

Cross-Border Military Deals

EU Procurement Law Exemption for Government-to-Government Contracts

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Government-to-government (G2G) contracts represent a popular tool among EU Member States to procure defence equipment and other sensitive goods as well as related works and services, such as capacity training or maintenance and logistical support. In particular, many EU countries frequently purchase equipment from the US through its Foreign Military Sales (FMS) program. Intra-EU defence trade is also common, with France and Germany being the Union's two largest sellers of defence and security goods and services. While such G2G contracts hold many advantages from a security policy point of view, they may negatively affect competition in the defence and security market for private operators. Nevertheless, such G2G transactions can be exempted from compliance with EU public procurement law.

The applicable legal framework

EU law sets a legal framework of harmonized rules for public procurement in the internal market to create a competitive level playing field for businesses across Europe. Directive 2009/81/EC, the so-called 'Defence and Security Directive' (**DSD**), lays down common procedural rules for the procurement of military and other sensitive security equipment as well as related works and services which are designed to strengthen the European defence and security market. However, when EU governments decide to purchase military equipment directly from the governments of other countries, i.e. either from other EU Member States or from third countries, they may do so without having to carry out a competitive procurement procedure. This exemption from the DSD for G2G contracts is stipulated in its Art. 13 lit. f. In justifying this exemption, Recital 30 of the DSD refers to the "specificity of the defence and security sector".

The European Commission (**Commission**) provides detailed information on its interpretation of the G2G exemption contained by Art. 13 lit. f DSD in its 'Guidance Note: Defence- and security-specific exclusions' (Ref. Ares(2016)764884 of 12 February 2016, '**Guidance on specific exclusions**' hereafter) and its 'Guidance on the award of government-to-government contracts in the fields of defence and security' (OJ C 450 of 2 December 2016; '**Guidance on G2G contracts**' hereafter).

The G2G exemption's personal and material scope of application

The exemptive ground in Art. 13 lit. f DSD applies to "a government" purchasing military equipment or related items from "another government", i.e. from "the State, regional or local government of a Member State or third country", Art. 1 no. 9 DSD. On the other

hand, contracts concluded by other contracting authorities, such as bodies governed by public law or public undertakings, including state-owned companies, are not eligible for this exemption (Guidance on specific exclusions, para. 25).

Though law makers considered restricting the material scope of the G2G exemption to the sale and purchase of surplus equipment, this limitation did not make it into the final version of the DSD (see also Guidance on specific exclusions, para. 26). Rather, the wording of the Directive refers broadly to the purchase of “military or sensitive equipment”, not making any distinction between new, used or surplus stock. Accordingly, the Commission takes the view that the DSD’s G2G exemption is also applicable to the purchase of new equipment (Guidance on specific exclusions, para. 26).

The G2G exemption in practice: A circumventive loophole?

In general, G2G contracts can serve to promote military alliances and improve the interoperability of the armed forces of the contracting parties. This holds especially true for G2G service contracts, e.g. when fighter pilots of one contracting party provide the air force of the other contracting party with training assistance (see Guidance on specific exclusions, para. 25). Considering the trade of surplus equipment, G2G contracts also allow the selling country to free up budget and storage, while the EU country acting as the buyer can acquire much-needed equipment at reasonable prices. It has also proven to be an effective means to quickly build up defence capabilities.

While the benefits of G2G contracts are undeniable, both for service contracts and for the purchase of surplus equipment, the practical benefits and risks of purchasing new military equipment through G2G transactions need to be examined in a more nuanced manner: Recent practices of EU Member States give rise to the concern that at least some are making use of the loopholes created by the broad wording of Art. 13 lit. f DSD. This applies, in particular, to instances where a piece of new military equipment could be purchased directly on the market but is instead acquired via a G2G contract (see e.g. recently concluded G2G contracts between Belgium and France as well as between Poland and South Korea). EU governments then lose the opportunity to seek out the most economical fit among private operators in a competitive procurement procedure - at the expense of procurement efficiency. In other cases, however, there is no alternative to G2G procurement, e.g. when purchasing new missiles or spare parts for existing equipment through the US FMS system. Restricting the material scope of the G2G exemption to surplus supplies altogether would therefore prevent EU countries from effectively using and maintaining their proven equipment.

Legal limits to the application of the G2G exemption

Whether an EU government procures from another Member State or a third country, a G2G contract always means that no private operator in the former country has had the

opportunity to compete for the contract. Hence, there is a heightened risk of not purchasing the most economical option. This distortion of competition is even more pronounced when considering procurement from a third country. While a G2G contract between two EU countries would still ensure that the equipment purchased from the selling government was once procured from a private operator in application of the DSD (provided the Member State did not exceptionally rely on Art. 346 (1) TFEU's exemptive ground in protection of its essential security interests), the same cannot be said for procurement from a third country. Third countries are not bound by EU law and thus their equipment will not have been subject to the DSD at any point in the supply chain.

One thing is certain: Member States making use of an extensive interpretation of the G2G exemption, purchasing new supplies via G2G contract when they could also be procured from private operators, run the risk of legal challenges to their contract awards. There are good reasons to argue that Member States should therefore carry out a thorough analysis of the market conditions for the goods or services to be procured, only resorting to G2G procurement where competition in the internal market for a particular item is absent or impractical (Guidance on G2G contracts, p. 3). For one, the DSD's overall objective is "to foster, develop and sustain a European Defence Technological and Industrial Base that is capability driven, competent and competitive" (Recital 3 DSD). Secondly, the CJEU's general case law on exemptive grounds to EU public procurement rules calls for their restrictive application (see e.g. *Commission v Austria*, C-187/16, para. 77; *Bayerischer Rundfunk*, C-337/06, para. 64). This notion is, thirdly, further supported by the DSD itself, providing that exemptive grounds may not be used for the purpose of circumventing its remaining provisions, Art. 11 DSD.

BLOMSTEIN will continue to closely monitor the EU's policy on G2G defence procurement and the EU Member States' related procurement practices. If you have any questions in the meanwhile, please do not hesitate to contact our [Defence Team](#).
