Defence and Security Public Contracts Regulations 2011

Chapter 5 – General Exclusions in the DSPCR

Purpose

1. Procurers may exclude certain defence and security procurements from the Defence and Security Public Contracts Regulations (DSPCR) 2011 by use of a general exclusion. This guidance sets out the general exclusions available, and what procurers need to do when applying an exclusion.

2. Specifically, the guidance explains what we mean by an exclusion, sets out the legal framework, explains in what circumstances you may apply exclusions and their effect, and how to apply an exclusion.

3. This guidance does not deal with the application of any treaty exemptions, which you can find guidance in Chapter 4 – Treaty Exemptions.

What are general exclusions?

4. General exclusions are provisions in the DSPCR that allow us to dis-apply the DSPCR for specific procurements because the requirement:

   a. is not appropriate for a competitive market;

   b. is unsuited to the specific rules set out in the DSPCR;

   c. concerns or involves national security interests; or

   d. is to protect specific interests, e.g. Research and Development (R&D).

What is the legal framework?

5. Regulation 7 (General exclusions) sets out a number of exclusions, which cover:

   a. disclosure of information;

   b. intelligence activities;

   c. co-operative programmes based on Research and Development (R&D) between Member States;

   d. military or security operations outside the European Union (EU);

   e. international rules;

   f. acquisition of land;

   g. government to government sales;

   h. arbitration or conciliation services;

   i. financial services except insurance services;

   j. employment and other contracts of service; and

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k. R&D services.

6. You must interpret the wording of general exclusions strictly. However, the case law of the Court of Justice of the EU (CJEU) clarified the principle of strict interpretation does not mean that the terms in which a general exclusion is framed "must be construed in such a way as to deprive that exception of its intended effect"[1]. This means a strict interpretation cannot result in any pre-conditions that are not set out in its wording of the exemption.

7. CJEU has also held that an exception "must be construed in a manner consistent with the objectives that it pursues". Consequently, in interpreting the general exclusions, it is necessary to consider not only its wording but also the context, in which it occurs and the objectives pursued by the rules of which it is part[2].

8. This means that in interpreting and applying general exclusions, you must take account of the objectives of the Directive. The objectives of the Directive are, among other things, laid down in recitals 2 and 3 of the Directive, which state that:

> "2. The gradual establishment of a European defence equipment market is essential for strengthening the European Defence Technological and Industrial Base and developing the military capabilities required to implement the European Security and Defence Policy
>
> 3. Member States agree on the need to foster, develop and sustain a European Defence Technological and Industrial Base that is capability driven, competent and competitive. In order to achieve this objective, Member States may use different tools, in conformity with Community law, aiming at a truly European defence equipment market and a level playing field at both European and global levels…"

9. Recital 2 and 3 may be highly relevant to the interpretation of a general exclusion if you are considering procurement through a co-operative programme or international organisation.

10. Recital 1 of the Directive states that "national security remains the sole responsibility of each Member State, in the fields of both defence and security", is relevant in relation to this exclusion, as national security can be the reason why you choose to use a general exclusion.

11. There is no case law from the CJEU on the extent that TFEU principles (e.g. non-discrimination, equality of treatment) apply to contract awards under a general exclusion in the DSPCR. However, as a matter of policy, you should seek to minimise any violation of these principles, subject to the wording of the general exclusion.

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[1] See Case C-19/13 Fastweb, paragraph 40.

[2] See, inter alia, Case 292/82 Merck, paragraph 12; Case C-34/05 Schouten, paragraph 25; Case C-433/08 Yaesu Europe, paragraph 24; and Case C-112/11 Ebookers.com, paragraph 12.

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Justifying use of a general exclusion

12. Article 11 of the Directive states on the use of exclusions that "none of the rules, procedures, programmes, arrangements or contracts referred to in this section may be used for the purpose of circumventing the provisions of this Directive".

13. This rule means your ability to use a general exclusion is subject to you being able to provide a proper military, security or economic justification for use of the exclusion. You must explain this in the business case, and show that you have examined the full range of procurement options, and there are objective reasons for choosing the procurement option chosen under the exemption. The justification is likely to flow from the subject of exclusion, e.g. you will base the justification for the disclosure of information exclusion on the national security reasons for protecting the information.

