
Pascal Friton and Florian Wolf

The Protection Of “Key Defence And
Security Technology” Under The Revised German Public
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*Pascal Friton and Florian Wolf**

1 Introduction

The recent Coronavirus outbreak has been unprecedented in the history of the European Union not only from an epidemiological point of view, but also in exposing the sudden need of Member States to have, within their borders, certain goods immediately available to them. With the Coronavirus pandemic, the immediate concern was medical protective equipment and ventilators. Some Member States have already announced their intention to ensure domestic production of such goods in the future.¹ What is reasonable with regard to the protection of the population against health risks also holds true for national defence and security. It might be of interest to Member States to ensure their national industrial capability to produce particular goods that are essential for defence and security. But is that legally permissible under the EU procurement directives?

Even though the defence sector and the procurement of defence equipment are strongly influenced by political and strategic interests, they are – as a general rule – subject to the EU public procurement directives, in particular Directive 2009/81/EC.² However, EU law provides for certain exceptions concerning the defence sector to acknowledge the special requirements of procuring defence equipment, as well as Member State’s autonomy regarding their defence strategy.

* Dr Pascal Friton and Dr Florian Wolf, BLOMSTEIN Partnerschaft von Rechtsanwälten mbB, Berlin, Germany.

¹ For instance, the German government recently announced that it will support the development of domestic production capacities for key pharmaceuticals and medical protective equipment with one billion euro, cf. https://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Schlaglichter/Konjunkturpaket/2020-06-03-eckpunktetpapier.pdf?__blob=publicationFile&v=9 (in German).

² Directive 2009/81/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security, OJ L 216, 20.8.2009, p. 76–136.

Importantly, pursuant to Article 346 of the Treaty on the Functioning of the European Union (TFEU), neither the Treaties nor EU public procurement rules apply to contracts that impact essential national security interests. The provision allows Member States to define their essential national security interests and in doing so limit the scope of EU public procurement law. This exemption has always played an important role in Member States' procurement of defence equipment.

In Germany, a new law came into force on 2 April 2020 modifying several provisions of existing national public procurement law. The new rules specify that contracts relating to key national defence and security technology are essential national security interests under Article 346 TFEU.³ As this leads to the possibility of excluding a broad set of "key technology" industry sectors from the application of procurement law, raising the question as to whether Germany's new public procurement provisions are incompatible with Article 346 TFEU. If compatible, key technologies may be secured by the German government with greater speed and legal certainty.

2 The legal and political context of the revised German procurement law

Germany's new procurement provisions are the result of intense political debate centred on protecting industry technological capabilities considered key for the nation's security. While there was broad consensus that certain technologies were key for national security, disputes arose as to which technologies and how they are best protected. The German government produced a Strategy Paper in 2015 defining key defence and security technologies.⁴ For example, it defined submarines as key technology while classifying surface combat ships as technological capabilities open for a European or global cooperation. However, from a public procurement perspective, this Strategy Paper had no direct legal implication.

The German navy's 2015 launch of a highly controversial public procurement procedure for surface combat ships with an EU-wide call for tender instigated the debate on the protection of key technologies. This public procurement process amplified the pressure on the German legislator to revise existing public procurement rules in order to give greater protection to German industries or companies producing key defence and security technology. Existing procurement provisions were considered inappropriate. As a result, the Strategy Paper was updated in February 2020, seeking to strengthen the capability of German shipyards for

³ Bundesanzeiger_BGBI&jumpTo=bgbI120s0674.pdf" \t "_blank" BGBl. I, Nr. 16 v. 1.4.2020, p. 674 (in German).

⁴ https://bdi.eu/media/themenfelder/sicherheit/downloads/20150708_Strategiepapier_der_Bundesregierung_zur_Staerkung_der_Verteidigungsindustrie_in_Deutschland.pdf (in German).

producing key naval technologies in future. Surface warships are now defined as national key technologies in the Paper.⁵ In addition, the German procurement regulations were modified.

