Defence and Security Public Contracts Regulations 2011

Chapter 4 -Treaty Exemptions

Purpose

1. This guidance explains what Article 346 is, the limited circumstances in which Article 346 may be applied and what procurers need to consider and do when applying a Treaty on the Functioning of the European Union (TFEU) exemption to exempt a defence or security procurement from the Defence and Security Public Contracts Regulations (DSPCR) 2011, or from a legal obligation under the DSPCR.

2. Specifically, the guidance sets out the legal framework, explains what a treaty exemption is and how you apply a treaty exemption. You should refer to separate guidance for the general exclusions in the DSPCR at Chapter 5.

What are treaty exemptions?

3. Article 346 is an exemption from, or relaxations of, our obligations under the TFEU. Failure to comply with TFEU obligations can only be justified on the basis of treaty exemptions. Treaty exemptions also allow us not to apply all or part of the DSPCR for specific procurements.

What is the legal framework?

4. The UK must adhere to the obligations set out in the TFEU. One aim of the European Union (EU) is to seek to remove trade barriers within the EU in order that goods, services, labour and capital may move as easily within the single European market as they may within a particular state. From the TFEU obligations flow rules which procurers must apply when awarding contracts, including those whose value falls below the thresholds.

5. In the context of public procurement, the TFEU prohibits discriminatory measures and unfair treatment. The obligations that stem from the TFEU are:

   a. non-discrimination on the ground of nationality within the EU;

   b. equal treatment of all EU suppliers;

   c. public transparency of the procurement process;

   d. mutual recognition, i.e. acceptance of equivalent documents, certificates and standards among EU Member States; and

   e. proportionality, i.e. any measure the procurer takes must be proportionate to the requirement being procured.

6. The DSPCR set out a procurer's obligations with regard to certain defence and security procurements, but the procurer only owes the duty to comply with

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the DSPCR to suppliers established in EU Member States. Moreover, if you comply with the DSPCR then you will be compliant with TFEU obligations.

The Treaty of the European Union (TEU)

7. The DSPCR refers to Article 4(2) which states that "national security remains the sole responsibility of each Member State". It therefore remains the UK's responsibility to define its essential security interests.

Article 346 TFEU

8. You will need to decide as part of your procurement strategy whether a treaty exemption applies. The TFEU sets out a number of exemptions that EU Member States may apply, some of which may be relevant for defence and security procurements. Article 346 TFEU is the most relevant treaty exemption for procurements within the scope of the DSPCR. Article 346 allows a procurer to:

a. withhold information the disclosure of which the UK considers contrary to the essential interests of UK security; and

b. take measures necessary for the protection of UK essential security interests which are connected with the production of, or trade in, arms, munitions and war material; provided that these measures do not adversely affect competition in the common market for products which are not specifically intended for military purposes.

9. It is the UK's responsibility to define and protect its security interests. Other treaty exemptions (Articles 36, 51, 52, and 62 of the TFEU) are of lesser relevance in the context of defence procurement but are set out for reference in Annex A. These exemptions provide for cases where compliance with European procurement law would undermine the UK's public security or essential security interests.

Protecting security interests under the DSPCR

10. The DSPCR provides measures specifically created for defence and security procurements, including safeguarding security interests of the UK to an extent, through provisions for protecting security of information and security of supply.

11. Procurers must therefore apply the procedures set out in the DSPCR rather than using the Article 346 TFEU exemptions where those procedures adequately protect the UK's essential security interests.

12. The DSPCR should provide safeguards for the protection of the UK's security interests. There may exceptionally be circumstances where despite using the measures in the DSPCR, the security interests of the UK would still be compromised e.g. a requirement to adopt security measures that limit information to UK nationals or maintain national industrial capability. Article 346 may be used in those circumstances to exempt a requirement from the DSPCR or to depart from the strict requirements of the DSPCR.

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Article 346(1)(a) TFEU and Regulation 7(1)(a) – security of information

13. The security of information exemption under Article 346(1)(a) allows procurers to withhold the supply of information if disclosure would oblige the procurer to "supply information, which they consider contrary to the essential interests of UK security".

14. Article 346(1)(a) allows you to withhold the information, however it does not automatically exempt the requirement from DSPCR. Instead, it allows procurers to impose restrictions that would otherwise breach the UK's TFEU obligations as set out at paragraph 5. For example you may be able to withhold details of a requirement under Article 346(1)(a) which are not material to the outcome of a competition run under the DSPCR but which may then be released to a winning bidder.