14. Your justification for the use of certain exclusions in particular for co-operative programmes, government to government sales and international organisations exclusions will require the business case to identify all the procurement options and explain why the chosen solution under the exclusion is the best choice.

15. Administrative reasons, such as lack of resources to run a procurement under the DSPCR, do not pass muster as a justification for using an exclusion.

16. In summary, your decision to award a contract under a general exclusion must be preceded by an analysis, which clearly establishes that there is a valid justification for using the general exclusion.

Disclosure of information

17. Regulation 7(1)(a) states:

> "(1) These Regulations do not apply to the seeking of offers in relation to a proposed contract or framework agreement—
>
> > (a) where the application of these Regulations would oblige the United Kingdom to supply information the disclosure of which it considers contrary to the essential interests of its security;"

18. Regulation 7(1)(a) can be used for contracts or framework agreements where, if you were to apply the rules of the DSPCR, the UK would be obliged to supply information which, if disclosed, it would consider contrary to the essential interests of its security.

19. You can apply the exclusion at Regulation 7(1)(a) in certain circumstances in defence or security procurements, for example:

   a. to contracts which are so sensitive that it would be inappropriate to apply the DSPCR. That may be the case where the very act of advertising the requirement is contrary to the essential interests of the UK (e.g. if the act of advertising a requirement would reveal covert military or sensitive security capabilities or requirements); or

   b. to sensitive purchases which require an extremely high level of confidentiality either in respect of the award procedure or the performance

of the contract, e.g. procurement for sensitive activities carried out by police and security forces related to border protection, combating terrorism or organised crime.

20. You may only apply this exclusion if the specific provisions in the DSPCR addressing security of information concerns (see Chapter 12 – Security of Information) are insufficient to address adequately the security of information requirements in a particular procurement. These provisions in the DSPCR include:

a. specific selection criteria set out at Regulations 25(2)(m) (Information as to technical or professional ability);

b. the ability to impose special conditions (Regulation 36(2) (Conditions for performance of contracts)); and

c. the ability to seek commitments relating to the security of classified information (Regulations 38 (Security of information) and 39(2)(b) (Security of supply)) for the performance of the contract.

21. The MOD expects these provisions in the DSPCR should be sufficient in the majority of cases for MOD procurements to protect its security interests with regard to protection of classified information. Sensitive procurements in Other Government Departments (OGDs) and Agencies will involve different security interests, sensitivities and requirements. OGDs and Agencies should therefore take their own security interests into account when considering an exclusion under Regulation 7(1)(a), noting paragraphs 23 to 26 below.

22. Regulation 7(1)(a) is based on Article 346(1)(a) Treaty on the Functioning of the European Union (TFEU) which says that "no Member State shall be obliged to supply information the disclosure of which it considers contrary to the essential interests of its security".

23. Whilst Article 346(1)(a) TFEU allows procurers to withhold information, it does not automatically exempt the requirement from the DSPCR. Instead, it allows procurers to impose restrictions that would otherwise be contrary to the UK's TFEU obligations. The DSPCR exclusion at Regulation 7(1)(a) however, does allow you to exclude the requirement from the DSPCR.

24. The exclusion at Regulation 7(1)(a) can be used in conjunction with Article 346(1)(a) TFEU if the procurer has to withhold information contrary to its obligations under the TFEU and the DSPCR. You can find further guidance on excluding defence and security procurements from our obligations under the TFEU in Chapter 4 – Treaty Exemptions.

25. You may need to use both Article 346(1)(a) TFEU and Regulation 7(1)(a) in the context of highly confidential and sensitive material where, for example, access is required to classified information that has been marked with a national caveat, such as UK Eyes Only or other similar national caveats. This may occur in the context of:

a. non-military security contracts; and

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b. military contracts where the application of Article 346(1)(b) is not possible, as not all modern weapons (e.g. 5.56mm calibre assault rifles) are covered by Article 346(1)(b).

26. In order to apply the regulation 7(1)(a) exemption to those requirements it would normally be necessary to show that the procurement process and/or the performance of the contract requires the bidders and/or the successful contractor:

a. have access to material protectively marked as SECRET (or higher) that has a UK Eyes only or joint UK Eyes / other national eyes caveat; or

b. have access to particularly secretive sites or equipment for which only UK nationals cleared to an appropriate 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.

