defence of Spain. Moreover, Spain argued that the company’s production was principally intended for the Spanish armed forces which was also covered by the Spanish law on State secrets. The Italian manufacturer, on the other hand, considered the actions of Spain to distort competition. The Commission did not act, whereby the Italian manufacturer brought an action for failure to act against the Commission on the basis of 265 subparagraph 3 TFEU.

In this case, the Tribunal stated that the position of Article 346(1)(b) TFEU among the Treaty’s “general and final provisions” confirms a general effect for the activities which it covers and on the conditions which it sets forth, that can affect all ordinary legal provisions in the Treaty. Furthermore, the Tribunal set out that the Article confers a “particularly wide discretion” on the Member States when assessing the need protect its essential security interests.\(^4\) By its wording, it seems to widen the by the Court previously established narrow scope of Article 346(1)(b) TFEU. Consequently, it was used by the Italian government in Commission v. Italy in order to try to justify derogation from Treaty rules on the basis of Article 346(1)(b) TFEU.\(^4\) However, the Court has never confirmed this part of the judgement of the Tribunal in its following case law, it has on the contrary continued to repeat its narrow interpretation from Johnston. Most recently in *Finnish turntables*, and it is furthermore used by the Advocate General Kokott in the pending case *Commission v. Austria*.

However, as interpreted by Trybus, the general effect of the provisions and the wide discretion of Member States must be separated from the necessity of the measures in question and the judicial scrutiny applied to it by the Tribunal. Accordingly, the judgement is not as controversial as it first can be perceived. The Tribunal did not express a certain rule regarding military export of hard defence material, but it has been argued in doctrine, based on the narrow interpretation of Treaty exemptions, that such equipment would not be included within the meaning of a Member State’s essential security interests as opposed to hard defence material intended to satisfy domestic needs.\(^4\)

### 2.2.1.4 Measures (not) necessary for national security: *Spanish Weapons*

The armaments exception in Article 346(1)(b) TFEU was narrowly defined in itself in the judgement of 1999 *Spanish Weapons*, when the Court for the first time applied the Johnston doctrine to this specific part of the Article. The case concerned a Spanish law that exempted exports and intra EU-transfers of hard defence material from value-added tax (VAT), while an EU Directive included all exports, imports and intra EU-transfers in the scope of VAT. Spain argued that the state complied with EU law on the basis of what is now Article 346(1)(b) TFEU, and that the exemption from VAT tax was necessary for the effectiveness of its armed forces and to guarantee the achievement of the essential objectives of its overall strategic plan. However, it seemed like

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Spain intended to give its defence industries a competitive advantage by exempting their products from VAT and thus reducing their costs. Furthermore, this affected the revenue of the Union. The Court ruled that Spain had “not demonstrated that the exemptions provided for in the Law are necessary for the protection of the essential interests of its security...It follows that the VAT exemptions are not necessary in order to achieve the objective of protecting the essential interests of the security of...Spain”. This case confirms that the Court has the power to review the decision of a Member State to invoke Article 346(1)(b) TFEU, and the grounds of justification.

The Military Exports cases provided a similar background. Sweden, Denmark, Finland, Italy, Portugal, Greece and Germany exempted imports of military products from custom duties. The countries had not calculated or payed the resources of the EU component of the customs duties due to this exemption which they based on Article 346(1)(b) TFEU. The Court repeated paragraph 22 of Spanish Weapons and stated again that the burden of proof that a situation is justified by Article 346(1)(b) TFEU relies on the Member State trying to invoke the Article. Moreover, the Court rules that the Member States had “not shown that the conditions necessary for the application of Article 346 TFEU are satisfied”, thus confirming the judgement in Spanish Weapons.

2.2.1.4.1 Proportionality and intensity of scrutiny

The usage of the word “necessary” by the Court implies that there is a proportionality test involved concerning Article 346(1)(b) TFEU. The very use of this word in certain Treaty provisions resulted in the establishment of the principle in EU law.\(^{48}\) According to de Búrca, the proportionality test offers “a spectrum ranging from a very deferential approach, to quite a rigorous and searching examination of the justification for a measure”\(^{49}\). In Spanish Weapons, the Court refers to the Johnston judgement where there is no differentiation between the types of security exemptions in the Treaty. However, only the public security exemptions were discussed.\(^{50}\) The Court repeated this in Sirdar and Kreil, where it applied a proportionality test in relation to public security, without separating the security type exemptions in the Treaty.\(^{51}\)


and Dory regarding articles concerning public safety and mentions Article 346 TFEU among others, again without differentiating between the exemptions.\textsuperscript{52}

Trybus argues that this, in the light of Spanish Weapons, more specifically leads to Article 346 TFEU. Moreover, it is suggested that the principle of proportionality has to be applied when the Court has jurisdiction, since proportionality is a crucial aspect of the rule of law and the EU and all Member states are founded on the rule of law, as can be seen in the Preamble of the TEU (Lisbon) and its Article 2. In addition, the principle is a requirement in and has to be met by EU legislation and case law.\textsuperscript{53}

Furthermore, the wording of Article 346 TFEU allows Member States to take measures “as it considers necessary for the essential interests of its security”. Again, in the Military Exports cases, the Court stated that the mere costs of military equipment cannot make it necessary to exempt them from customs duties.\textsuperscript{54} The Court also express necessity as a standard of review by stating that Member States cannot make derogations from Treaty rules on the basis of Article 346(1)(b) TFEU on “no more than reliance” on its essential security interests.\textsuperscript{55} If they could have done so however, the “necessity” would be determined by the Member States alone, and thereby leaving no room for proportionality or any other tests to be applied by the Court.

Regarding intensity of scrutiny, since the exemption from VAT in Spanish Weapons and from export duties in Military Exports were clearly unnecessary, the judgements do not serve as an example for a strict scrutiny by the Court. As previously shown in the Tribunal’s judgement Fiocchi Munizioni, the scrutiny leaves a wide margin of political discretion to the Member States.\textsuperscript{56} According to experts in the field, there is generally a higher

degree of judicial deference or self-restraint in certain specific policy contexts, including national security.\textsuperscript{57}

\textbf{2.2.1.5 Burden of proof}

The Court has repeatedly, over time, held that the responsibility to justify a derogation from the Treaty on the ground of Article 346 TFEU relies within the Member States. In Case C-414/97 Spanish Weapons\textsuperscript{58} from 1997, the Court states that “it is for the Member State which seeks to rely on those exceptions to furnish evidence that the exemptions in question do not go beyond the limits” of cases regarding Article 346 TFEU. Furthermore, the Court made clear in C-294/05, Commission v. Sweden from 2008 that although Article 346 TFEU “refers to measures which a Member State may consider necessary for the protection of the essential interests of its security or of information the disclosure of which it considers contrary to those interests, that Article cannot however be read in such a way as to confer on Member States a power to depart from the provisions of the Treaty based on no more than reliance on those interests.”\textsuperscript{59} In the same case, the Court concludes that it is for the Member State which seeks to take advantage of the Article to prove that it is “necessary to have recourse to that derogation in order to protect its essential security interest”\textsuperscript{60}. The latter statement was repeated in C-615/10 Finland v. Commission in 2009.\textsuperscript{61}

Trybus criticises the Court and argues that it might have gone too far on this point. The Member States have been given the possibility to derogate from the rules of the Treaty on the basis of their essential security interests in the Treaty, which gives them a necessary flexibility to fulfil their responsibility concerning defence. However, putting the burden of proof solely on the Member States compromises this flexibility to an extent that can be seen as contrary to the reason of this flexibility. Therefore, a possible alternative solution would be to have an evidentiary presumption in favour of the respective government, including the benefit of any reasonable doubt.\textsuperscript{62}

\textsuperscript{57} Martin Trybus, \textit{Buying Defence and Security in Europe} (Cambridge University Press 2014), p. 112.
\textsuperscript{61} C-615/10 Finnish Turntables [2012] ECLI:EU:C:2012:324, para. 45.
\textsuperscript{62} Martin Trybus, \textit{Buying Defence and Security in Europe} (Cambridge University Press 2014), p. 120.
2.2.1.6 Procedural requirements and review procedure

In Case *Fiocchi Munizioni* mentioned above, the Court brings up the procedural aspect of Article 346 TFEU. It states that two specific legal remedies are set out in the Treaty concerning measures adopted by the Member States on the basis of Article 346(1)(b) TFEU. Firstly, subparagraph 1 of Article 348 states that if a measure taken in circumstances referred to in Article 346 TFEU has the effect of distorting the conditions of competition of the Internal Market, the Commission shall examine how those measures can be adjusted to Treaty rules together with the Member State concerned according to Article 348(1) TFEU. The Court sets out that if a State aid measure adopted under Article 346(1)(b) TFEU appears to distort competition in the Internal Market, for example by benefitting activities which are related to the products on the 1958 list mentioned in Article 346(2) TFEU, but are also capable of being of civilian use, or products covered by the list which are intended for export, the procedural requirements in 348 TFEU shall be applied. Secondly, the Commission or any Member State may bring the matter directly in front of the Court, by derogation from the procedure in Articles 258 and 259 TFEU, if it considers that another Member State is misusing the ground for exemption in Article 346 TFEU, according to Article 348 subparagraph 2 TFEU.