15. You can only exempt the procurement from the DSPCR where the security restrictions on disclosing information mean that you cannot use the DSPCR. In that case, you will use the general exclusion at Regulation 7(1)(a) of the DSPCR to exempt the requirement from the DSPCR in conjunction with Article 346(1)(a) (see Chapter 5 – General Exclusions in the DSPCR).

16. An outline of the decision making process is at Annex B.

National Eyes Only Information

17. You may need to use the Article 346(1)(a) exemption together with the general exclusion at Regulation 7(1)(a) of the DSPCR if the requirement demands that the supplier's staff have personal security clearances and are citizens of the UK. Such a "national eyes only" condition infringes the principle of non-discrimination on the ground of nationality in the TFEU and you can only apply it on the basis of a treaty exemption.

18. In order for the Article 346(1)(a) exemption to apply to classified information, it would normally be necessary to show that the proposed contract:

a. involves access to material classified as SECRET (or higher) and bearing a UK Eyes Only or other similar caveat;

b. could potentially involve access to particularly sensitive sites or equipment for which only UK nationals cleared to an appropriately high security level can have access to; or

c. is subject to restrictions of a similar nature required for the protection of the UK's essential security interests.

Foreign Arms Export Controls

19. Imported military equipment is very likely to be subject to export controls that may impose restrictions on the disclosure and use of information (e.g. technical data and software) associated with the equipment. During the award of the contract for the equipment, you should seek to minimise the restrictions that might prevent suppliers in the EU from participating in any subsequent contract for support of the equipment.

20. Such restrictions on the disclosure and use of information invariably require the consent of the foreign export control authorities concerned before you can disclose information to or for use by, amongst others, third country nationals, dual nationals, and contractors working on the procurer's behalf.

21. Arms export controls will not affect procurement processes for the initial procurement of military equipment. However, they are likely to restrict the method of procurement for maintenance, modernisation or adaptation of military equipment that is already in service. That does not mean necessarily that you cannot use the DSPCR to meet such requirements. You must take this decision on a case-by-case basis.

22. For example, it may be possible in some circumstances to amend the terms of a license before embarking on a procurement process to enable a greater degree of competition. MOD procurers should seek advice from DES IRG in the first instance. In that case, and more generally, the ability to receive the controlled information may be used as a supplier selection criterion in a procedure run under the DSPCR (including the non-competitive negotiated procedure under Regulation 16 where justified).

23. You may use Article 346(1)(a) exemption to withhold information subject to export controls, if you can show that the proposed contract:

a. involves access to information (including software) provided by another country (or contractors located in that country) that may not be transferred to third country nationals or dual nationals, or other entities (whether located in the UK or in third countries) without the consent of the export control authorities of that other country; and

b. failure to honour those restrictions would result in sanctions or damage to key relationships with foreign nations contrary to the essential interests of UK security.

Authority to use Article 346(1)(a) TFEU exemption

24. Procurers should issue local instructions that set out the level for authorisation of the Article 346(1)(a) exemption.

25. For the Ministry of Defence (MOD):

a. Directorate of Business Resilience – Defence Security – Science & Technology Industry (DBR-DefSy-STInd) are responsible for determining whether and the extent to which the Article 346(1)(a) exemption applies to a procurement that involves information classified as SECRET (or higher) and bearing a UK Eyes Only caveat.

b. Acquisition teams must consult Defence Intellectual Property Rights (DIPR) on the extent to which restrictions on information under arms export control law applies to the procurement, if the acquisition team does not understand the full extent of the restrictions. Authorisation to use Article 346(1)(a) to exempt a procurement from the DSPCR on account of these restrictions must be approved by a Band B Commercial Officer.

26. MOD acquisition teams must consult either DBR-DefSy-STInd or DIPR (as appropriate) and keep any advice on the exemption in a registered file.

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27. You are not required to apply an additional exemption under Article 346(1)(a) where your procurement is already exempt from the DSPCR under Article 346(1)(b).

Article 346 TFEU(1)(b) – warlike stores

28. The warlike stores exemption under Article 346(1)(b) allows the UK to take measures it considers necessary for the protection of the essential security interests of the UK connected with the production or trade in arms, munitions or war materiel. The measure taken may allow the procurer to exempt all or part of any procurement from the DSPCR depending on the circumstances.