27. Application of Regulation 7(1)(a) does not necessarily preclude competition in those circumstances. It may still be appropriate to advertise and compete such a requirement, for example amongst suitably cleared list x companies.

28. Alternatively it may be appropriate to split the requirement, exempting that part of the requirement which is subject to the UK Eyes Only restrictions and competing the remainder under the DSPCR. However, where it is objectively justifiable to award a single source contract using the exception you may do so. For further advice (MOD only) contact CLS-CL.

Secret Activities

29. In order to apply the regulation 7(1)(a) exemption to those requirements it would normally be necessary to show that the procurement process and/or the performance of the contract requires the bidders and/or the successful contractor to:

a. have access to material protectively marked as SECRET (or higher) that has a UK Eyes Only or joint UK Eyes / other national eyes caveat; or

b. have access to particularly secretive sites or equipment for which only UK nationals cleared to an appropriate 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.

30. Application of Regulation 7(1)(a) does not necessarily preclude competition in those circumstances. It may still be appropriate to advertise and compete such a requirement, for example amongst suitably cleared List X companies.

31. Alternatively it may be appropriate to split the requirement, exempting that part of the requirement which is subject to the UK Eyes Only restrictions and competing the remainder under the DSPCR. However, where it is objectively justifiable to award a single source contract using the exception you may do so. MOD procurers should seek further advice from CLS-CL.

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Intelligence activities

32. Regulation 7(1)(b) states:

> "(1) These Regulations do not apply to the seeking of offers in relation to a proposed contract or framework agreement —
>
> (b) for the purposes of intelligence activities;"

and is applicable to contracts or framework agreements "for the purposes of" intelligence activities. It is based on the assumption that contracts related to intelligence are, by definition, too sensitive to be awarded in a transparent and competitive procedure.

33. The DSCPR does not define "Intelligence" but it includes both military and security intelligence functions. In addition, "intelligence activities" is not a defined term in the DSPCR but it includes counter-intelligence activities.

34. The exclusion at Regulation 7(1)(b) applies to contracts for the purposes of intelligence activities, which could include the collection, communication and processing of information required to maintain and defend the security and resilience of the procurer's activities, infrastructure, and economic well-being, and influence and deter those who are hostile to that requirement. For MOD it does not cover contracts that are merely incidental to the carrying out of those activities. However, it is for OGDs and Agencies to interpret the scope and extent of intelligence activities, and applying the exemption under Regulation 7(1)(b) taking account of their own specific requirements and sensitivities, as well as the categories outlined in paragraph 30 below.

35. Subject to the rules excluding "in-house procurement" set out in Chapter 2 – Scope, categories of contract covered by the exclusion at Regulation 7(1)(b) include but are not limited to:

a. contracts awarded by the intelligence services[3] for their intelligence activities, including counter-intelligence;

b. contracts awarded by dedicated intelligence services sections located within procurers who are not part of the intelligence services, (e.g. such "non-intelligence procurers" may include central government departments, the armed forces, security forces or agencies, police forces, and utilities), for their intelligence activities;

c. contracts awarded by non-intelligence procurers to the intelligence services for specific supplies, services and works for the purposes of intelligence activities of the non-intelligence procurer concerned, e.g. protection of government information technology (IT) networks;

d. contracts awarded by dedicated intelligence services sections located within non-intelligence procurers to the intelligence services, provided the contract is also in support of the intelligence activities of the non-intelligence procurer;

[3] "Intelligence services" refers to the functional body and not to an activity. It includes the SIA, departmental intelligence services sections and other administrative sections concerned with intelligence matters.

e. contracts awarded by non-intelligence procurers which provide benefits to the intelligence services in respect of their intelligence activities, provided the contract is also for the intelligence activities of the procurer; and

f. contracts awarded by the intelligence services for the intelligence activities of others, provided the subject of the contract is for the purposes of intelligence activities.

Co-operative programmes based on R&D

36. Regulation 7(1)(c) states:

"(1) These Regulations do not apply to the seeking of offers in relation to a proposed contract or framework agreement —

(c) where the contract is to be awarded or the framework agreement is to be concluded in the framework of a co-operative programme based on research and development, conducted jointly by at least two Member States for the development of a new product and, where applicable, the later phases of all or part of the life cycle of the product;"

and it exempts contracts or framework agreements concluded in the framework of a co-operative programme based on R&D conducted by at least two Member States for the development of a new product, and where applicable, the later phases of the life-cycle of the product. It is different to the exclusion available for the provision of R&D services (Regulation 7(1)(l)) which is detailed in Chapter 10 – Research and Development.