Furthermore, the Court explains that a Member State wishing to rely in the exemption in Article 346(1)(b) TFEU does not have to notify the Commission in advance, since the provision allows derogation from state aid laws. In addition, the Commission cannot use the examination procedure in Article 108 TFEU in these circumstances. When Member States use Article 346 TFEU, the consequence is a complete derogation from the Treaty rules, including obligations concerning EU State aid. Contrary to the situation concerned in Article 108 TFEU, there is no obligation for the Commission to adopt a decision regarding the measure concerned. In addition, the Commission cannot decide to address a final directive or decision to the Member State in question. It can also be noted, that the Court differentiates the case of *Fiocchi Munizioni* from the facts in Commission Decision 1999/763/EC of 17 March 1999. In this case, the Commission initiated a procedure under Article 108(2) TFEU, while Germany in its defence relied on Article 346(1)(b) TFEU. In *Fiocchi Munizioni* on the other hand, the Commission opened bilateral examinations on the basis of Article 348(1) TFEU.

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64 Ibid, para. 72.
The Case *Fiocchi Munizioni* confirms that the Commission is confined to the special procedure laid down in Article 348 TFEU when a Member State invokes Article 346(1)(b) TFEU, and that the Commission has the power to assess whether or not the arguments of the Member States are credible or not. Naturally, when dealing with Article 346(1)(b) TFEU, the question arises when the special review procedure in Article 348 TFEU shall be used instead of the more conventional option in Article 258 TFEU. The latter Article was used in Case *Spanish Weapons* as enforcement procedure, and no party invoked Article 348 TFEU which was pointed out by the Advocate General, “not even the Court of its own motion”.65

Furthermore, Advocate General Ruiz-Jarabo Colomer emphasizes that the procedure in Article 348(2) TFEU was used once in 50 years in case *FYROM*66, thereby inclining how rarely the Article has been used.67 However, in the Military Export cases, Germany68 and Greece69 questioned the admissibility of the use of Article 258 TFEU since they had relied on Article 346 TFEU, and therefore the Commission could not use the standard enforcement action but had to use the special one as prescribed in Article 348 TFEU. According to the Court however, the Article 348 TFEU is only applicable when the Commission alleges that Member States have used the exemption in Articles 346 and 347 TFEU improperly, and in the cases in question the aim of the Commission was to obtain a declaration of failure to fulfil provisions mandatory on the basis of secondary law.70

Moreover, as further stated by the Advocate General, the wording of Article 348 TFEU does not in any language support the interpretation that the Commission is under the obligation to use the procedure in Article 348 TFEU, but it “*is framed merely as a right*”.71 In addition, the Advocate General argues that the subject matter of any legal proceedings is determined by the applicant and not by what the defendant claims, and the Commission in the present case was seeking a declaration of failure to fulfil obligations under Article 31 TFEU and several other secondary law provision, not on the basis of Article 346 TFEU which was used by the defendant. The applicant’s choice

71 Opinion of Advocate General Ruiz-Jarabo Colomer in Case 239/06, *Commission v. Italy*, in footnote 23.
of action is not made subject to argumentation by the defendant in the defence.\(^{72}\) In the end it was concluded that, since the Military Export cases did not involve any distortion of competition, Article 348(2) TFEU was not applicable, and that Article 258 TFEU does not present a disadvantage to Member States in comparison with Article 348 TFEU.\(^{73}\)

### 2.2.1.7 The Commission’s 2006 Interpretative Communication

On the 7\(^{th}\) of December 2006, the Commission’s “Interpretative Communication on the application of Article 296 TEC in the field of defence procurement” was finally released to prevent possible misinterpretation and misuse of Article 346 TFEU. Although the already existing case law have been argued to quite clearly have given guidance to the interpretation of Article 346(1)(b) TFEU, it was nevertheless deemed necessary to use another measure in order for the Member States to comply with the legislative framework.\(^{74}\) There seemed to be no impact on the actual defence procurement at the time, and the Member States largely ignored the case law due to difficulty to follow the rules, out of defiance or simply by ignorance.\(^{75}\)

The Commission identified procurement law as an area for action towards establishing a European Defence Equipment Market (EDEM) in its Communication of March 2003.\(^{76}\) This resulted in a Green Paper on defence Procurement in September 2004, on which stakeholders were invited to comment in order to improve openness and transparency of the defence market.\(^{77}\) The consultation confirmed that the existing legal framework at the time did not function properly, and pointed out uncertainties regarding the scope of Article 296 TEC (now Article 346 TFEU) as one of two main factors for this. In the Communication, the divining line between what constituted defence acquisitions concerning Member States essential security interest and what did not was considered vague, at times making it unclear which rules that apply to which contracts. Consequently, the application of Article 296 TEC was deemed problematic and the use of it varied considerably between

\(^{72}\) Opinion of Advocate General Ruiz-Jarabo Colomer in Case 239/06, Commission v. Italy, para. 35-37.

\(^{73}\) Ibid, para. 41.


Member States. In response to this, the Commission adopted the Interpretative Communication started the preparations of what is now the Defence Procurement Directive.

The Communication is built on existing case law. It sets out that the scope of Article 296 (1)(b) TEC is limited by the concept of “essential security interests” and the Council list of 1958 and that Article 296(1)(a) goes beyond defence. In addition, it is up to Member States to define and protect their security interests. However, exemptions must be interpreted strictly. Moreover, procurement of goods and services directly related to the armaments on the list are said to also be covered by Article 346(1)(b) TFEU as well as modern, capability-oriented acquisition methods. Furthermore, the Communication explains that the term “specifically military purposes” shall be understood, as to concern only the procurement of equipment which is designed, developed and produced for specifically military purposes. The Communication is outdated on this point in the light of the recent judgement of Finnish Turntables, as mentioned above. In paragraph 40 of this case, the Court sets forth that “specifically military purposes” refers to the “intrinsic characteristics of a piece of equipment specifically designed, developed or modified significantly for those purposes”. Consequently, this must be understood as the terms not being cumulative.

Furthermore, the Communication explains that the application of the exemption is not automatic as confirmed by the Court and that the article have been acknowledged to give Member States a broad degree of discretion when deciding how to best protect their essential security interests. Referring to paragraph 22 in Spanish Weapons, where the Court set out that “it is for the Member State which seeks to rely on those exceptions to furnish evidence that the exemptions in question do not go beyond the limits of such [clearly defined]cases” and to demonstrate “that the exemptions...are necessary for the protection of the essential interests of its security”, the Commission argues that “essential” is a particularly strong wording that limits exemptions to procurements of the highest importance for Member

States’ military capabilities.\textsuperscript{83} Trybus argues that this in itself needs an interpretation, which is not provided by the Commission. Furthermore, the Interpretative Communication argues that every exemption should be made on a case-by-case basis “with great care”.\textsuperscript{84}

According to Article 288 TFEU, the Communication is not legally binding since that only applies to Directives, Regulations and Decisions. This has been further clarified by the General Court in \textit{Germany v. Commission}.\textsuperscript{85} Since the release of the Communication in 2006, several significant cases have been added to the pile of relevant case law, such as \textit{Agusta, Military Export} and \textit{Finnish Turntables}. However, it provides an insight in the way in which the Commission approaches the exemption of Article 346 TFEU. According to the Green Paper on Defence Procurement, the Communication was intended to complement the Defence Procurement Directive.\textsuperscript{86}

\textbf{2.2.2 The secrecy exemption of Article 346(1)(a) TFEU}

Article 346(1)(a) TFEU provides that:

\emph{“no Member State shall be obliged to supply information the disclosure of which it considers contrary to the essential interests of its security”}.

This rule constitutes a possibility to derogate from the general obligation of Member States to supply information to the institutions of the European Union according to secondary EU law provisions or Articles 337 TFEU\textsuperscript{87} and 4(3) TEU.\textsuperscript{88} Therefore, the Article is only applicable if there is an obligation

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\textsuperscript{83} Commission, ‘\textit{Interpretative communication on the application of Article 296 of the Treaty in the field of defence procurement}’ (Communication) COM(2006) 779 final [2006], section 4 “Conditions of Application”.

\textsuperscript{84} Commission, ‘\textit{Interpretative communication on the application of Article 296 of the Treaty in the field of defence procurement}’ (Communication) COM(2006) 779 final [2006], section 5 “How to apply Article 346 TFEU”.


\textsuperscript{87} Article 337 TFEU reads: “\textit{The Commission may, within the limits and under conditions laid down by the Council acting by a simple majority in accordance with the provisions of the Treaties, collect any information and carry out any checks required for the performance of the tasks entrusted to it}.”