The revised German public procurement law provisions aim to simplify the process for awarding contracts for key technologies. In this regard, they add a new sentence to section 107 (2) of the German Act Against Restraints for Competition (GWB), specifying that public contracts or concessions concerning key defence and security technology affect essential security interests under Article 346 (1) TFEU. This allows contracting authorities and entities in Germany to make use of the derogation set out in Article 346 TFEU by referring to a “key technology”. However, the fact that a certain product is defined as a key technology on a national level might not be sufficient to fulfil the conditions of Article 346 TFEU.

3 Article 346 TFEU

Article 346 TFEU states that measures adopted by the Member States in connection with the legitimate requirements of national interest may be excluded from the application of EU law. Given the wide wording of Article 346 (1) TFEU, the exemption applies to all EU law, including the procurement directives as well as the fundamental rules and general principles of EU law.⁶ Therefore, if the conditions of Article 346 (1) TFEU are fulfilled, Member States may adopt deviating legislation for procurements in the field of defence and security.⁷

Pursuant to Article 346 (1) (a) TFEU, a Member State shall not be obliged to disclose information if it is considered contrary to the essential interests of its security. While this provision affords the concerned Member State discretion in defining “information contrary to the essential interests of the Member State,” the European Court of Justice (ECJ) may overrule its decision.

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 that are connected with the production of or trade in arms, munitions and war material. In 1958 the Council issued a list of products to which the derogation of Article 346 (1) (b) TFEU may apply (the 1958 list).⁸ The provision clarifies

⁵ https://www.bmwi.de/Redaktion/DE/Downloads/S-T/strategiepapier-staerkung-sicherheits-und-verteidigungsindustrie.pdf?__blob=publicationFile&v=4 (in German).

⁶ Heuninckx, 346, the Number of the Beast? – A Blueprint to Protect Essential Security Interests in EU Defence Procurement” (2018) 2 P.P.L.R. p. 51 (55).

⁷ Steinicke, in: Steinicke/Vesterdorf, Brussels Commentary on EU Public Procurement Law, 2018, Part I, Article 1, para. 9; Sundstrand, Article 346, EU defence procurement and the European Court of Justice, Thomson Reuters Government Contracts Year in Review for 2019 (February 2020), p. 2.

⁸ There have been no amendments since then and the list was often assumed outdated, cf. Trybus, Defence derogations from the Treaty, Chapter 3, p. 89.

that such measures shall not adversely affect the conditions of competition in the internal market regarding products that are not specifically intended for military purposes. The exemption is limited to “necessary” measures and the protection of “essential interests” of the Member State’s security, leaving the definition of both terms to the interpretation of the Member State in question.⁹ Security concerns regularly raised in the context of defence and security procurement – and possibly constituting essential security interests within the meaning of Article 346 TFEU – are mainly security of supply and of information.¹⁰ The ECJ may review the Member States’ definitions.¹¹

As with any exemption from EU law, Article 346 TFEU is to be interpreted restrictively. In 2006 the Commission clarified that a restrictive interpretation was appropriate in the field of defence procurement in a communication on the application of Article 296 TEC, the provision preceding Article 346 TFEU.¹² Acknowledging the Member States’ interest in protecting and securing their essential national security interests, the Commission nonetheless stated the importance of greater openness in European defence markets. According to the Commission, the fragmentation of the different national regulatory frameworks, namely regarding public procurement, was a source of inefficiency and extra cost. It therefore negatively impacted the competitiveness of Europe’s Defence Industrial and Technological Base as well as Member States’ efforts to adequately equip their armed forces.¹³ The use of the derogation provided by Article 346 TFEU should therefore only be permissible under strict conditions, preventing misuse and ensuring that the derogation remains an exception limited to cases

⁹ Sundstrand, Article 346, EU defence procurement and the European Court of Justice, Thomson Reuters Government Contracts Year in Review for 2019 (February 2020), p. 2; Heuninckx, 346, the Number of the Beast? – A Blueprint to Protect Essential Security Interests in EU Defence Procurement” (2018) 2 P.P.L.R. p. 51 (65 et. seq.); Wegener, Calliess/Ruffert, EUV/AEUV, 5th edition 2016, Article 346 AEUV, margin number 3.