37. Recital 28 of the Directive explains the rationale for this exclusion:

"Member States often conduct co-operative programmes to develop new defence equipment together. Such programmes are particularly important because they help to develop new technologies and bear the high research and development costs of complex weapon systems. Some of these programmes are managed by international organisations, namely the Organisation Conjointe de Coopération en Matière d'Armement (OCCAR) and NATO (via specific agencies), or by agencies of the Union, such as the European Defence Agency, which then award contracts on behalf of Member States. This Directive should not apply to such contracts. For other such co-operative programmes, contracts are awarded by contracting authorities / entities of one Member State also on behalf of one or more other Member States. In these cases too, this Directive should not apply."

38. There are several conditions that must be met in order to use the exclusion at Regulation 7(1)(c) which are explained in turn below. These are:

a. co-operative programme;

b. joint R&D;

c. developing a new product; and

d. later phases – production and maintenance.

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Co-operative programme

39. The co-operative programme must involve at least two Member States (of which one will be the UK for the purposes of this guidance) but can also include additional non-Member States.

40. Although the DSPCR are silent on the issue, the co-operative programme does not necessarily have to be concluded by central government departments (e.g. they can be concluded by forces, services or agencies not part of the central government departments). However, if this is the case, the participants must be acting on behalf of their Member State.

41. There must also be genuine co-operation between the participants. That means a proportional sharing of the technical and financial risks and opportunities within the programme along with an effective (if proportional) participation in the management and decision-making process of the programme by all parties.

42. A Member State joining a co-operative programme on completion of the R&D phase can benefit from this exclusion for the later phases of the programme, if it becomes a full member of the programme. However, a Member State cannot use the exclusion if it participated in the R&D phase of a co-operative programme but decided to make its purchases for the later phases of the programme outside the co-operative programme.

43. An international organisation, e.g. NATO (the North American Treaty Organisation) or OCCAR (the Organisation for Joint Armaments Co-operation), or an EU agency, (e.g. the European Defence Agency (EDA)), may manage the co-operative programme on behalf of the Member States. The international organisation or agency may act as either agent or principal in this regard.

44. In addition, and as long as the principle of genuine co-operation applies, one of the participating Member States may take on this management role and award a contract under the "lead nation" model, for and on behalf of, all participating Member States.

Joint R&D

45. The co-operative programme must include a joint R&D phase. R&D is defined in Regulation 3 (Interpretation) of the DSPCR (see Chapter 10 – Research and Development) and covers any of the following three main activities:

a. fundamental research;

b. applied research; and

c. experimental development.

46. R&D does not include the making and qualification of pre-production prototypes, tools and industrial engineering, industrial design or manufacture.

47. In terms of Technology Readiness Levels (TRL), R&D would typically include fundamental research (TRL 1-4), applied research (TRL 4-6) and experimental demonstration (TRL 6-9).

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Developing a new product

48. A key factor in applying the exclusion is the nature of the programme and its purpose, i.e. the aim of the co-operative programme is the development of a new product. Co-operative programmes involving purchases of off-the-shelf, or technical adaptations to existing or off-the-shelf equipment, do not qualify for the exclusion unless such adaptation will result in a fundamentally new product.

Later phases – production and maintenance

49. Contracts for the production and maintenance of the new product and all other later phases of the product life cycle may benefit from this exclusion if these later phases formed and remain part of the co-operative programme requirements. So, for example, a new product resulting from a R&D co-operative programme which is subsequently put into production, would be covered by the exclusion if the option to produce was covered in the original R&D programme and the co-operative programme remains in existence.

50. Procurers must notify the European Commission ("the Commission") immediately after entry into the co-operative programme unless there is one or more non-Member States involved in it. You must notify the Commission when a new Member State joins the programme after notification, unless there are one or more non-Member States involved. You can find out how to notify the Commission in Chapter 19 – Statistics and Records.

51. If there are no non-Member States involved then, on setting up the programme, each Member State involved in the programme must notify to the Commission of:

a. its share of R&D expenditure relative to the overall cost of the programme; and

b. the cost-sharing agreement as well as the intended share of purchases per Member State, if any, of the resulting product.