\textsuperscript{88} Article 4 (3) TEU reads: “\textit{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 fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union. The Member States shall facilitate}”
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under EU law to supply information. This gives the Member States the political power to decide whether their essential security interests are affected. The provision is subject to the scrutiny of the Court of Justice of the European Union, as well as to the bilateral communication between the Commission and a Member State as set out in Article 348(1) TFEU if the Commission finds it necessary.89

Procurement Directives stipulate several conditions which require the Member States to provide information to EU institutions, such as the obligation to publish contract notices and contract award notices in the Official Journal of the EU. These obligations can be contrary to the a Member State’s essential security interests, due to the them letting anybody interested take part of the information. In the field of defence, this is not a system that works well in all areas. Article 346(1)(a) TFEU ensures that Member States have the possibility to withhold information which they deem contrary to their essential security interest to make public.90

2.2.2.1 Violation of Article 346(1)(a) TFEU

However, there is a risk of abuse of Article 346 (1)(a) TFEU. Member States are able to withhold evidence of essential necessity for the ECJ to scrutinise a measure taken on grounds of national security. Concerning Article 346(1)(b) TFEU, it is up to Member States to prove that a situation is covered by the Article following the case of C-414/97 Spanish Weapons and subsequent case law. Consequently, the same obligation might compromise letter (a)91, when the exempted information in question is the only proof available. Trybus argues that the disclosure of such information is not likely to constitute a serious problem security wise; the Commission has previously proved to be able to safeguard information in matters related to competition law under Article 28 Regulation 1/2003/EC.92

It has previously been argued that the exercise of a legitimate procedural right should not be used against Member States. In an EU context, this would result in Member States being able to refuse to disclose information when relying

89 Article 348 (1) reads: “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”.

91 Ibid.
92 Ibid, p. 130.
on Article 346 (1)(a) TFEU since the Court would accept the use of Article 346 (1)(b) TFEU in good faith. However, the Court can scrutinise the exercise of the discretion in Article 346 (1)(a) by the use of the in camera procedure in Article 348 subparagraph 2 TFEU. The Article excludes the public from the proceedings, which prohibits the Member States from relying on the privilege in Article 346 (1)(b) TFEU to avoid supplying information to the Court. Moreover, the Member States cannot use the privilege if measures on the basis of Articles 346(1)(b) or 347 TFEU are the subject of these proceedings.  

Furthermore, the Court has repeatedly, over time, confirmed the strict interpretation of Article 346 TFEU. This would be severely undermined if Member States were allowed to withhold information needed by the Court to scrutinise exemptions made under Article 346(1)(a) TFEU. Consequently, the narrow interpretation would be of symbolic meaning without real effect. Furthermore, a Member State who abuse letter (b) of the provision would likely not hesitate to abuse letter (a) to cover up the tracks. In addition, the Court has clearly allocated the burden of proof to the Member States. Moreover, Article 348 subparagraph 2 TFEU accommodates the secrecy need since the public is excluded. This need has further been respected when reading the judgement to the public, by derogation from Article 34 of the Statute of the Court for example. In the case of a judgement relating to Article 348 TFEU, which has never occurred, not even the operational part is likely to be read out. In addition, it has been argued to be unlikely that a Member State abuses Article 346(1)(a) TFEU if it has been brought to Court on the basis of having violated Article 346(1)(b) TFEU. This would result in an uncommon confrontation between a Member State and the institutions; Member States usually cooperate with them and follow judgements from the Court.

However, there is a fine balance between compromising the wide discretion that has been granted the Member States in the Treaty, the nature of secrecy and on the other hand taking the difficulties for the Commission to supply enough evidence when a disproportionate use of the conditions in Article 346(1)(a) TFEU has occurred. Trybus suggests that a similar evidence rule for all defence exceptions should be used, which would result in Article 346(1)(a) TFEU not being able to be used as a defence against the obligation to submit information in order to find evidence of a violation. Looking at

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cases *Spanish Weapons* and *Military Weapons*, Article 348 TFEU is a special procedure and Article 258 TFEU is the enforcement procedure used in practice.

### 2.2.2.2 Intensity of Scrutiny: German Military Export

Until recently, the standard of review in Article 346(1)(a) TFEU was unclear. In the *Military Export* cases, some Member States argued that they were under no obligation to provide the Commission with the necessary information which the Commission needed to prove the alleged infringement. In *German Military Exports*, Germany argued that the used enforcement action in Article 258 TFEU was inadmissible since the Commission could not prove that there had been an infringement, due to the nature of the case; since the Member States were not obliged to provide the information requested by the Commission regarding their exports, it was not possible for the Commission to prove any infringement. Furthermore, Germany claimed that it did not have to hand over the information in question, and that the action was inadmissible because it was based on an alleged failure to fulfil Treaty obligations which could not be proved.

The Court did not accept this line of reasoning, and stated the Member States must make the information in question available to the Commission to permit inspection according to Article 4(3) TEU, in order to make sure that the transfer of the EU own resources is correct. Although, Member States can still “on a case-by-case basis and by way of exception, on the basis of Article 346 TFEU, either restrict the information sent to certain parts of a document or withhold it completely”.

Trybus argues that even though the judgement concerned Article 346 TFEU as a whole, it is clear that the part regarding exemption from the obligation to provide information refers to Article 346(1)(a) TFEU. The judgement is the first ruling concerning Article 346(1)(a) TFEU, and an exemption was not allowed. The “case-by-case” exemption was clearly expressed, and in *German Export*, the Court ruled on this to apply to the exemption as a whole. The Court did not use the word “necessary”, but it did examine the arguments from the state of Germany thoroughly by analysing the safeguards of confidentiality in place and deeming them to be sufficient for the secrecy requirements concerned. Accordingly, the exemption in Article 346(1)(a) TFEU is not automatic nor categorical, just as the second exemption of the Article, letter (b). Moreover, it has to be interpreted narrowly, on a case-by-

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97 Ibid, para. 76
case basis, as an exception, it has to be specifically invoked and Member States has the burden of proof. There is no specific mentioning of a proportionality test, but in the light of the courts previous assessment of Article 346(1)(b) TFEU and the Opinion of Advocate General Kokott in Commission v. Austria it can be assumed to exist.\(^98\)

Moreover, Article 346(1)(a) TFEU was officially addressed in case ZZ (C-300/11) in 2013, were the Court was asked if the principle of effective judicial protection could be set aside on the basis of Article 346(1)(a) TFEU and the interests of State security, by not informing a Union citizen of the essence of the grounds against him.\(^99\) ZZ was a dual French and Algerian citizen residing in the United Kingdom, and he was denied entry due to public safety reasons after travelling outside of the UK. The question referred to the Court concerned whether or not the United Kingdom was allowed to not disclose the essence of the grounds of its decision on the basis of Article 346(1)(a) TFEU and State security among other provisions. The Court stated once more, that the mere fact that a decision concerns State security does not result in European Union law being inapplicable.

### 2.2.2.3 A glimpse into the future: Commission v. Austria

In the pending Case C-187/16, Commission v. Austria, the Court has the chance to give further guidance on the interpretation of Article 346(1)(a) TFEU. The Commission alleges that Austria has infringed EU public procurement law, due to Austria by law exclusively reserved the manufacture of security-related documents for the private undertaking Österreichische Staatsdruckerei GmbH, which was formerly owned by the State of Austria. Austria relied on its essential national security interests, since Staatsdruckerei alone demonstrated the appropriate organisational, technical and structural security measures for performing contracts such as protection of secret information. The Commission argued that it is possible to organise a public invitation to tender in a way where the only successful parties could be undertakings specialized in manufacture of documents subject to special security requirements and were supervised accordingly.

In the Opinion released on the 20 of July 2017, Advocate General Kokott begins by repeating the general character of Article 346(1)(a) TFEU, as opposed to Article 346(1)(b) TFEU it is not limited to arms, munitions and war material but can be applied to non-military procurement processes as

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\(^{99}\) Case C-300/11, ZZ [2013] ECLI:EU:C:2013:363.
well. As established in case law, essential security interests constitute a concept of EU law which must interpreted autonomously. Furthermore, the wide discretion of Member States to define this which was set out in *Fiocchi Munizioni* is acknowledged. However, Advocate General Kokott precedes by reminding the Court of its reasoning in Case C-414/97 *Commission v. Spain*, where the Court stated that the provisions in Article 346 TFEU do not make it possible for Member States to derogate from their duties under EU law based on no more than reliance on their essential national security interests. Furthermore, Advocate General Kokott argues that it is up to the Member States to offer substantiated evidence in each case in order to show precisely which national security interests are affected and to what extent compliance with EU law would interfere with those security interests.\(^{100}\)

In addition, she sets forth that even if the Commission is correct, it is nevertheless undeniable that the factors mentioned (authenticity and protection against counterfeiting for official documents, protection of the security arrangements for the manufacturing of them) can affect essential national security interests. Moreover she states, the resolution in this case depends on if the security interests and measures can justify a complete derogation from EU law, regarding public contracts. After reminding the Court of the strict interpretation of Article 346(1)(a) TFEU, Advocate General Kokott states that it is up to the Member States to prove that it is necessary to use the exemption in order to protect its essential security interests. Interestingly, she explicitly states that “the Member State concerned must therefore ultimately undergo a proportionality test”. Moreover, not wanting to disclose security-related information to foreign entities or entities controlled by foreign nationals, especially entities or persons from states outside of the EU, is put forward as examples of justified derogations.\(^{101}\)

Another point of interest is the fact that the Advocate General, instead of dismissing the Austrian law because the exemptions in Article 346 TFEU among other factors only is supposed to be applied on a case-by-case basis and therefore not in a national code\(^{102}\) or consequently assumingly in a national piece of legislation, refers to a different line of case law. According to those, a measure is only appropriate for ensuring attainment of the objective pursued “if it genuinely reflects a concern to attain it in a consistent and systematic manner”. Since Austria had not taken any measures to ensure that Straatsdruckerei did not fall under the control of foreign stakeholders, Advocate General Kokott found there to be no security-related justification

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\(^{101}\) Ibid, para. 51-54.