29. The rules for using the Article 346(1)(b) exemption are unchanged and operate by:

a. first, establishing whether the goods appear on the list of products to which Article 346(1)(b) applies as set out in the official translation of Council Decision 255/58. Article 346(1)(b) can also cover the procurement of services and works directly related to the goods included in this list; and

b. second, deciding whether the protection of essential national security interests requires that all or part of the procurement be exempt by evaluating and recording:

(1) details of the essential security interest concerned;

(2) the connection between this security interest and the procurement;

(3) why using the exemption in this specific case is necessary to protect these essential security interests; and

(4) why using the exemption does not adversely affect the conditions of competition in the internal market for non-military products.

30. An outline of the decision making process is at Annex C. If you can fully satisfy the rules for using the Article 346(1)(b) exemption, the TFEU will not apply to that measure. That may mean that all or part of the procurement is exempt from the DSPCR or from certain obligations within the TFEU depending on the circumstances.

31. The Commission has explained its opinion on the use of the exemption contained in Article 346 TFEU in their Interpretative Communication, from which we should presume that you should compete the type of goods, services and works within the scope of the DSPCR unless the rules at paragraph 29 above apply.

32. You must base the use of Article 346(1)(b) TFEU on a case-by-case assessment and consider it as part of drawing up the procurement strategy at the earliest possible time.

33. There will be some requirements where you can clearly justify the use of Article 346(1)(b) TFEU to exempt the procurement from the DSPCR as a whole e.g. highly demanding security of supply requirements and important reasons of national sovereignty, etc. In other circumstances Article 346(1)(b) may be used to depart from certain requirements of the DSPCR only.

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34. Every case must demonstrate why application of the provisions of the DSPCR would not be sufficient to protect the essential security interest and that use of the exemption is the least restrictive means available to achieve that protection. MOD procurers should contact CLS-CL for further advice on the application of Article 346(1)(b).

Authority to use Article 346(1)(b) TFEU exemption

35. Procurers should issue local instructions that set out the level for authorisation of treaty exemptions.

36. For the MOD, you must seek authorisation to use Article 346(1)(b) to exempt a procurement from the DSPCR from a Band B Commercial Officer in order to establish a consistent approach across MOD. By this means, officials with the appropriate knowledge and experience will be instrumental in setting the precedents that will shape how we conduct our future procurement.

37. Whilst authority to use Article 346(1)(b) is delegated to Band B Commercial Officers, the 1-Star Commercial Officer retains ultimate responsibility and accountability for correct application of TFEU exemptions in their operating centres.

38. For MOD organisations that do not have a Band B Commercial Officer in their chain of command, authorisation for application of Article 346(1)(b) should be at Band B level within that organisation and the submission staffed through a Band B Commercial Officer in their operating centre. The Director Commercial Operations for DE&S based teams and the MOD Commercial Director for non-DE&S based teams will be available to offer advice on complex cases, as necessary.

39. Best practice is for you to prepare a formal submission (i.e. issue, recommendation, timing, background, presentation) to the Band B Commercial Officer (or equivalent) to maintain an audit trail in case of a legal challenge. It is important to prepare a structured argument, which must include:

a. details of the specific treaty exemption being considered;

b. the essential security interest concerned, e.g. security of supply such as UK maintenance capability for a specific platform, or national sovereign capability requirements;

c. an explanation of the proposed measures to protect the essential security interest, e.g. exemption from the DSPCR in order to award the contract to a national supplier;

d. any implications of the proposed measures on military operations or our relationship with key Allies;

e. an assessment that shows the proposed measures are the least restrictive means available to protect that essential security interest, e.g. it would be disproportionate to exempt the entire procurement if you need to withhold only part of the award criteria, or using a national supplier was the minimum necessary to maintain the requirement for security of supply of that product;

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f. an explanation of why these measures cannot be put into effect by procurement under the DSPCR, e.g. by use of the security of supply or security of information provisions.

40. You are not required to apply an additional exemption under Article 346(1)(b) where your procurement is already exempt from the DSPCR under Article 346(1)(a).

Mixed contracts

41. Regulation 6(5) describes the rules that apply to single contracts that partly come under the DSPCR but with the other part being outside the application of national regulations implementing EU procurement law. This may be where the latter part is exempt under a treaty exemption such as Article 346(1)(b).

42. The DSPCR do not apply to the contract award if a treaty exemption applies to part of the contract, if the award of a single contract is "justified for objective reasons".