52. The information they provide must be sufficient to demonstrate that the programme concerns the development of a new product and that the participation of the Member State is material, rather than just a symbolic contribution, to a national programme, (i.e. the activity is genuine collaboration rather than an export of defence or security goods or services).

53. In its evaluation of the information provided to it to ascertain that the exclusion is correctly applied, the Commission will take into account the differences between the size of budgets and contributions to the programme made by each Member State. However, the focus will be on scrutinising the co-operative nature of the programme and quality of the participation of each Member State.

54. Procurers should develop local procedures for notifying the Commission of this information and issue appropriate instructions to their staff.

55. For the MOD, a Senior Commercial Officer at Band C1 level (or above) will prepare the submission to the Commission for approval by the project team leader within the MOD who is responsible for the co-operative project.

Operations outside the EU

56. Regulation 7(1)(d) states:

> "(1) These Regulations do not apply to the seeking of offers in relation to a proposed contract or framework agreement —
>
> > (d) where the contract is to be awarded or the framework agreement is to be concluded in a State which is not a member State, including a contract or framework agreement for a civil purchase, carried out when forces are deployed outside the territory of the EU where operational needs require them to be concluded with economic operators located in the area of operations;"

57. This exclusion at Regulation 7(1)(d) covers the procurer's military, security or civil operational requirements that are placed by the procurer locally during operations in a third country. A third country means any State, including Norway, who is not a member State.

58. If the procurer is deployed outside the EU on a temporary basis on a military or security operation (e.g. to support specific crisis management operations), the procurer does not have to use the DSPCR to procure goods, works or services (including civil purchases) that they are required to source locally for operational reasons.

59. This may be the case where the award of the contract within the EU may be impractical, overstretch supply lines or result in delay and costs that would pose a real threat to the operational capability of the troops or security services deployed.

60. The exclusion will apply where the personnel of the procurer and the contractor are located in the area of operations. This could be a purely local supplier or the local subsidiary of a company established in a Member State or another third country. However, contracts for operational requirements placed by procurers located in the EU would not qualify for the exclusion.

61. The area of operations refers to the geographical zone designated for operations and may include one or more non-Member States in which the operations are being undertaken along with third countries in the surrounding geographical zone. This recognises the reality of operations on the ground and the difficulties that can arise which might necessitate contracting with suppliers in the countries where operations are taking place.

62. The geographical zone designated as the area of operations may extend beyond the immediate area of conflict or activity (e.g. an intermediate country providing transport facilities) but should be limited to the geographical neighbourhood in order to limit the risk of abuse and misinterpretation of the exclusion. If you award contracts to suppliers outside the area of operations then there is no justification for applying this exclusion.

63. The exclusion covers civil purchases undertaken in the area of operation, directly connected to, and arising out of, the conduct of those operations. Examples include non-military products; works and services for logistical purposes such as storage; transport; distribution; maintenance and disposal of material; transport of personnel; acquisition or construction, maintenance,

operation and disposal of facilities; acquisition or provision of services, medical and health service support; food and water supply.

International exclusions

64. Regulation 7(1)(e) and (f) states:

"(1) These Regulations do not apply to the seeking of offers in relation to a proposed contract or framework agreement —

(e) which is governed by specific procedural rules —

(i) pursuant to an international agreement or arrangement concluded between the United Kingdom and a State which is not a member State, including Norway;

(ii) pursuant to a concluded international agreement or arrangement relating to the stationing of troops and concerning the undertakings of a member State or a State which is not a member State, including Norway; or

(iii) of an organisation, of which only States are members (an "international organisation") or of which only States or international organisations are members, purchasing for its purposes;

(f) which must be awarded by a member State in accordance with specific procedural rules of an organisation referred to in sub-paragraph (e) (iii);"

65. The international agreement, arrangement or rules of the organisation referred to in Regulation 7(1)(e) must specifically set out details of the contract award procedure, including the principles and steps you must follow for the types of contract to be included, which itself must be compatible with EU law. If this information is not included within the terms of the agreement or arrangements or you do not follow it then you cannot use the exclusion.

66. The term international agreement or arrangement covers not only treaties[4] but also instruments such as Memoranda of Understanding (MOUs)[5] together with other forms of international instruments between States.