\(^{102}\) Such as in Case C-157/06, *Commission v. Italy* [2008], ECLI:EU:C:2008:530.
for the categorical derogation, and therefore states that Austria has failed to fulfil its obligations under the Treaty.\textsuperscript{103} Furthermore, it is mentioned that this case gives the Court of Justice the opportunity to go beyond procurement and further develop the scope and limits of Article 346 TFEU.\textsuperscript{104}


\textsuperscript{104} Ibid, para. 4.
3 The Defence Procurement Directive

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 year. 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. According to the Commission, the Directive seeks to achieve this by providing tailor-made rules for such procurement, and thereby limiting the use of exemptions such as Article 346 TFEU, to exceptional cases. Consequently, the Directive works as a tool in supporting the establishment of an open and competitive European defence equipment market and seeks to strengthen the competitiveness of the European defence technological and industrial base (EDTIB).

The uptake of the Directive has shown a steady upward trend since it entered into force. The value of defence and security contracts awarded under the Directive has increased more than tenfold, to reach a total turnover of approximately EUR 30.85 billion.\textsuperscript{105} However, the use of the Directive is unevenly distributed between the Member States. Before the Directive’s adoption, 18 Member States maintained offsets regulations systematically. The Commission took the stance in its Evaluation Report of the Defence Procurement Directive, that these regulations were clearly incompatible both with the EU treaties and with the correct transposition and application of the Defence Procurement Directive. According to the report, 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, the Commission acknowledged the challenge of ensuring that the strict conditions of Article 346 TFEU are met in practice.

Moreover, the Commission concluded that the text of the Directive was sufficient to its purpose, and that it was moving towards achieving its objective. The Commission explicitly stated that an amendment of the text was not necessary, and it refrained from putting forward a legislative

\textsuperscript{105} EUR 30.85 billion is the minimum value since many contract award notices does not include the final value of the contract. Using the value of average contracts, the value is estimated to reach to about EUR 34.55 billion.
Given that this report was published in 2016, it is likely that the text will stay unchanged at least for the near future. However, the Commission presented a number of ways forward, such as seeking out the Member States concerned where the implementation has not given desired results. This have recently been demonstrated; on the 25th of January 2018, the Commission opened infringement procedures against five Member States for not applying EU rules on public procurement in defence and security markets correctly.\(^\text{107}\)

### 3.1 Scope

The Directive is applicable to contracts awarded in the area of defence and security regarding the supply of military equipment (including any parts, components and/or subassemblies thereof) as well as the works and services concerning specifically military purposes or sensitive works and services. Articles 30, 45, 46, 55 and 296 TFEU is exempted from the principles of the Treaty, and consequently from secondary law originating from these.\(^\text{108}\)

Therefore, no provisions in the Defence Procurement Directive should prohibit the imposition or application of measures necessary for the protection of the interests justified by these Articles in the Treaty. The Defence Procurement Directive does not have to be applied when awarding contract in the scope of the Directive if it can be justified by reasons such as public security or by the protection of a Member States’ essential security interests. This can be the case when extremely high demands on security of supply is required, or when the contract concerned is so secret and/or important for national sovereignty that the Articles in this Directive is not sufficient to guarantee the Member States essential security interest. The definition of this is the sole responsibility of the Member States.\(^\text{109}\)

Moreover, the Court has stated that the possibility to derogate from the Defence Procurement Directive should only be allowed if it is strictly necessary to protect the legitimate interests that articles such as 346 TFEU

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\(^{108}\) Article 2 of the Defence Procurement Directive.

\(^{109}\) Recital 16 of the Defence Procurement Directive.

\(^{110}\) Recital 29 of the Defence Procurement Directive.
safeguard. Derogations from the Directive must therefore be proportionate to the pursued goal and cause as little disturbance to the free movement of goods and services as possible.  

Furthermore, the Council and European Parliament encourages the Member States in the preamble of the Defence Procurement Directive to base their decisions regarding contracts in arms, munitions and war material on what is most economically beneficial and by doing so taking into account the need for a globally competitive European Defence Technological and Industrial Base (EDTIB), the need for open and fair markets and to obtain mutual benefits.  

In addition, Article 13 TFEU specifically excludes the Defence Procurement Directive from contracts awarded by a government to another government regarding the supply of military or sensitive equipment, works and services directly linked to such equipment or to specifically military purposes, sensitive works and sensitive services. Neither does the Directive apply when Member States would be forced to disclose information which it considers contrary to the essential interests of its security. Contracts, were at least two Member States participate in a cooperative programme based on research and development of a new product, are excluded from the application of the Defence Procurement Directive. When such a cooperation between Member States is concluded, it shall be indicated to the Commission by the Member States the share of research and development expenditure in relation to the overall cost of the programme, the cost-sharing agreement and the expected share of purchase per Member State, if any.

3.2 Security of supply

After determining that the contracting entity and the contract is within the scope of the Defence Procurement Directive, and the appropriate procedure has been chosen, one of the remaining factors to consider is the need of security of supply. It is not explicitly defined in the Defence Procurement Directive; however the (non-binding) Commission’s Guidance Note Security of Supply defines the term 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”. Moreover, the Guidance Note defines the concept of security of supply as broad, which covers a wide range of industrial, legal,

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111 Recital 17 of the Defence Procurement Directive.
112 Recital 18 of the Defence Procurement Directive
technological and political aspects, and includes the ability of Member States to use their armed forces with a sufficient degree of national control. The notion of security and supply in the Defence Procurement Directive is motivated by the need for Member States, in times of peace and war, to secure the access to relevant supplies such as goods, services and works. The life cycle of contracts in the Defence Procurement Directive and in other relevant international agreements is usually long, and the security of supply is necessary both initially and onwards.

It is essential for an efficient national defence and security and consequently national security as well. According to the Commission’s Guidance Note Security of Supply, the Member States need a “guarantee”, “control” and “no third-party constraints”. Without these, the effective use of the armed forces and other security activities can be compromised or undermined. Risk factors include unreliable economic operators in the supply chain, disrupted transport etc., if a country between the purchasing Member State and the supplying State would be occupied and therefore cutting of supply for example. However, the need to ensure a security of supply can be relevant in domestic contracts as well, although the degree of control by the Member State is severely reduced once the supply is located in another country. This is addressed in the 2007 Commission Staff Working Document. Furthermore, it can be noted that defence and security transfers must be authorised following requirements in the state of production, which in an EU context relates to the Intra-Community Transfers Directive. This Directive was a part of the “Defence Package” just as the Defence Procurement Directive, and Trybus argues that these measures are intended to reduce the importance of security of supply in practice over time, in favour of the Internal Market.

3.2.1 Possible requirements under Article 23 of the Defence Procurement Directive

Article 23 of the Defence Procurement Directive concerns security of supply and allows requirements for the transfer, export and transit of products. Article 23 subparagraph 2(a) of the Defence Procurement Directive sets out that the following requirement may be included in the contract documentation: “certification or documentation demonstrating to the satisfaction of the contracting authority/entity that the tenderer will be able to honour its obligations regarding the export, transfer and transit of goods associated with the contract, including any supporting documentation received from the Member State(s) concerned”. This enables the contracting authority to protect itself from the potential risk of “refusal, withdrawal or delay of relevant export and transfer authorisations, but also possible
conditions linked to these authorisations”. The Guidance Note on Security of Supply sets forth a non-exhaustive list of examples of requirements that can be included and that cannot be included. Under an individual licences regime, the economic operator cannot be required to guarantee that a licence will be granted. Trybus argues that this would be discriminatory, since an economic operator cannot guarantee the behaviour of its national licensing authority. Therefore, the requirement must be that the economic operator can show that it has done or will do, everything necessary to acquire the desired licence.

Article 23 subparagraph 2(b) of the Defence Procurement Directive allows the following requirements to be included in the contract documentation: “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 or security arrangements”. The Guidance Note on Security of Supply explains that this concerns the “so called ‘black boxes’ and ‘anti-tamper devices’”, which are subsystems and components that form an integral part of the equipment that needs to be purchased but cannot be modified or accessed by the supplier or purchaser. The risk addressed here is the same as in letter (a), that of withdrawal, refusal or delay of necessary authorisation. This allows the contracting authority to react to the risk, while the tenderer needs to inform the contracting authority comprehensively of any relevant restrictions.

