

# The Defence and Security Public Contracts Regulations 2011

## Introduction

1. The new Defence and Security Public Contracts Regulations 2011 (the “new Regulations”) will implement the new European Union (EU) Defence and Security Procurement Directive<sup>1</sup> (the “new Directive”) into UK law on 21 August 2011.
2. The Ministry of Defence (MOD) has responsibility for bringing the new Regulations into UK law. They will apply to defence and sensitive security procurements by contracting authorities<sup>2</sup> and utilities<sup>3</sup> (the “procurers”) throughout England, Scotland, Wales and Northern Ireland.
3. The purpose of this guidance is to raise awareness of the new Regulations across Government. Procurers will need to establish at an early stage if their procurement falls under the new Regulations, and take account of its new provisions in their procurement strategies.

## Why introduce new Regulations?

4. Currently in the EU, most defence and sensitive security equipment is procured using national procedures, which differ greatly in terms of publication, tendering procedures, etc. This is a major obstacle to a common defence and security equipment market in Europe.
5. The European Commission believes the current EU Public Sector Procurement Directives do not always permit effective defence and security procurement. They believe as a consequence that some EU Member States exempt procurements from the current Directives to avoid burdensome rules or for economic reasons rather than to protect national security interests.
6. By introducing a Directive specifically adapted to the needs of the highly sensitive defence and security markets, the European Commission hopes to encourage some EU Member States away from invoking unnecessary exemptions.
7. EU Member States are obliged to introduce the new Directive into their national law – for the UK this takes the form of secondary legislation - the new Regulations. The result of which will be to open the majority of EU Member States’ defence and security procurements to competition

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<sup>1</sup> Directive 2004/81/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 services contracts by contracting authorities or entities in the fields of defence and security, and amending Directive 2004/17/EC and Directive 2004/18/EC.

<sup>2</sup> “Contracting authority” is defined by regulation 3 of the Public Contracts Regulations 2006

<sup>3</sup> “Utility” is defined by regulation 3 of the Utilities Contracts Regulations 2006

across the EU. This will provide European industry with the opportunity to compete for programmes that may previously have been unfairly limited to national companies.

## **What are the key issues for procurers?**

8. From 21 August 2011, the majority of defence and sensitive security procurements are expected to be competed under the new Regulations through the Official Journal of the European Union (OJEU).

9. Procurement under the new Regulations must follow its common advertising rules for publishing in OJEU. The tender and contract documents must be drafted with care to ensure the correct information is given and the correct procurement procedures are followed.

10. The new Regulations have more flexible rules that for example allow post tender negotiations. This includes provisions to protect defence and security interests that may be used where previously we would have used an exemption, including tools which will:

- a. provide the ability to protect classified information throughout the award and performance of the contract; and
- b. enable an assessment of the capability of suppliers to meet security of supply requirements.

11. Any decisions to exempt procurements from new Regulations are likely to come under greater scrutiny. You should only use an exemption for the purpose that it is intended for (e.g. to protect the interests that it is designed to safeguard). Before using an exemption, you need to establish that you cannot use the new Regulations to meet your requirement.

12. You must consult your legal advisers if you are not clear whether using an exemption is allowed for a specific procurement.

13. There are a range of legal rights and remedies available to aggrieved parties who suffer, or risk suffering, loss or damage as a result of a procurer's failure to comply with the new Regulations. This includes allowing the UK courts to declare a contract ineffective.

14. You must maintain an audit trail of any major procurement decision (e.g. use of an exemption) in case of a legal challenge.

## **What contracts are covered?**

15. The new Regulations will cover only specific contracts in the fields of defence and security for the procurement of:

- a. military equipment (i.e. arms, munitions and war material) and associated goods, services and works; and

b. sensitive security equipment and associated goods, services and works (i.e. where the contract contains, involves or requires information which is classified in the interests of national security).

16. The new Regulations will apply to all contracts within its scope which have a value (exclusive of VAT) equal to or greater than:

a. £313,694 – for Goods and Services

b. £3,927,260 – for Works

17. Procurement of civil and non-sensitive security goods, services and works will still be covered by the Public Contracts Regulations 2006 (PCR 2006) and the Utilities Contract Regulations 2006 (UCR 2006) (or their equivalent regulations in Scotland).