¹⁰ Cf. Recital 9 and 10 of Directive 2009/81/EC; Heuninckx, 346, the Number of the Beast? – A Blueprint to Protect Essential Security Interests in EU Defence Procurement” (2018) 2 P.P.L.R. p. 51 (56).

¹¹ Poell, Offsets in Defence Procurement under EU Law, EuZW 2013, p. 774 (776) underlines that in more recent cases, the ECJ has gradually increased the level of scrutiny; cf. also Sundstrand, Article 346, EU defence procurement and the European Court of Justice, Thomson Reuters Government Contracts Year in Review for 2019 (February 2020), p. 2; Wegener, Calliess/Ruffert, EUV/AEUV, 5th edition 2016, article 346 AEUV, margin number 3.

¹² Judgment of 20 March 2018, Commission/Austria (Österreichische Staatsdruckerei), C187/16, EU:C:2018:194; Judgment of 8 April 2008, Commission/Italian Republic (Agusta Bell), C337/05, EU:C:2008:203; Judgment of 7 June 2012, Insinööritoimisto InsTiimi, C615/10, EU:C:2012:324; Commission of the European Communities, Interpreting communication on the application of Article 296 of the Treaty in the field of defence procurement, 7.12.2006, COM (2006) 779 final, p. 5.

¹³ Commission of the European Communities, Interpreting communication on the application of Article 296 of the Treaty in the field of defence procurement, 7.12.2006, COM (2006) 779 final, p. 1.

where deviant national legislation is the Member States’ only option to protect their security interests.¹⁴

This narrow understanding of Article 346 TFEU is confirmed by the ECJ’s established case law on that matter. The ECJ has repeatedly ruled that Article 346 TFEU is a derogation that is to be applied strictly in exceptional situations on a case-by-case basis.¹⁵ Following the settled case law of the ECJ, the burden of proving the existence of exceptional circumstances justifying the derogation from EU law lies on the person seeking to rely on those circumstances.¹⁶

Although this ECJ jurisprudence appears clear at a glance, different viewpoints as to the applicability of Article 346 TFEU have been expressed in recent review proceedings in Germany: it was argued that a case-by-case decision on the applicability of Article 346 TFEU is not required. Rather, it is sufficient if the defence equipment concerned was included in the 1958 list. In addition, it was claimed that the German legislator had made it clear that, in principle, all goods on the 1958 list affected essential security interests of the Federal Republic of Germany and that a case-by-case decision was therefore not necessary. In other words: Article 346 TFEU automatically applies if the procured goods are on the 1958 list.

This view is unconvincing for several reasons. Most importantly, it is not compliant with the requirement that the contracting authority or entity take into account the circumstances of the individual case when it decides on the applicability of Article 346 TFEU. A decision in every individual case is necessary because, according to the case law of the ECJ, the contracting authority or entity must demonstrate and prove that the protection of its essential security interests is not served in the context of a public procurement procedure in accordance with the EU public procurement directives. In this vein, Directive 2009/81/EC describes a number of possibilities to secure the (confidentiality) interests of the Member States in public procurement procedures.

Therefore, Member States cannot justify the application of Article 346 TFEU in advance for the procurement of all goods on the 1958 list, because the purported need to avoid a public procurement procedure can only be assessed on a case-by-case basis.

¹⁴ Commission of the European Communities, Interpreting communication on the application of Article 296 of the Treaty in the field of defence procurement, 7.12.2006, COM (2006) 779 final, p. 5.

¹⁵ Judgment of 8 April 2008, Commission/Italian Republic (Agusta Bell), C337/05, EU:C:2008:203 with reference to further rulings; Heuninckx, 346, the Number of the Beast? – A Blueprint to Protect Essential Security Interests in EU Defence Procurement” (2018) 2 P.P.L.R. p. 51 (64).

¹⁶ Judgment of 8 April 2008, Commission/Italian Republic (Agusta Bell), C337/05, EU:C:2008:203 with reference to further rulings; Steinicke, in: Steinicke/Vesterdorf, Brussels Commentary on EU Public Procurement Law, 2018, Part IV, Article 2, para. 7; Poell, Offsets in Defence Procurement under EU Law, EuZW 2013, p. 774 (777).