43. The DSPCR does not say what it means by "justified for objective reasons", as this will be different from one situation to another. The procurer will have to decide its meaning, on a case-by-case basis, and ensure a consistent approach within its own area.

44. You must strictly interpret "justified for objective reasons" when you are assessing whether a single contract is appropriate, as the application of these rules may result in, for example, the whole requirement being excluded from the scope of the DSPCR. You must not therefore join requirements solely for the purposes of benefiting from a treaty exemption.

45. In all cases, when assessing whether a single contract is justified for objective reasons, procurers relying on this provision must demonstrate that the various elements of the mixed contract relate to each other in a way that makes it reasonable and proportionate to award a single contract to a single supplier.

Competitive procurement

46. Using a treaty exemption may not necessarily mean non-competitive procurement in all cases.

47. If an open competition is not practical, you may organise a limited competition among a restricted field of tenderers. The restrictions may include the grounds of nationality. However, procurers must be able to prove, and keep a record of, why using a limited competition is a proportionate measure in the circumstances.

48. Procurers must still treat suppliers fairly by setting out the rules under which such a restricted competition is to run, ensuring that they comply with those rules and giving all participating suppliers equal opportunity. Failure to do so may give rise to a breach of implied contract to treat bidders equally and fairly.

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Notification to Tenderers

49. If you are exercising a TFEU exemption you should inform tenderers, in the contract documents, what that exemption is, and that the DSPCR does not apply to the procurement. You must only take this action when it will not compromise the security interest concerned.

What are the key points to remember?

1. You must assess the use of treaty exemptions on a case-by-case basis taking into account the facts in the specific case.

2. You can only adopt measures during a procurement that are contrary to the UK's European Union treaty obligations by using treaty exemptions.

3. You can only use a treaty exemption in exceptional circumstances, where necessary, taking into account the UK's national security interests..

4. You must find out if you need to protect a specific security interest before using a treaty exemption.

5. You may only use measures under a treaty exemption that are strictly necessary to protect those specific security interests.

6. You may only use measures under a treaty exemption that are the least restrictive available, i.e. the one which least interferes with the internal market of the EU.

7. You must be aware that our use of treaty exemptions will come under increasing scrutiny from the Commission.

Annex A

Other TFEU exemptions

50. The TFEU sets out a number of exemptions, in addition to Article 346, that EU Member States may apply, some of which may be relevant for defence and security procurements.

51. Regulation 6(1) (Application) states the DSPCR are subject to the treaty exemptions at Article 4(2) of the Treaty of the European Union (TEU) and Articles 36, 51, 52, 62 and 346 of the TFEU:

a. Article 36 TFEU allows a procurer to depart from the TFEU obligations to ensure the free movement of goods as a result of restrictions or prohibitions that are justified on grounds that include public security;

b. Article 51 TFEU allows procurers to depart from the TFEU obligations to ensure freedom of establishment and freedom to provide services where the activities are connected with the exercise of official authority;

c. Article 52 TFEU allows a procurer to depart from the TFEU obligations to allow nationals of, or companies established in, other Member States the right to set up business in the UK when justified on the grounds of public policy, public security or public health;

d. Article 62 TFEU allows a procurer to apply the exemptions in Articles 51 and 52 to the TFEU provisions on services to depart from the TFEU obligations to allow nationals of, or service providers in, other Member States to freely provide services in the UK; and

52. You should only use treaty exemptions in exceptional cases, and where necessary, taking into account the UK's national security interests. The application of an exemption must be proportionate in the specific circumstances of the case, the measures must be limited to what is necessary to protect public security of those essential security interests and there must be no other, less restrictive, measure that you can take that is capable of achieving the same protection. If the provisions of the DSPCR will satisfy the procurer's concerns then you should not use a treaty exemption.

53. The Court of Justice of the EU is the final arbiter of whether you have properly applied a treaty exemption. The Court is rarely, if ever, persuaded that economic considerations (at least on their own) are acceptable justifications for Member States not to comply with their treaty obligations.

54. Articles 36, 51, 52 and 62 TFEU contain express exemptions from the treaty obligations, amongst other things, on the grounds of public security. Public security in this context can mean either the internal or the external security of the UK.

55. You can use these exemptions on their own or in conjunction with Article 346 TFEU. Like Article 346 TFEU, you can invoke them to exclude procurements from the provisions of the DSPCR.