Article 23 subparagraph 2(c) of the Defence Procurement Directive sets out that the following requirements can be included in the contract documentation, which relates to the organisation of the supply chain: “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”. The risk addressed here is that of disruptions in transportation or through problems with licensing in relation to subcontractors in the supply chain. This provision enables the contracting authority to ensure the stability and reliability of the chain; disruptions here can affect the security of supply just as much as if it would occur with the prime contractor, and the contracting authority might have even less control. Moreover, requirements concerning the future changes in

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the supply chain represent a more general commitment compared to requirements related to the time of the tender.\textsuperscript{117}

In addition, supply chains involving only operators from EU Member States are separated from supply chains which includes operators from a third country. Trybus validly points out that this should be further differentiated; a supply chain which only involves operators from the Member State of the prime contractor implies even fewer risks. Furthermore, the Guidance Note on Security of Supply emphasizes the principle of non-discrimination on the basis of nationality, which accordingly only allows for “objective and performance-based considerations”. However, one such consideration can be geography in relation to transportation, but not in relation to national territory. Nevertheless, all requirements need to comply with EU Internal Market law, including the principle of proportionality.\textsuperscript{118}

Furthermore, Article 23 subparagraph 2(d) and (e) of the Defence Procurement Directive allows requirements concerning additional needs resulting from a crisis. Article 23 subparagraph 2(d) of the Defence Procurement Directive allows requiring: “a commitment from the tenderer to establish and/or maintain the capacity required to meet additional needs required by the contracting authority/entity as a result of a crisis, according to terms and conditions to be agreed”. Article 23 subparagraph 2(e) of the Defence Procurement Directive allows requiring: “any supporting documentation received from the tenderer’s national authorities regarding the fulfilment of additional needs required by the contracting authority/entity as a result of a crisis”.

The purpose of these provisions is to safeguard against the risk related to additional needs that might arise due to a crisis, but was not a part of the original contract. Article 1(10) of the Defence Procurement Directive defines the term “crisis”. Moreover, this provision is less relevant according to the Guidance Note on Security of Supply, since these requirements concern the conditions of the contract after it has been awarded, and thus not a situation that would provide a ground for derogation from the Directive.\textsuperscript{119} Trybus points out the important aspect that in a crisis, there is a risk that several contracting authorities have additional needs and therefore the economic operator might be overwhelmed. Consequently, this might be of interest to address.\textsuperscript{120} In addition, a crisis can justify the use of the negotiated procedure

\textsuperscript{117} Commission ‘Guidance Note Security of Supply’ (Guidance Note), 2016 p. 13, para. 37.
\textsuperscript{118} Commission ‘Guidance Note Security of Supply’ (Guidance Note), 2016 p. 13, para. 38.
\textsuperscript{119} Commission ‘Guidance Note Security of Supply’ (Guidance Note), 2016 p. 13, para. 40.
without prior publication of a contract notice on the basis of Article 28(1)(c) of the Defence Procurement Directive.

Article 23 subparagraph 2(f) of the Defence Procurement Directive sets out that contracting authorities and entities can require: “a commitment from the tenderer to carry out the maintenance, modernisation or adaptation of the supplies covered by the contract”. This concerns follow-on work according to the Guidance Note Security of Supply, and serves to protect the contracting authorities from the risk that important maintenance, adaption and modernisation needed for the operability of the concerned equipment are not performed, which compromises the utility and therefore national security. Due to the long life cycle of defence related contracts, this can be considered to cover in the initial supply contract. The Commission recommends “to specify such a commitment with more detailed stipulations on the nature and content of the maintenance, modernisation or adaptation to be performed, including, if possible, at least a general agreement on prices”.121

Moreover, Article 23 subparagraph 2(g) of the Defence Procurement Directive enables contracting authorities and entities to require: “a commitment from the tenderer to inform the contracting authority/entity in due time of any change in its organisation, supply chain or industrial strategy that may affect its obligations to that authority/entity”. The risk addressed here is that of being surprised by business decisions affecting security of supply. This requirement give the contracting authority time to address these changes. Considering changes in supply chain, letters (g) and (c) should be read together.

Lastly, according to Article 23 subparagraph 2(h) of the Defence Procurement Directive, contracting authorities are allowed to 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”. This commitment provides a safeguard against the risk of ceasing production of military or security equipment, due to bankruptcy or business decision. This provision enables the contracting authority to take over the production if the economic operator ceased production, making the production in-house. This is potentially the heaviest requirement since it transfers considerable assets and intellectual property to the contracting authority.122

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121 Commission ‘Guidance Note Security of Supply’ (Guidance Note), 2016 p. 15, para. 43.
3.3 Security of information

Security of information is not explicitly defined in the Defence Procurement Directive, however the Commission’s Guidance Note Security of Information clarifies the notion as “the ability and the reliability of economic operators to protect classified information”. It is described as “a particularly important feature” of the Defence Procurement Directive due to the “sensitive nature of many defence and security procurements”. Since the exemption concerns the “ability and reliability of economic operators”, it affects the qualification and selection of tenderers as well as the rules on contract conditions, award criteria and publication of the contract. The Commission Staff Working Document further sets out that security of classified information needs to be safeguarded throughout the life cycle of the contract and even its performance. Classified information is defined in Article 1(8) of the Defence Procurement Directive as:

“any information or material, regardless of the form, nature or mode of transmission thereof, to which a certain level of security classification or protection has been attributed, and which, in the interests of national security and in accordance with the laws, regulations or administrative provisions in force in the Member State concerned, requires protection against any misappropriation, destruction, removal, disclosure, loss or access by any unauthorised individual, or any other type of compromise.”

However, there is no EU security of information regime and the Member States are in charge of which information that needs to be classified, the level of confidentiality and to grant the necessary security clearances, which are not automatically recognized by the other Member States. Article 7 of the Defence Procurement Directive enables contracting entities to impose requirements on prime contractors and subcontractors in order to protect classified information throughout the tendering and contracting phases. Article 22 of the Defence Procurement Directive however, allows requirements aimed to secure the protection of classified information on the

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123 Commission ‘Guidance Note Security of Information’ (Guidance Note) at 1.
125 Commission ‘Staff Working Document on simplifying terms and conditions of transfers of defence-related products within the Community - Impact Assessment Summary’ (Staff Working Document), para. 47-48.
required level of security through contract performance conditions. These performance conditions include a commitment to safeguard information on subcontractors and confidentiality.

The commitment to safeguard confidentiality enables the contracting authorities and entities to set out two requirements, as can be found in Article 22 subparagraph 2(a) and (b) of the Defence Procurement Directive. Firstly, they may require “a commitment from the tenderer and the subcontractors already identified to appropriately safeguard the confidentiality of all classified information in their possession or coming to their notice throughout the duration of the contract and after termination or conclusion of the contract, in accordance with the relevant laws, regulations and administrative provisions”, according to Article 22 subparagraph 2(a) of the Directive. Furthermore, Article 22 subparagraph 2(b) of the Defence Procurement Directive provides the possibility to require “a commitment from the tenderer to obtain the commitment provided in point (a) from other subcontractors to which it will subcontract during the execution of the contract”.

The Guidance Note Security of Information sets out that letter (b) allows for verification using security clearances of the tenderer’s “general ability to safeguard classified information at the required level”. Moreover, the contracting authority may require a commitment from the prime contractor and its already identified subcontractors to safeguard the confidentiality of all classified information that is in their possession or will come to their information during and after the contract, according to letter (a). As stated in the Guidance Note, the two letters constitute a compliment to the selection criterion in Article 42(1)(j) of the Defence Procurement Directive and results in a system were the contracting authority is able to first make sure that only reliable operators fulfilling the necessary requirements are invited to tender, and secondly that they are responsible for ensuring that the classified protection is adequately protected.127

Article 22 subparagraph 2(c) and (d) of the Defence Procurement Directive are focused on subcontractors involved in the procurement process. According to letter (c), the contracting authorities or entities are allowed to require sufficient information on already identified subcontractors in order to ensure that the subcontractors fulfil the capabilities necessary to “appropriately safeguard the confidentiality of the classified information to

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which they have access or which they are required to produce when carrying out their subcontracting activities”. Moreover, letter (d) sets forth that they also may require that the same apply to any new subcontractor before awarding a subcontract.

This information will be materialised as certificates handed out by the national or designated security authority of the tenderer will ensure that all subcontractors involved in the relevant chain of supply hold the necessary national clearances regarding security, according to the Guidance Note Security of Information.128 As a result, potential contractors will be able to consult these authorities concerning what constitutes relevant information in the procurement in question. Since defence and security contracts in general have longer supply chains of contractors, and due to the natural sensitivity of these contracts, it is necessary to verify the reliability of subcontractors.129

3.4 Offset requirements

Offsets constitutes the practise of Governments to require industrial compensation as a condition of granting contracts for their defence and security supplies. Offsets come in a variety of forms; they can be direct, indirect or a combination of both. Direct offsets concerns the performance of the contract and include local subcontracting, technology transfer, training requirements or co-production. Indirect offsets are not related to the concerned matter of procurement. It may take the form of civil offsets, such as obliging foreign bidders to invest in the customer’s local economy or to procure a counter-trade in exports of civil goods or services of a specific value (often 100 % of the contract price). Indirect offsets can also be military, for example sub-contracts awarded by the supplier to local defence companies for other military products. Offsets have previously been a regular practice of governments inside and outside Europe, however the possibility to use offsets has been severely limited by the European Commission in order to promote greater international competition and transparency in defence procurement. Moreover, offsets is considered as an obstacle to create an open European Defence Equipment Market (EDEM). One of the main reasons to why offsets, until recently, have been left largely untouched is their perceived politically sensitive nature: offset requirements can provide several work positions and opening of factories etc.130

128 Ibid.
130 Lorraine Campos “An end to offsets in European Defence trade?” (Reed Smith LLP, 2012).
In the recently published Guidance Note on Offsets from 2016, the Commission states that the requirements of offsets constitute a breach of the basic principles of the Treaty since they discriminate against economic operators, goods, and services from other Member States, and obstruct the free movement of goods and services on the Internal Market. Since offsets violate primary law, it cannot be tolerated or regulated under secondary law such as the Defence Procurement Directive. This is why offsets are not regulated or even mentioned in the Defence Procurement Directive. Since offsets impose an economic return in the national industry of the purchasing Member State, they violate Article 18 TFEU which prohibits discrimination on the ground of nationality. Furthermore, offset requirements constitute measures having equivalent effect as quantitative restrictions on import and export, which violate Articles 34 and 45 TFEU regulating the free movement of goods. Moreover, the freedom to provide services in Articles 56 and 62 TFEU is violated as well.