4 The revised German public procurement law

The revised German law on procurement in the defence and security sector aims to simplify and speed up procurement processes. It is set out in the statutory recitals of the revised law that the legal space for a faster and more efficient award of contracts provided by the EU law should be used more consistently – meaning that the scope of derogations from procurement law should be fully utilised. Therefore, legal clarifications and general examples for the use of derogative provisions were added to the existing laws. The scope of application of Article 346 TFEU has been clarified.¹⁷ According to the already existing section 107 (2) sentence 1 GWB, the procurement provisions do not apply to contracts:

1. if the application of public procurement law would oblige the contracting authority or entity to provide information in connection with the procurement procedure or the performance of the contract, the disclosure of which it considers contrary to the essential interests of the security of the Federal Republic of Germany within the meaning of Article 346(1)(a) TFEU or
2. which fall within the scope of Article 346 (1) (b) TFEU.

Section 107 (2) sentence 1 number 1 GWB already adopted the wording of Article 346 (1) (a) TFEU and its concept of “essential security interests”. Section 107 (2) sentence 1 number 2 GWB referred to Article 346 (1) (b) TFEU and, thus, also to the requirement that “essential security interests” must be concerned. However, it remained unclear, when exactly security interests could be considered “essential”.

The German legislator tried to provide the contracting authorities and entities further guidance by adding new sentences 2 and 3 to section 107 (2) GWB. According to the newly added second sentence of section 107 (2) GWB, “essential security interests” within the meaning of Article 346 (1) TFEU may be affected in particular if the public contract or concession concerns key defence industrial technologies. The classification of a technology as a key technology for the defence industry is made by a decision of the Federal Government, for

¹⁷ The German legislator also changed the provision implementing Article 28 (1) (c) of Directive 2009/81/EC. This Article of the Directive allows for a negotiated procedure without publication of a contract notice in cases where an immediate contract award is necessary due to an urgency resulting from a crisis. In order to allow a faster procurement of military products in cases where a sudden need for such products arises, Section 12 (1) No. 1 b) aa) of the German Procurement Regulation in the Areas of Defence and Security (VSVgV) has been modified. It now clarifies that a negotiated procedure without publication of a contract notice is generally permissible *inter alia* when mandated missions or equivalent obligations of the German Armed Forces (Bundeswehr) require new procurements at short notice. According to the reasoning of the law, this addition intends to provide greater clarity regarding the cases in which a crisis requires a faster procurement.

example in the Bundeswehr White Paper or in the Federal Government’s Strategy Paper on Strengthening the Defence Industry in Germany. Sentence 3 of section 107 (2) GWB clarifies that in cases where essential security interests within the meaning of Article 346 (1) (a) TFEU may be affected, a “particularly high level of confidentiality” is required in addition to the involvement of key technology.

In the statutory recitals of the revised law it is stated that the added second sentence should provide guidance for the interpretation of the term “essential security interests” in Article 346 (1) TFEU. With reference to the communication of the Commission of 2006 mentioned above, the statutory reasons set out that the application of these rules, which constitute an exception to public procurement law and as such must be interpreted strictly, requires an individual assessment in each case. Accordingly, the guidelines for interpretation provided by sentence 2 and 3 of section 107 (2) GWB are worded in such a way (“may be affected”) that a contract concerning key technology does not automatically affect essential security interests of the Federal Republic of Germany. For each individual case, the other conditions of Article 346 TFEU must be fulfilled for the use of the derogation.

5 Compatibility of German law with Article 346 TFEU

The revised German procurement law raises the question of its compatibility with EU law, in particular with Article 346 TFEU. As Article 346 TFEU is an exemption from EU law, it can only be applied in well-founded exceptional cases. The ECJ has ruled repeatedly that derogations of the Treaty are limited to “exceptional and clearly defined cases” and that there is no inherent general exception excluding all measures taken for reasons of public security from the scope of EU law.¹⁸ Furthermore, the ECJ has stated that the application of Article 346 TFEU requires a case-by-case evaluation. The definition of categorised cases (“key technologies”) in the new sentences 2 and 3 of section 107 (2) GWB, to which Article 346 TFEU can be applied by German contracting authorities, appears to deviate from this understanding of Article 346 TFEU. The revised German procurement law would therefore be incompatible with Article 346 TFEU if every key technology would automatically be excluded from the scope of public procurement law. However, the new provisions do not categorically exclude key technologies from procurement law. They only clarify that essential national security interests may in particular be concerned by contracts in relation to key technologies. This allows for a case-by-case evaluation as required by the ECJ.