## **What are the main features of the Regulations?**

18. The new Regulations are not entirely new. Much of it reflects existing procurement law, particularly PCR 2006. The new Regulations do, however, contain innovations and amended provisions so you should read them carefully before using them. An overview of the main features of the new Regulations is set out below.

### **Competitive Procurements**

19. The default procedures in the PCR 2006 are the open and restricted procedures. However, your starting position in the new Regulations will be a free choice of running a competition under the restricted procedure or the negotiated procedure with prior publication of a contract notice.

20. The new Regulations do not include the open procedure or the dynamic purchasing systems.

21. The competitive dialogue procedure may only be used for particularly complex procurements if the contract cannot be placed under the restricted or negotiated procedure.

### **Non-Competitive Procurements**

22. In the new Regulations, non-competitive procurement (or in certain instances limited competition) may be carried out under the negotiated procedure without publication of a contract notice, but only if it is justified for the following reasons:

a. If irregular, unacceptable, unsuitable tenders or no applications are received in response to a call for competition during a restricted, competitive dialogue or negotiated procedure.

b. Where for technical reasons or for reasons connected with protection of exclusive rights, the contract may only be awarded to a particular supplier. Artistic reasons are no longer a justification.

- c. Where the normal and accelerated time limits laid down for the competitive restricted and negotiated procedures cannot be met:
  - (1) for reasons of urgency resulting from a crisis; or
  - (2) due to the nature of the market for air and maritime transport services when deploying military or security forces abroad; or
  - (3) for extreme urgency brought about by events not foreseeable or attributable to the procurer.
- d. For additional deliveries by the original supplier under similar conditions to PCR 2006, except that the length of such contractual arrangements may not generally exceed five years.
- e. Where goods are quoted and purchased on a commodity market.
- f. To take advantage of particularly advantageous terms in a closing down sale or where a supplier is bankrupt, insolvent or being wound up.
- g. For research and development services other than those services exempt under the research and development exemption.
- h. Where goods are solely for the purpose of research, experiment or development, and not with a view to establishing commercial viability or recovering research and development costs.
- i. For either additional works or services, or new works or services under similar conditions to PCR 2006.

### **Security of Information**

23. The new Regulations are intended to provide procurers with the ability to protect classified information throughout the tendering and contracting process, which includes the ability to:

- a. impose obligations on contractors and subcontractors to safeguard information throughout the tendering and contracting procedure;
- b. reject contractors and subcontractors where they:
  - (1) do not possess the necessary reliability to exclude risks to national security; or
  - (2) have breached obligations relating to security of information during a previous contract in circumstances amounting to grave misconduct;

- c. request information from contractors and subcontractors to assess their ability to protect information;
- d. impose contractual obligations to protect information to the required level.

### **Security of Supply**

24. The new Regulations are intended to enable the procurer to assess the capability of a contractor and its subcontractor to meet their security of supply requirements.

25. You can, for example, require tenderer to provide information:

- a. demonstrating that they are able to honour their contractual obligations by obtaining the necessary export licences;
- b. identifying any restrictions on the disclosure, transfer or use of technology arising out of export controls or security arrangements;
- c. demonstrating that their supply chains comply with the security of supply requirements set out in the contract documents.

26. You can also require suppliers to provide commitments on security of supply. These can include commitments from the supplier to:

- a. ensure that changes in their supply chain during the performance of the contract will not adversely affect the security of supply requirements;
- b. establish and/or maintain the industrial capacity required to meet additional needs arising from a crisis;
- c. carry out the maintenance, modernisation or adaptation of the supplies covered by the contract;
- d. provide all necessary licences and information to produce spare parts, components, assemblies and testing equipment in the event that the supplier is no longer able to provide these supplies.

### **Subcontracting**

27. The new Regulations will allow you the option to:

- a. require tenderers to indicate what they propose to subcontract;
- b. require tenderers to indicate any planned changes of subcontractors before or during the life of the contract;

c. oblige successful tenderers to award all or a certain portion of its proposed subcontracts to third parties through advertising in OJEU;

d. reject a subcontractor selected by a tenderer at any stage of the contract award procedure or during contract performance in accordance with all or part of the selection criteria for the main contract.

28. Generally, the prime contractor you select will take full responsibility for delivering the requirement. That said, you should encourage the prime contractor to use competition to place subcontracts and advertise any subcontract opportunities in the Government's Contract Finder portal.