However, when Article 346 TFEU or another EU law exemption is rightfully invoked, the Directive does not apply according to Article 2 and Recital 16 of the Defence Procurement Directive. This is the case for prime contractors carrying out the offset obligations that are located outside of the EU as well. Since offset requirements discriminate in favour of subcontractors located in the contracting Member State, they are in breach with EU law. Therefore, the Court has held that offsets, like all measures adopted on the basis of EU law exemptions, need to be justified on a case-by-case basis and cannot be used to promote a purpose of purely economic nature. Consequently, offsets cannot be justified when they mainly aim to boost national employment or industries. Nevertheless, offset requirements that are genuinely intended to protect a Member State’s essential security interests, and that have economically advantageous side effects, are not automatically unlawful. However, they still need to comply with the principle of proportionality; that they do not go beyond what is appropriate and necessary to protect the essential security interests, and that this protection cannot be achieved by the use of less restrictive measures.

Furthermore, it is difficult to argue that offset requirements contribute to security of supply for military equipment when they are indirect and concern

131 Commission ‘Guidance Note on Offsets’ (Guidance Note), 2016.
133 Case C-322/01, Deutscher Apothekerverband [2003] ECLI:EU:C:2003:147, at [122].
the civil sector or non-military equipment. Consequently, they appear difficult to justify on the ground of national security in the light of the wording of Article 346(1)(b) TFEU “such measures shall not adversely affect the conditions of competition in the internal market regarding products which are not intended for specifically military purposes”.

3.5 Government-to-government contracts

Article 13 (f) of the Defence Procurement Directive exempts “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” due to the common practice of one government procuring military supplies, work and services from another country’s government. Since contracts between governments do not involve purchase from a private operator, they are not public procurement - the products or services concerned have already been procured by the selling government. Reasons for doing this might be to strengthen coalitions or improve interoperability in the battlefield, or due to security concerns (e.g. controlling the sale of weapons/limiting access to sensitive technology).

This exclusion is related to the in-house exemption established by the Court in case law, which concerns purchases within the same contracting authority or between the contracting authority and a body over which the authority exercises a comparable level of control as it does over its own departments.

Article 1(9) of the Defence Procurement Directive defines a government as the State, regional or local government of a Member State or third country, and this definition is used when identifying government-to-government contracts according to the Guidance Note Defence and Security-specific Exclusions. Furthermore, a “regional or local government entity having its own personality” is included. However, “contracts concluded by, or on behalf of, other contracting authorities/entities such as bodies governed by public law or public undertakings” are not exempted. The scope of the exemption thus excludes all bodies governed by public law, and is consequently quite narrow. Regarding material on the other hand, the scope is rather wide. A “broad range of very different purchases” concerning service contracts, is included. Regarding supply contracts, the exemption primarily focus on sales

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of equipment delivered from existing stocks (such as used items or items no longer considered necessary and therefore surplus).\textsuperscript{136}

The current wording includes new items\textsuperscript{137}, which according to Trybus can result in abuse if Member State A buys military equipment from a private company with the intention of selling it to Member State B. The Guidance Note Defence and Security-specific Exclusions states that only the contract between the two governments is excluded from the scope of the Defence Procurement Directive, not the contract between the selling government and the economic operator it buys from. Therefore, Member State A is obliged to ensure that the purchased equipment in the example is procured in accordance with the Defence Procurement Directive. Regardless in this example, the safeguard clause in Article 11 of the Defence Procurement Directive applies, which states that “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”. It is a general provision, which would catch the intention of Member State A to circumvent the Defence Procurement Directive.

Trybus argues that the exemption of surplus items is conventional since it does not constitute public procurement due to no involvement of a private operator. Therefore, an explicit exemption of the Defence Procurement Directive would not be required. However, there is no definition of what surplus means. In order to distinguish between surplus and new items it needs to be clarified how long the equipment in question has to be stored by the selling government. Trybus states, that by wrongly labelling new equipment as surplus and then selling it, a Member State government is able to circumvent the Defence Procurement Directive, consequently defying the objective of the Directive and the Internal Market. However, this would again be caught by the safeguard clause in Article 11 of the Directive. Nevertheless, such an intention might be difficult to prove. Another issue is whether or not the equipment was procured before or after the transposition deadline of the Defence Procurement Directive, since it has established higher levels of transparency and non-discriminatory procedures.\textsuperscript{138}


\textsuperscript{137} And most likely will continue to do so since the Commission has stated that it is satisfied with the text of the Defence Procurement Directive, although the exemption was only intended for used items in the beginning of the legislative process. See Martin Trybus, Buying Defence and Security in Europe (Cambridge University Press 2014), p. 295.

Regarding the exemption of new equipment, it is only the contract between the selling government and the buying government that is excluded from the Defence Procurement Directive, not the contract between the selling government and the entity it bought the equipment from. Legal problems arising from this situation can for example be if the contract is valued below the thresholds of the Defence Procurement Directive when it was procured, but is valued above the thresholds afterwards when the selling government has the object of the procurement in its possession.

Trybus argues that such a contract cannot be in the scope of the exemption in Article 13 (f), and therefore needs to be procured on the basis of the Defence Procurement Directive, since the general rule is that exemptions of the Directive shall be interpreted narrowly. However, only when both the selling and the buying government are EU Member States. The Guidance Note Defence and Security-specific Exclusions states that an EU Member State is not allowed to buy military equipment from a government of a third country, outside the EU, in order to circumvent the Defence Procurement Directive. Especially not when “market conditions are such that competition within the Internal Market would be possible”. ¹³⁹ This refers to the general safeguard clause in Article 11 of the Defence Procurement Directive. The Guidance Note focuses on new equipment, as it would be practically impossible to require countries such as the USA and Australia to have procured used equipment in line with the European Defence Procurement Directive.

Moreover, the Commission seems to have taken on an increasingly stricter interpretation of the exemption grounds. Commissioner Michel Barnier warned Bulgaria and Romania in 2012 that they might be violating the Defence Procurement Directive if they proceeded with the planned purchase of fighter jets from the stocks of Portugal’s existing fleet. ¹⁴⁰ The details of the proposed transactions are not public in their entirety, but the planes were used which would put the deal within the exemption in Article 13 (f) according to the Commission’s Guidance Note on Defence and Security specific exclusions. Still, Barnier argued that the exclusion never can be applied when a competition for the contract can be found within the internal market. Barnier’s office later referred to the safeguard clause in Article 11. ¹⁴¹ In the following Communication on the defence and security sector, the

Commission in 2013 stated that government-to-government contracts appeared to be interpreted in a way which circumvents the aim of the Directive and that the Commission will take steps to clarify the limits.\textsuperscript{142}

Trybus states that the Guidance Note in this regard is unclear concerning the interpretation of Article 13 (f) and third countries, but suggests a narrow interpretation of the exemption. This would be in line with the general attitude in settled case law.\textsuperscript{143} Again, the safeguard clause in Article 11 applies where there is a warning to not abuse the government-to-government exemption. Abusing the government-to-government exemption may result in the Commission initiating an infringement procedure under Article 258 TFEU, and ultimately bring an action before the Court of Justice of the European Union, or private litigation in national courts.

If it would be possible for a Member State to circumvent the Defence Procurement Directive and the complications of including both Member States and third-country operators in a procurement procedure by purchasing from a third country government, Article 13 (f) of the Directive would become a loophole and undermine the Internal Market. The Court has never allowed that, which can be seen in several cases that have been codified in the safeguard clause of Article 11 of the Defence Procurement Directive. In this regard, the Guidance Note seems to prioritise the EU Internal Market - and procurement on the basis of the Defence Procurement Directive - over third country government-to-government purchase.

Trybus argues that a purchase of a new item from a third-country government only can be exempt through Article 13 (f) of the Directive when that purchase cannot be procured in the EU, due to no providers (and therefore no competitors) of that equipment existing within the Internal Market. The objectives of the Defence Procurement Directive include competition and the free movement of goods and services in the Internal Market. According to Trybus, it would require a very wide interpretation of the government-to-government exemption and considerable compromising of the purchase from some third countries when the product or service could be procured in the EU, when there is competition in the Internal Market.\textsuperscript{144}

\textsuperscript{142} Commission, ‘Towards an EU Defence Equipment Policy’ (Communication) COM/2013/0542 final, p. 6.