¹⁸ Judgment of 8 April 2008, *Commission/Italian Republic (Agusta Bell)*, C337/05, EU:C:2008:203 with reference to further rulings; Judgment of 7 June 2012, *Insinööritoimisto InsTiimi*, C615/10, EU:C:2012:324.

In accordance with this interpretation, the speaker for the German Federal Ministry of Economics stated that with the new regulations an exemption for the procurement of key technologies is only possible but not mandatory.¹⁹

It remains to be seen under which circumstances German contracting authorities will be able to apply Article 346 TFEU if a contract is related to a key technology. The ECJ ruled in *Agusta Bell*, *Insinöörtoimisto InsTiimi* and *Österreichische Staatsdruckerei* that a Member State wishing to use the exemption of Article 346 TFEU needs to prove that a specific essential national security interest is concerned.²⁰ While the ECJ has established that purely industrial or economic interests cannot justify restrictions,²¹ a Member State's interest in securing technological sovereignty related to key defence technologies is more likely to fall within the scope of Article 346 TFEU. Contracting authorities or entities will have to prove that there is a need to secure national industrial capability to produce specific defence equipment. The more important the defence technology, the more likely the contracting authority or entity will be able to prove that producing this specific technology within national borders is of essential interest for the national security. The current worldwide Coronavirus pandemic illustrates this. In a crisis, states show a tendency to fall back into a purchasing behaviour strongly influenced by national interests. An example is the recent overbidding of prices for the delivery of goods such as face masks. In such an economic and political climate, it appears reasonable to maintain the production of certain products within the nation's own borders. This is especially true regarding key technologies for which there is a heightened interest in not having to procure them abroad or being forced to rebuild the national production when a sudden need for such products emerges.

This leads to the follow-up question as to what is actually necessary to secure Germany's capability to produce certain key technologies "within the nation's own borders". Contracting authorities and entities will have to prove that only the procurement of specific defence equipment from a domestic economic operator maintains the national industry's capability to supply the State with this defence equipment in the future. That evidentiary burden entails various problems.

The first question is why the contracting authorities or entities must procure goods from the German economic operator today in order to ensure its future capability to produce these goods. The contracting authority or entity could argue

¹⁹ Transcript of the national press conference of October 30th 2019, <https://www.bundesregierung.de/breg-de/aktuelles/regierungspressekonferenz-vom-30-oktober-2019-1686874> (in German).

²⁰ Judgment of 8 April 2008, *Commission/Italian Republic (Agusta Bell)*, C337/05, EU:C:2008:203; Judgment of 7 June 2012, *Insinöörtoimisto InsTiimi*, C615/10, EU:C:2012:324 and Judgment of 20 March 2018, *Commission/Austria (Österreichische Staatsdruckerei)*, C187/16, EU:C:2018:194.

²¹ Judgment of 15 December 2009, *Commission/Finland*, C-284/05, C-294/05, C-372/05, C-387/05, C-409/05, C-461/05 and C-239/06C615/10, EU:C:2009:781.

that the capability of a national industry to produce specific defence equipment does often depend on a continuous procurement of these goods by the national government because research and development are only economically feasible if it is guaranteed that the national government will purchase the goods. It can therefore be necessary to procure defence technology from national companies continuously in order to enable them to constantly develop state of the art technology. However, it may be doubted that a continuous procurement by the national contracting authorities is in any case necessary to protect domestic production of key technologies. Many defence companies are global players that export technology to partners around the world. If it is possible to compete with other companies and run a profitable business by exporting goods, then further justification may be needed as to why continuous procurement by the national government alone supports the companies' future capability to produce key technologies. One possible justification could be that the exported goods have a lower technical standard than those used by NATO member states and therefore technological leadership cannot be ensured by export alone.