29. Using the new Regulations to mandate the prime contractor to use subcontract competition at EU level requires very careful consideration, as the measures can add costs and delays to the procurement without providing benefits to either the procurer or the contractor. You will need to justify any mandate by taking into account:

a. the value of the contract (e.g. it may be disproportionate to mandate subcontract competition for low value contracts);

b. the nature of the contract (e.g. using subcontract competition for high technology equipment may not be possible due to exclusive rights or technical reasons); and

c. the structure of the market (e.g. is there likely to be a sufficient response from the market to challenge the existing supply chain).

## **How do I use Article 346 TFEU?**

### **Treaty Exemptions**

30. The principles of the Treaty on the Functioning of the European Union (TFEU) generally apply when procurers are awarding contracts. Our main obligations from the TFEU are:

a. Non-discrimination on the ground of nationality;

b. Equal treatment of all suppliers;

c. Transparency of the procurement process;

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

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

31. Failure to comply with these TFEU obligations can only be justified on the basis of a treaty exemption in the TFEU. Treaty exemptions also allow us not to use all or part the new Regulations for specific procurements. Article 346 TFEU is the main treaty exemption in the TFEU.

32. You may still use Article 346 TFEU to exempt all or part of the procurement from the TFEU and the new Regulations if, exceptionally, it is strictly necessary to protect the essential interests of national security. Any measures under Article 346 TFEU must be proportionate and the minimum necessary to protect the essential interests of national security.

33. Whilst you can still apply Article 346 TFEU, our approach to applying the exemption is much more likely to come under the scrutiny after the new Regulations come into force. The European Commission has stated its intent to monitor the effects of the new Regulations more closely than was the case for previous EU Directives.

34. Our freedom of choice in deciding what is proportionate and necessary to protect essential interests of national security is likely to diminish over time. It is not possible to reckon the extent to which this might occur because it depends on the attitude of the Court of Justice of the European Union (CJEU).

35. The CJEU is very unlikely to accept economic reasons alone as a justification for EU Member States not complying with their obligations from the TFEU or applying the new Regulations, or both.

#### **Article 346 (1) (a) TFEU - the Security of Information Exemption**

36. You are still able to use Article 346 (1) (a) TFEU to exempt all or part of the procurement from the TFEU and the new Regulations if it would oblige you "to supply information, the disclosure of which they consider contrary to the essential interests of their security".

37. This could occur if the contract requires that the contractor's staff have personal security clearances and are citizens of the purchasing nation. Such a "national eyes only" condition infringes the obligation of non-discrimination on the ground of nationality in the TFEU and can only be on the basis of Article 346 (1) (a) TFEU.

38. Article 346 (1) (a) TFEU allows you to withhold the information. Procurers may use new Regulation 6 (1) (a) (described at paragraph 43.b below) with Article 346 (1) (a) TFEU if exempting the contract from the new Regulations is strictly necessary and proportionate.

#### **Article 346 (1) (b) TFEU - the Warlike Stores Exemption**

40. You are still able to use Article 346 (1)(b) TFEU to exempt all or part of the procurement from the TFEU and the new Regulations if you need to take specific measures when procuring warlike stores which are considered necessary in order to protect the essential national security interests.

41. The rules for using Article 346 (1) (b) TFEU have not changed. Very simply, it is operated by:

- a. Seeing whether the goods appear on the list of warlike stores in [Council Decision 255/58](#). This exemption also covers the procurement of services and works directly related to the goods on this list; and
- b. If the goods, services or works are warlike, deciding whether the protection of essential national security interests requires that all or part of the procurement should be exempt by evaluating and recording:
  - (1) the essential security interest concerned; and
  - (2) the connection between this security interest and the procurement; and
  - (3) why using the exemption in this specific case is necessary for the protection of the identified essential security interest.

42. Whilst the rules for using Article 346 (1)(b) TFEU have not changed, the new Regulations provide measures on, amongst other things, security of information and security of supply that previously would have been justification for using an exemption. You must use these new measures instead of the exemption if they fully meet our security needs.