4 Analysis and Conclusions

4.1 The scope of Article 346 TFEU

As stated in *Fiocchi Munizioni* (para. 58) and later codified in Recital 16 in the Defence Procurement Directive, it is the sole responsibility of Member States to define their essential security interests. However, the Court has repeatedly confirmed that Member States cannot simply refer to those interests in order to depart from EU law; exemptions are limited to exceptional and clearly defined cases, and the measures taken cannot go beyond the limits of these cases. The grounds for exemption are to be interpreted narrowly, and the burden of proof is on the Member State invoking it. This concerns the whole of Article 346 TFEU, and therefore applies to letter (a) and (b). This makes sense; the exemption needs to be interpreted narrowly for the very introduction of a Defence Procurement Directive to be worthwhile. Due to the limited amount of case law regarding Article 346(1)(a) TFEU specifically, it is difficult to distinguish a potential difference in the Court’s intensity of scrutiny when assessing the two provisions.

What can be said about the Court’s attitude in judgements involving 346(1)(b) TFEU, is that a measure is deemed disproportionate when the article is used in bad faith and when it has been clearly unnecessary on the basis of national security. Moreover, the same applies if the measure adopted by a Member State damages the Internal Market more than necessary. This can be seen in *Spanish Weapons*, were Spain supported its national defence export companies by exempting them from VAT on the basis of Article 346(1)(b) TFEU, and the *Military Exports* cases, were several Member States made imports of military equipment duty-free by relying on the same provision. However, it is difficult to determine the limit of “more than necessary”. It can be argued that the Court should apply a low threshold in this regard, due to the matter being national security. Considering previous case law such as *Fiocchi Munizioni* and recital 16 in the Defence Procurement directive, this makes sense. The Member States are given a wide space to manoeuvre; it is up to them to define the term essential security interest and Article 346(1)(b) TFEU is said to have a general effect and is intended to preserve the freedom of action of Member States. At the same time, Article 346 TFEU is to be interpreted narrowly. Consequently, more guidance such as case law is needed to assess the balance between these two.
It can also be noted that the majority of cases before the Court regarding Article 346 TFEU was initiated by the Commission, and the Commission seems to have been aiming for low hanging fruit considering the background facts and success rate. The Member States’ reliance on Article 346 TFEU has been weakly argued for and often been clearly disproportionate, such as the national code in Agusta and Spanish Weapons as well as Military Exports mentioned above. The Commission seem to be going for similar fruit again following the recent infringement proceedings against five Member States concerning the direct award of a number of defence contracts in breach of the Defence Procurement Directive, and unjustified offsets requirements.

Furthermore, the scope of a Member States ability to take measures necessary to protect their essential security interests set out in Article 346(1)(b) TFEU relates to products for civil use, dual use and specifically military purposes. The legal situation regarding these categories, at least in theory, is rather clear; products for civil use is not covered by the exemption ground in Article 346(1)(b) TFEU already according to its wording – exemptions should relate to “arms, munitions and war material”. Products that are specifically designed and developed for military purposes are also within the scope of the Article, which can be seen in Finnish Turntables, and qualifies for further assessment. Products for dual use can be exempted on the basis of Article 346(1)(b) TFEU, providing it has been significantly modified for military purposes. However, more case law or guidance is needed to clarify what the concept “significantly modified” means.

Looking at the level of scrutiny of the Court, a measure should be well grounded and proportionate. The Court does not want to provide possible loop holes which could undermine the Internal Market, which indicates that modifications that have constituted a heavy investment, in time, money, resources etc., which cannot easily be changed into a civil product where these investments would be of significant relevance, should stand a better chance of being accepted under Article 346(1)(b) TFEU.

Regarding the intensity of scrutiny of Article 346(1)(a) TFEU, it is not well known. As previously mentioned, it was indirectly brought up by the Court in German Military Exports due to Germany arguing that the Commission could not prove the alleged infringement. This was true, but only because Germany claimed that it did not have to provide the Commission with the information. Article 346(1)(a) TFEU was officially addressed in case ZZ (C-300/11) in 2013, were the Court was asked if the principle of effective judicial protection could be set aside on the basis of Article 346(1)(a) and the interests of State security, by not informing a Union citizen of the essence of the grounds against him. The Court stated shortly once more, that the mere fact
that a decision concerns State security does not result in European Union law being inapplicable, thus repeating existing case law established in *Italy v. Commission* (C-387/05).

This provides for an interesting link to Advocate General Kokott’s statement in her Opinion in *Commission v. Austria*, that these are days where threat of international terrorism is a focus of public interest everywhere. The Court now has the opportunity to further clarify the scope of Article 346(1)(a) TFEU. What can be said in the light of ZZ is that again, just as when dealing with letter (b) of the same provision, the use of Article 346(1)(a) TFEU needs to be well grounded and proportionate. Setting aside the basic fundamentals which ensures the right to a fair trial cannot be done by simply invoking State security. This was put forward by the Court in the present case by referring to *Italy v. Commission* (one of the Military Export cases) para. 45, which repeats case law established in cases *Kreil* and *Sirdar*. Although not repeated in ZZ, in these cases as well as in *Johnston*, the Court held that when determining the scope of any derogation from a fundamental right, the principle of proportionality must also be observed.

Concerning the scope of Article 346(1)(b) TFEU in relation to the possibility to use offset requirements, it differs depending on which category of offsets that are at hand. Civil offsets seem unlikely to be accepted by the Court under Article 346 TFEU, due to letter (b) in combination with case law prescribing that only material which “by virtue of its intrinsic characteristics may be regarded as having been specifically designed and developed, also as a result of substantial modifications, for military purposes”. Military offset requirements on the other hand, are in a slightly better position. In order to be justified, they will have to be necessary to protect the essential security interests of the Member State in question. This is a high threshold. According to case law, the exemption of Article 346 TFEU is to be interpreted narrowly, and since the Commission’s position regarding offsets is that they stand in direct contrast with Treaty law, the threshold should be even higher. The contracting entity/authority in the Member State concerned will have to show that the offset requirements are proportionate.

Furthermore, indirect military offset requirements appears to be difficult to justify under Article 346(1)(b) TFEU. In addition, indirect offsets that benefit non-military equipment or the civil sector distorts the EU Internal Market for civilian goods. However, there are plausible situations where it could be argued to fulfill the grounds of justification. For example, smaller countries might find themselves in a situation where they need to acquire certain knowledge related to production, or development of products intended for specifically military purposes due to their essential security interests.
Moreover, indirect military offsets relating to maintaining existing shipyards on domestic soil or building new ones might be justified in a situation where an island country wants to ensure the continued openness of its sea lanes. Provided, for example, that the relationship with a close neighboring country is tense, even bad at times, this could be a genuinely necessary measure to protect their essential security interests. Still, regardless, these measures must comply with the principle of proportionality.

Moreover, direct military offset requirements seem less difficult to justify under Article 346(1)(b) TFEU, due to them naturally being intended for specifically military purposes. Moreover, the Commission address this slightly lower threshold in the Guidance Note Security of Supply, where it provides several scenarios in which the requirement of direct military offsets can be lawful.

In addition, discrimination on the basis of nationality is a fundamental characteristic of offsets as applied today. However, if a Member State were to require “EU offsets” from a third country prime contractor, it does not appear to be in violation of EU law. If the offsets are allowed to be carried out within the EU and not specifically in one Member State, it does not appear to be discriminatory, and therefore lawful as long as it complies with other fundamental rules and principles of EU law. This construction would not be in breach of World Trade Organisation (WTO) rules either, since trade in defence equipment is not covered by the WTO Government Procurement Agreement. On the other hand, this would probably be a demanding process to organise and without knowing that there will be an economic benefit, this practice is not likely to be used often if at all.

Concerning government-to-government contracts, it seems to be the position of the Commission that Article 13(f) of the Defence Procurement Directive is primarily intended for used equipment and surplus stock. Trybus also argues that a contract exempting new equipment should not fall under the government-to-government exemption due to the main rule that exemptions should be interpreted strictly. On the other side however, there is no support for an exclusion of new equipment in the wording of the Directive. Consequently, it can be argued that the focus of the Commission should be on compliance of the initial equipment purchase from the private market with the Defence Procurement Directive. Furthermore, the Commission acknowledges in paragraph 26 of the Guidance Note on Defence- and Security-specific Exclusions that Article 13(f) of the Defence Procurement

Directive “applies to all contracts for the supply of military or sensitive equipment, including, in principle, even purchases of new material”. This makes sense; the Defence Procurement Directive is still applicable when the selling government procures from the private sector, ensuring that the goods are procured in accordance with the Directive.

In addition, considering the safeguard clause in Article 11 of the Defence Procurement Directive, following the actual wording of the Directive arguably would not constitute a circumvention of the Directive. The purpose of the Defence Procurement Directive is to establish a European Defence Equipment Market (EDEM) by presenting contracts in the defence sector to competition. This is set out in Recital 2 and 4 of the Defence Procurement Directive. Allowing government-to-government transactions on the “secondary equipment market” will not obstruct this.