The second question is what exactly is a “German” supplier of key technology. Would it be sufficient for the protection of key technologies to procure the relevant goods from a German subsidiary, for instance of a Swedish parent company, if the production facilities of the German subsidiary were located in Germany? In such a case, there remains a risk that in times of crisis, the German subsidiary lacks autonomy to decide whether to produce the key technology primarily for the German state. The Swedish parent company could instruct its German subsidiary to transfer know-how or production capabilities to Sweden. As a result, German contracting authorities or entities could not directly award a contract to such German subsidiary of a Swedish parent company while arguing this would be necessary to protect the capability to produce key technology in Germany. What does this then mean for any company with foreign shareholders? Would they be excluded from direct awards of contracts concerning key technology or could Germany set a threshold for foreign ownership? Or would it be sufficient if the German subsidiary entered into a contractual agreement with the parent company to restrict the parent's right of control with regard to key technology in the event of a (precisely defined) crisis? Likewise, would it be sufficient for the German subsidiary to include in the public contract obligations towards the contracting authority or entity to ensure the supply of key technologies in the event of a crisis?

The questions raised above show that, if the German government invokes the protection of key technologies in order to justify the application of Article 346 TFEU, robust and stringent argument is necessary in each particular case. It is the settled case law of the ECJ's that a Member State seeking a derogation has to prove in each case that the conditions of the derogations are fulfilled. It is therefore

expected that the ECJ would require the German government to explain in detail why the direct award to a German company is the only measure by which the protection of the national key technology can be ensured. In *Österreichische Staatsdruckerei*,²² the Court examined each of the Austrian government's arguments defending the validity of a direct award to an Austrian company, and denied them on the grounds that a public procurement procedure would have adequately safeguarded the relevant national security interests. For instance, the Austrian government argued that administrative supervision by the Austrian authorities of a contracting partner in Austria (the Austrian State Printing House – *Österreichische Staatsdruckerei*) was the only means of ensuring confidentiality of sensitive information. However, the ECJ found that “the Republic of Austria does not show that verification of respect for the confidentiality of the information which would be communicated for the printing of the official documents at issue would be less well safeguarded if that printing were awarded, in the context of a tendering procedure, to other undertakings having confidentiality and security arrangements imposed on them under a contractual mechanism subject to the rules of private law, whether those undertakings are established in Austria or in other Member States”. If the ECJ applied such a strict approach also to the “key technology” argument of the German government, the Court would only accept convincing and consistent reasoning.

6 Summary

The threshold conditions for obtaining an exemption under Article 346 TFEU are high. A Member State invoking this provision must prove that essential national security interests are concerned and that measures taken by the Member State are necessary. The Member State must also explain why a public procurement procedure will not protect its essential national security interests.

The German legislator recently tried to provide contracting authorities and entities with guidance as to when these conditions are met. In the revised public procurement law it defined the so-called “key technologies” and clarified that essential security interests may be concerned if a contract related to a key technology is to be awarded. However, the definition of key technologies does not automatically exempt all procurements of key technology from the application of public procurement law. The contracting authorities must also prove on a case-by-case basis that the conditions of Article 346 TFEU are met.

Therefore, the revised German procurement law allows an interpretation that is compatible with Article 346 TFEU and the conditions for applying this

²² Judgment of 20 March 2018, *Commission/Austria (Österreichische Staatsdruckerei)*, C-187/16, EU:C:2018:194.

derogation as they are set out in the case law of the ECJ. It provides guidance for contracting authorities making use of Article 346 TFEU. It certainly has political significance with regard to the strong criticism of EU-wide tender proceedings, but this political aspect has no impact on the legal possibilities regarding the application of Article 346 TFEU. No legal provision can relieve the contracting authorities or entities of the task that ECJ case law has given them. Individual cases must justify why directly awarding a contract to a national economic operator is necessary to protect essential security interests. Depending on the respective contract, a number of questions may arise, the answers to which require a great deal of argumentation. As is clear from the above, there is still no case law where the ECJ has accepted a direct award using Article 346 TFEU as a legal ground. Contracting authorities and entities wanting to use Article 346 TFEU therefore will have a difficult task in figuring out how to make use of the exception.