## **What other exemptions are in the new Regulations?**

43. In addition to the TFEU exemptions, there are exemptions in the new Regulations which allow you not to apply the new Regulations, including exemptions for:

- a. contracts awarded in accordance with:
  - (1) specific rules under international agreements or arrangements between EU Member State(s) and one or more third countries;
  - (2) specific rules under international agreements or arrangements on the stationing of troops between an EU Member State and one or more third countries;
  - (3) specific rules of international organisations that have specific procurement rules;
- b. contracts which would oblige EU Member States to supply information, the disclosure of which is contrary to its essential security interests;



- c. contracts for intelligence activities;
- d. cooperative programmes between EU Member States based on research and development for a new product;
- e. contracts awarded in a third country during military or security operations if operational needs require them to be placed with local suppliers;
- f. research and development services except where the benefits accrue exclusively to the procurer for the conduct of its own affairs and where the procurer wholly pays for the service.

## **What about industrial participation or offset?**

44 The new Regulations do not mention industrial participation, offset or any other form of economic compensation for awarding a contract to a foreign supplier.

45. The legal opinion of the European Commission is very clear - industrial participation or offset is not permitted under the TFEU, unless properly justified on the basis of Article 346 TFEU, as it breaches EU Member States obligations on non-discrimination and equal treatment of suppliers across the EU.

46. When placing a contract under the new Regulations, you must not:

- a. actively seek offers of industrial participation or offset as part of the tendering procedure; or
- b. include industrial participation or offset in either the award criteria or contract conditions.

47. You should consult your legal advisers if in any doubt.

## **When will I start using the new Regulations?**

48. The new Regulations will apply to procurement procedures beginning on or after 21 August 2011.

49. The new Regulations will not apply to:

a. any procurement procedure which is considered to have started before 21 August 2011. This will be the case if you have:

(1) published a contract notice or advertisement seeking expressions of interest; or

(2) contacted any supplier to seek an expression of interest or offer for a proposed contract; or

(3) responded to an unsolicited approach from a supplier.

b. Any call off from a framework agreement already in existence before 21 August 2011, or if the procurement procedure for the framework itself started before 21 August 2011.

50. This policy should help you make a smooth transition to the new Regulations.

## **Can procurement decisions be challenged?**

51. The new Regulations contain review procedures which will enable suppliers to challenge procurement decisions and provide effective remedies to protect their rights. These procedures are very similar to those introduced to the PCR 2006 and UCR 2006 but contain important elements which are tailored to the defence and security market.

52. In particular, you must be aware that any procurement decision may be subject to a legal challenge. For the avoidance of doubt, this includes but is not limited to any decision:

- a. to apply an exemption in the TFEU or the new Regulations;
- b. to use the negotiated procedures without prior publication of a contract notice;
- c. not to invite a supplier to tender after it has expressed an interest in the requirement;
- d. to award the contract to a supplier.

53. You must ensure that the reasons for taking any procurement decision, including any defence or security issues, are recorded at the time that the decision is made. This evidence will be required in the event of future challenge.

54. Any failure to comply with the new Regulations could result in an aggrieved supplier bringing an action in the UK courts for damages and/or for a decision or action to be set aside.

55. The new Regulations require a 'standstill period', before concluding a contract. This gives rejected tenderers the opportunity to start a review procedure at a time when unfair decisions can still be corrected. If this standstill period has not been respected, the new Regulations require the UK courts under certain conditions to set aside a signed contract, by rendering the contract "ineffective".

56. The new Regulations also seek to combat illegal direct awards of contracts, which is the most serious infringement of European procurement law. The UK courts may render contracts ineffective if they have been illegally awarded without any transparency and competitive

tendering required by the new Regulations. In these cases the contract will need to be tendered again, this time according to the new Regulations.

57. The UK courts will have to take into account defence and security interests when considering applications for interim orders (such as injunctions) or when deciding whether or not to make a declaration of ineffectiveness.

## **Who will coordinate and monitor the new Regulations?**

58. MOD will retain the lead for the new Regulations after it comes into force, including statistical reporting and any enforcement. We will work closely with the Cabinet Office's Efficiency and Reform Group, who will coordinate the action required for the civil security and utilities areas.

## **Where can I find further information?**

59. Further detailed guidance on the new Directive can be found on the European Commission's [Defence Procurement Guidance Notes](#). This guidance reflects the views of the Commission.

60. The MOD will also publish user guidance before the new Regulations come into force.