67. An agreement or arrangement specifically related to the stationing of troops covers not only troops from a Member State in a non-Member State, or Norway, or vice versa, but troops from a Member State stationed in another Member State. The most relevant application of this exclusion is likely to be an agreement or arrangement concluded between Member States only, as other

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[4] Treaty is a generic term for an agreement concluded between States (or other entities such as international organisations having international personality) in written form and intended by them to be binding in international law.

[5] Memorandum of Understanding is a form frequently used to record informal non-legally binding arrangements between States on matters which are inappropriate for inclusion in treaties (e.g. for confidentiality) or where the form is more convenient than a treaty.

arrangements with third country participation will be covered by Regulation 7(1)(e)(i) as well.

68. Regulations 7(1) (e)(iii) and (f) refer to contracts or framework agreements awarded by, or in accordance with the specific procedural rules of, an international organisation.

69. The term "international organisation" refers to a permanent institution with separate international legal personality, set up by a treaty between States or intergovernmental organisations and having its own rules and structures. In the field of defence, NATO and OCCAR are the most prominent examples. However, you should note the EDA is not an international organisation but is an agency of the EU.

70. You must award the contract in accordance with the specific procedural procurement rules of the international organisation. The exclusion will apply when, as part of fulfilling its member role or commitments to the international organisation, the UK (or any other member of the international organisation) has to award a contract in accordance with those rules.

71. Purchases made by the international organisation in its own name and "for its purposes" may also qualify for this exclusion. The MOD interprets "for its purposes" in the context of the purpose or mission of the international organisation, which is normally set out in its Charter. For example, OCCAR was set up to manage co-operative equipment projects on behalf of its members. That is its purpose.

72. The Commission has a more restricted interpretation of "for its purposes". You should therefore use Regulation 7(1)(c) ahead of Regulations 7(1) (e)(iii) and (f) if all the conditions for use of Regulation 7(1)(c) are met. You must only apply one of the exclusions and document the justification for its use as described in paragraphs 13 – 15 above.

73. The Commission may challenge the use of Regulations 7(1)(e)(iii) and (f) if it regards:

a. the international organisation as acting only as an intermediary on behalf of one of its members – with the procurement contract concluded between the member and the supplier: or

b. the organisation is simply re-selling to one of its members supplies, works or services which it procured from a supplier at the request of that member.

Acquisition of land

74. Regulation 7(1)(g) states:

"(1) These Regulations do not apply to the seeking of offers in relation to a proposed contract or framework agreement —

(g) for the acquisition of land, including existing buildings and other structures, land covered with water, and any estate, interest, easement, servitude or right in or over land;"

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75. It excludes contracts for the acquisition of land and interests in land including the lease of land and buildings. However, you may classify certain land transactions as works contracts in certain circumstances. An example is a building constructed to the procurer's specifications on another party's land, which the other party subsequently transfers the ownership of to the procurer, see Chapter 6 – Classifying Contracts.

Government to government sales

Interpreting the Exclusion

76. Regulation 7(1)(h) states:

"(1) These Regulations do not apply to the seeking of offers in relation to a proposed contract or framework agreement —

(h) where the contract is to be awarded or the framework agreement is to be concluded by a government to another government relating to —

(i) the supply of military equipment or sensitive equipment;

(ii) work, works and services directly linked to such equipment; or

(iii) work, works and services specifically for military purposes, or sensitive works and sensitive services;"

77. The exclusion applies to contracts or framework agreements concluded by a government to another government relating to:

a. the supply of military equipment or sensitive equipment;

b. works and services directly linked to that equipment; or

c. works and services specifically for military purposes or sensitive works and sensitive services.

78. You can find definitions of the above terms in Regulation 3 (Interpretation). A government means central, regional and local government in a Member State or a non-Member State.

79. Only contracts concluded exclusively between two governments can constitute "contracts awarded by a government to another government" in the sense of Regulation 7(1)(h). Government to government supply contracts entail, in principle, transfer of title from the selling government to the purchasing government.

80. By contrast, the fact that a government provides guarantees of good execution, or similar forms of support to a contractor competing for a contract does not make the exclusion applicable to that contract. Moreover, the exclusion only covers the contract between the two governments; it does not cover related contracts concluded between the selling government and a contractor.