56. These exemptions may be of relevance where the procurement is for supplies, services or works which cannot benefit from Article 346(1)(b) and for

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which Article 346(1)(a) is also not applicable. For example, where there is a requirement for a UK industrial capability for the provision of sensitive equipment to which you cannot apply Article 346(1)(a). In this instance, and in other cases where essential interests in relation to public security are concerned, you could invoke Article 36 TFEU.

57. However, application is limited in the same way as Article 346 and to exceptional cases only. In other words:

a. application must be proportionate in the specific circumstances of the case;

b. limited to what is necessary to protect public security; and

c. there must be no other less restrictive measure that can be taken to achieve the same protection. If the provisions of the DSPCR will satisfy the procurer's public security concerns then you cannot use a treaty exemption.

58. Procurers should issue local instructions that set out the level for authorisation of these treaty exemptions.

MOD procurers must seek legal advice from CLS-CL and keep their approval of the exemption in a registered file.

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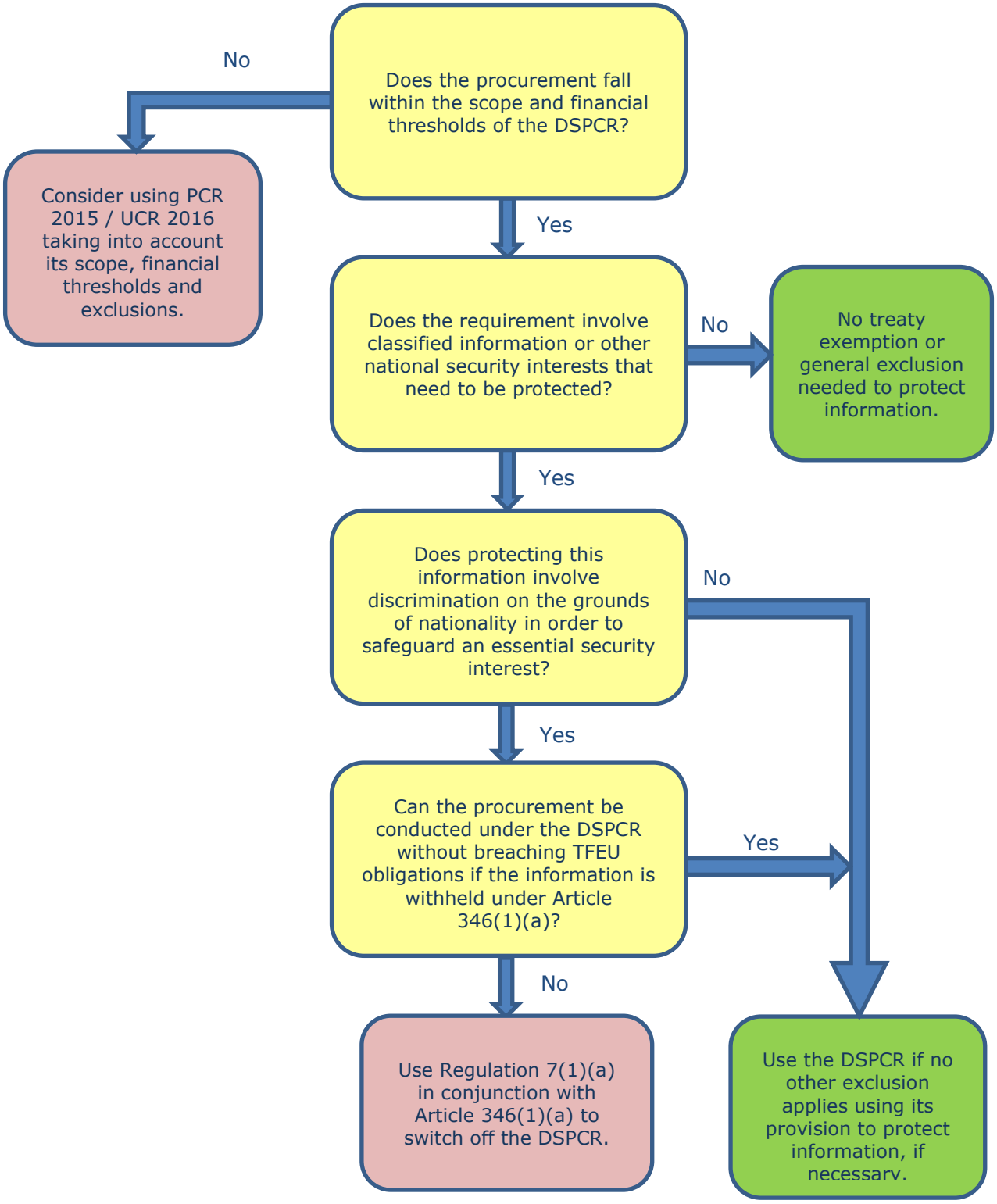
Annex B