Moreover, the Commission has repeatedly indicated that the purchase of equipment from a third country outside of the EU may circumvent the Directive. In the same Guidance Note, the Commission still warns Member States that they could be circumventing the Directive, if they purchase new material which could also have been delivered through an open competition within the EU, by using direct contract awards to third countries. This tendency by the Commission to promote the EU Internal Market appears again in Barnier’s letters to Romania and Bulgaria. This indeed resonates well with a pro-European perspective: when Member States opt for government-to-government purchases on a larger scale, it undeniably undermines the competitiveness of the European defence industries while placing the Member State’s money in a non-European market. Buying defence equipment in Europe contributes to improve the economy of the European defence sector, and thus creating more jobs and ideally lowering the prices as a consequence of competitive behaviour. Furthermore, with nothing stopping a Member State from procuring directly from a third country, the incentive to do so would be high since the flexibility is greater outside the scope of the Defence Procurement Directive.

To conclude the analysis of the government-to-government exemption in relation to Article 346 TFEU, such contracts can now be entered into without a tender procedure, which previously would have required the use of Article 346 TFEU.

In conclusion, the different grounds for derogation in the Defence Procurement Directive seem to provide for different kinds of thresholds. My interpretation is that Security of Information must be the easiest exemption to use, since it is closely related to an actual provision in Article 346 TFEU –
that of letter (a). This provision will be dealt with more closely when analysing Commission v. Austria below. However, Advocate General Kokott expresses this close relationship in paragraph 43 of her opinion, where she states that Article 346(1)(a) TFEU is fleshed out in Article 13 (a) of the Defence Procurement Directive. This provision is almost identical in its wording to Article 346(1)(a) TFEU. Government-to-government exemptions are not difficult to use either – but Member States selling to other Member States still need to procure the equipment in question in accordance with the Defence Procurement Directive. The different threshold concerning offsets has already been analysed, and the importance of security of supply will be highlighted below.

4.2 Potential outcomes and observations of Commission v. Austria

Interestingly, Advocate General Kokott did not make any reference to Article 346 TFEU as an exemption to be used on a case-by-case basis, which as previously stated has been established by the Court in German Export (C-372/05, para. 76). Trybus compared this way of reasoning with the national code in Italy v. Commission (C-157/06), and argued that a national code cannot be an exemption on a case-by-case basis; it becomes an automatic exemption and can therefore be illegal. This makes sense; Article 346 TFEU is to be interpreted strictly and in exceptional and clearly defined cases. In Commission v. Austria, Austrian law requires that the production of all documents entailing secrecy or compliance with secrecy rules to be awarded exclusively to the Österreichische Staatsdruckerei GmbH.

Since the Court has clearly stated that Article 346 TFEU shall be used on a case-by-case basis, it would be natural to notice this in the Opinion while also reaching the conclusion that Austria has failed to comply with its obligations under Treaty rules. Advocate General Kokott states that the resolution of the case depends on if the essential security interests and measures that Austria has presented can justify completely dispensing with the practice for the award of public contracts prescribed by EU law. Already here, before performing a proportionality test, it could be concluded that the Austrian law violates settled case law on Article 346 TFEU. It can also be noted, that the position of the Commission is that every exemption from Article 346 TFEU shall be done on a case-by-case basis “with great care”, further narrowing the scope, in its Communication on how to apply Article 346 TFEU.
Regarding public procurement, it seems to be clear that the possibility to exclude compliance with EU law should be removed in cases where the Member State can resort to less restrictive measures. These could be carrying out a tender with high requirements in the selection criteria and extensive confidentiality obligations. An example of high requirements in the selection criteria is an obligation to execute the contract in the territory of the contracting authority, as stated in Commission v. Germany (C-205/84).

This far, Article 346(1)(b) TFEU has been given significantly more space in case law. However, since 2011 there has been four cases regarding Article 346 TFEU at the Court of Justice, and half of them have concerned Article 346(1)(a) TFEU. This is not surprising, and corresponds well with the current climate of taking measures to protect information, which is also illustrated by the adoption of the General Data Protection Regulation (GDPR) entering into force in May of 2018. The purpose of the Regulation is to strengthen the protection of personal data, and illustrates that the Council and the European Parliament have realised the importance of protecting information. Moreover, Advocate General Kokott emphasized in her Opinion, that these are times when international terrorism is a focus of public interest everywhere, and this especially regards security of sensitive information.

Regardless of the outcome in Commission v. Austria, the approach of the Court to Article 346 TFEU as a whole and especially letter (a) will be interesting to observe. It is an excellent opportunity to further develop the scope of application of both, however it is not unlikely that the Court simply states that Austria interpreted the exemptions from EU public procurement too widely, and concludes that the direct award of the contract fails a strict proportionality test regardless. Moreover, last time the Court dealt with Article 346(1)(a) TFEU was in ZZ (C-300/11). It approached the Article in two paragraphs and stated shortly that the fact that a decision concerns State security does not make European Union law inapplicable, thus repeating existing case law and consequently not giving any further guidance on the matter.

To conclude, the importance of Article 346(1)(a) TFEU will likely increase, and more cases can be expected to reach the Court of Justice. The future development of Article 346(1)(a) TFEU is likely to be of importance also for the interpretation of Article 346(1)(b) TFEU. Examples of the two letters affecting each other can be seen in Case C-372/05 German Military Exports. In this case, Germany relied on Article 346(1)(b) TFEU when trying to justify duty-free imports of military equipment. The Court did not accept the arguments, but interestingly decided to rule on Article 346 TFEU as a whole, instead of only on letter (b). Consequently, a case concerning letter (b)
affected the future interpretation of letter (a). This relationship is also noticed by Kokott in para. 45 of the Opinion in Commission v. Austria. Furthermore, the relatively few judgements related to Article 346 TFEU overall increase the likelihood of Article 346(1)(a) and (b) TFEU affecting each other.

4.3 Will the European defence market turn into a competitive market?

The third question on which this thesis is based on is: will the defence market turn into a competitive market. Considering the answers to the previous questions and the thesis in general, it will be analysed below if we can expect to see a more competitive, and thus integrated, defence market.

The previously often used exemption in Article 346 TFEU brought most armament and related services outside of the EU’s trade, competition and procurement rules. This led to 28 different and segregated defence markets, resulting in reduced levels of innovation and competitiveness, higher prices, duplication and reduced transparency. Moreover, protectionism and inefficiency characterised the defence markets, and the industry is still rated as one of the three most corrupt business sectors in the world. An integrated European defence market is important for competition; it increases the supply of goods and services on the Internal Market. Operating in a market economy, a system based on supply and demand is supposed to promote the purchase of the best solution, instead of an inferior one which might be purchased on a fragmented marked instead simply because it comes from the national market. The prior would result in a more efficient defence market in terms of quality, but also from an economic and time-efficient perspective.

In order to achieve this, the Commission must become more active. As has been showed, there are plenty of guidance to access today; there are communications and guidance notes regarding the application of Article 346 TFEU and several other exemption specific ones. Consequently, lack of guidance does not seem to be the problem. This is further illustrated in Spanish Weapons, where the Spanish government relied on Article 346 TFEU in order to boost its growing defence export sector. In order to put pressure on Member States to comply with the Defence Procurement Directive and Article 346 TFEU, the Commission just opened infringement procedures against five Member States for not complying with the Directive.

Furthermore, the defence companies must start to challenge procurement decisions from Member States to correct the market. As stated in the Commissions implementation report on the Defence Procurement Directive,
high value deals are still regularly procured outside of the Directive. Many small factors is likely to make the difference, over time. The defence industry is politically sensitive as well, due to the high number of direct and indirect employees. The Member States are obstructing the effectiveness of the Directive; no one wants to be responsible for the loss of hundreds or thousands of jobs in one Member State as a result of another Member State being better competitors. Even though the idea is that the majority benefits from an integrated market, short term effects can be bitter for companies that do not keep up with competition and their employees.

Moreover, the ambition to integrate the European defence market put Member States and the principle of solidarity to the test. It is of course a risk to treat the Union as one entity in defence matters if there are doubts concerning its will to actually act and remain together in the future and during times of crisis. The Member States need to be able to trust each other. In matters of security of supply for example, there is a need to be able to count on the Member State producing spare parts on behalf of another Member State, to not deliberately refuse to deliver. In addition, it needs to be ensured that the supply chain is not cut off during a potential invasion. This can of course not be guaranteed, but some locations suit the purpose of a potential procurement better than others in this regard. To conclude this point, if the Member States build their defence industries or supply chains depending on each other, they need to be able to do so. Otherwise, the chain will collapse. However, an already integrated industry do work as an incitement for continuous cooperation.

Consequently, whether or not the defence sector will turn into a competitive market depends on many small measures such as the EDF initiative from the Commission. These small things, and the ability of the Commission to ensure that they are properly implemented, largely depends on the Member States support. The Member States are the procuring party in defence procurements, and it is therefore up to them to give the Directive the effect that the Commission wanted it to have. It is a power play, were collaboration and unity makes a big difference.

The guidance notes are not legally binding and the Court is able to rule against them if statements in the guidance notes are challenged before court. Because of the limited amount of case law, the current legal state is not as clear as one might normally think in this situation. Usually, when legal acts are not challenged, it means that the market is satisfied with the current situation. However, the defence market is often argued to be special, due to the very limited amount of buyers and their nature: the costumers in defence procurements are states. Therefore, the relationship between buyer and seller
is even more important than normal, and defence companies do not want to challenge it by taking one of few potential buyers to court. Consequently, the fact that there are few cases settled in court does not mean that the market functions well. On the contrary, it can be argued that it implies the opposite in this sector.
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