81. The exclusion would apply for example where the MOD decides, for operational reasons, to place a service contract with the government of another Member State for the training of its pilots by the air force personnel of that other

Member State. However, if that other Member State needed to procure goods and services to satisfy that service contract it would have to apply the procedures for contract awards in the Directive unless an exclusion applied.

82. Recital 30 of the Directive explains the rationale for this exclusion:

> "Given the specificity of the defence and security sector, purchases of equipment as well as works and services by one government from another should be excluded from the scope of this Directive."

83. The exclusion may apply to any contracts for the supply of military or security equipment (including, in principle, purchases of new material) that are government-to-government sales. In this context, the Member State transferring the equipment will need to comply with EU procurement law. For example, the United States of America (USA) Foreign Military Sales (FMS) regime by which the US Government sells military capability to its allies on a government-to-government basis in accordance with the US Arms Export Control Act.

Justifying the Exemption

84. To apply the exclusion under Regulation 7(1)(h) you must undertake "appropriate analysis", which clearly establishes that awarding a particular contract to another government is the only or the best option to fulfil the requirement. This analysis should in particular, identify whether competition is absent or impracticable, see paragraphs 88-89 or whether on the contrary, competition for the contract appears to be possible, see paragraph 90.

85. "Appropriate analysis" implies a good understanding of how the market can respond to the specific requirements, which may involve surveying the market before finalising the requirement. For example, you could publish a request for information notice on your website, for MOD personnel this would be through a request for information on the DCO. This will give potential suppliers the opportunity to comment on the proposed requirement that could result in identifying alternate solutions. You must document this analysis within the business case or contract files to justify the decision.

86. By their very nature, some contracts can only be awarded to other governments. For example in the training example in paragraph 81 above, contracting authorities generally award such contracts within the framework of military cooperation between States. Since there can be no commercial alternative, they have no impact on the functioning of the internal market.

87. In some situations, there may be no viable alternative to awarding a contract directly to another government. This may include, although is not limited to:

a. Where market analysis demonstrates that commercial competition is absent or impracticable.

b. The requirements identified can, for technical reasons or reasons connected with the protection of exclusive rights, only be satisfied by one particular government;

c. The requirement is an urgent operational requirement such as an urgency resulting from crisis or extreme urgency brought about by unforeseeable events;

d. Additional supplies from the original selling government are needed as partial replacement or extension of existing supplies and a change of source of supplies is not practicable due to reasons of interoperability.

e. Where it is clear from the outset that a call for competition would not trigger more competition or better procurement outcomes than government to government procurement.

Optional Pre-Procurement Advertising

88. In cases where the analysis in paragraph 87 is unclear whether competition for the satisfaction of the requirement is absent or impracticable, you should examine the market further via pre-procurement advertising. The objective of this further market examination is to establish whether at least one EU supplier could genuinely compete to satisfy the requirement (i.e. to deliver a similar or better solution that the government to government model).

89. Where it is clear from market analysis that you know all potential suppliers, sending requests for information to such suppliers can constitute an alternative to pre-procurement advertising.

90. Where it is not clear from the market analysis that all potential suppliers are known you should utilise the VEAT (VTN) on the OJEU. You should consult Chapter 17-Standstill Period, Contract Award and Voluntary Transparency Notices for detail on how to draft the VEAT (VTN).

91. You can also choose to invite potential suppliers to comment on the proposed requirements and to offer solutions that might facilitate competition or generate better value for money. Should you decide to do this you must ensure that equal treatment is respected and competition is not distorted.

92. At the same time you can contact other governments to explore whether the requirement can be satisfied via government to government. Then using the information gathered from the advertisement and from the discussions with other governments, you can finalise the procurement strategy with full knowledge of the market.

93. If based on an impartial assessment of the information gathered from pre-procurement advertising, you reach the conclusion that awarding a particular contract to another government is the only, or the best, option to fulfil the requirement; you will proceed with negotiations and ultimately award a government to government contract under the exclusion of Article 13.f of the Directive.

94. If, on the contrary, an impartial assessment of the information gathered from pre-procurement advertising, shows that one or more EU supplier is able to deliver a better value for money solution than the one offered by government to government. And there is no objective justification to procure from the selling government, you must start a procurement procedure under the directive. The relevant provisions of the directive must be complied with.