Article 346(1)(a) – Security of Information Exemption Process



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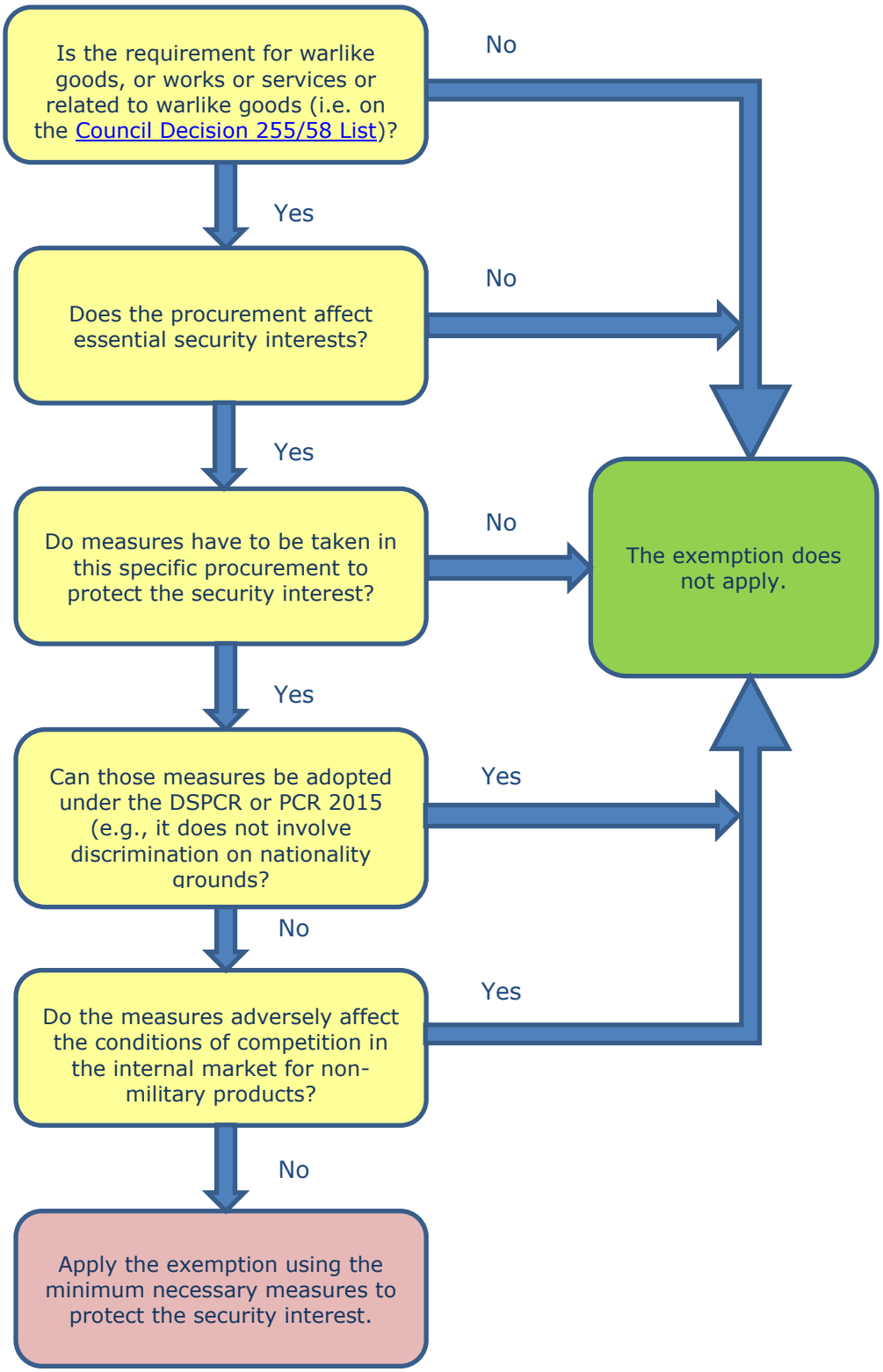
Annex C

Article 346(1)(b) – Warlike Stores Exemption Process



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