Arbitration or conciliation services

95. Regulation 7(1)(i) states:

"(1) These Regulations do not apply to the seeking of offers in relation to a proposed contract or framework agreement —

(i) for arbitration or conciliation services;"

96. Recital 32 of the Directive explains the rationale for this exclusion:

"Arbitration and conciliation services are usually provided by bodies or individuals designated or selected in a manner which cannot be governed by procurement rules".

97. This exclusion covers arbitration or conciliation services, which are undefined, so their normal meaning will apply. You may use these services in a dispute resolution process in contracts.

Financial services except insurance services

98. Regulation 7(1)(j) states:

"(1) These Regulations do not apply to the seeking of offers in relation to a proposed contract or framework agreement —

(j) for financial services, with the exception of insurance services;"

99. Recital 33 of the Directive explains the rationale for this exclusion:

"Financial services are also entrusted to persons or bodies under conditions that are not compatible with the application of procurement rules."

100. This exclusion covers financial services other than insurance services. Financial services are undefined but could include issue, purchase, sale or transfer of securities or other financial instruments to raise money or capital, and central bank services, i.e. the Bank of England.

101. Insurance services are undefined. They are not included in the exclusion and are categorised as a Part A service at Schedule 2 (Category 12) of the DSPCR.

Employment contracts

102. The exclusion at Regulation 7(1)(k) states:

"(1) These Regulations do not apply to the seeking of offers in relation to a proposed contract or framework agreement —

(k) for employment and other contracts of service;"

103. It covers employment contracts and other contracts of service. "Contracts of service" is undefined but may include the engagement of non-executive directors of Top Level Budgets or agencies or appointments from the private sector to senior civil service positions or chairpersons of public enquiries. You may distinguish "contracts of service" from "contracts for services" in that "contracts of service" are for employment, where the person is an employee for payroll and employment rights purposes.

104. You have to use two key tests to identify an employee, i.e. a person who works under a "contract of service". These are:

a. "mutuality of obligation", i.e. both parties to the contract have obligations to each other, the employee to perform work as directed, the employer to pay for the work performed; and

b. the "degree of control" exercised by the employer over the work performed by the employee

105. Other factors to take into consideration include:

a. whether the individual must perform the work personally, or is able to send a qualified substitute;

b. the nature of the pay and benefits that the employer provides;

c. whether or not the individual has a business structure;

d. who decides on how the contract should be performed;

e. the extent of the financial risk borne by the individual; and

f. who provides the materials and equipment necessary for the work.

106. The duration of the contract is also important; the longer the engagement or where it is not of a fixed term duration, the more likely it is that the relationship is employment.

Research and Development Services

107. The exclusion for the provision of R&D services at Regulation 7(1)(l) is explained at Chapter 10 – Research and Development.

Authority to apply the exclusion

108. Procurers should note that you must not apply an exclusion simply with the sole purpose of avoiding the requirements of the DSPCR. You must be able to justify objectively the application of the exclusion.

109. You must interpret the exclusion strictly and use it proportionately. You must record the circumstances justifying its usage and approval at the appropriate level on file.

110. Procurers should issue local instructions setting out the process for authorisation of DSPCR exclusions.

111. For the MOD, a Senior Commercial Officer at Band C1 level (or above) must authorise the use of the exclusion in order to establish a consistent approach across each area of business in the MOD.

112. You must record the decision to use the exclusion for audit purposes and in the event of legal challenge.

Competitive procurement under an exclusion

113. You should note that the availability of a general exclusion is not by itself sufficient justification for non-competitive procurement, as Government policy is to maximise the use of competitive procurement.

114. There may very well be circumstances where the reason for using the general exclusions prohibits or constrains use of competition, e.g.:

a. under the general exclusions for government-to-government sales, a non-competitive approach is very likely to be the only practical option; or

b. under the general exclusion for disclosure of information, it may only be possible to conduct a limited competition, i.e. compete amongst national suppliers who have the appropriate security clearance.

115. In order to seek best value for money, you must seek to maximise the use of competition in any exempt procurement except where you can justify the reasons not to do so.

What are the key points to remember?

1. Once you have decided that a treaty exemption does not apply, you must consider the application of the exclusions in the DSPCR.

2. If you choose to use an exclusion, it has the effect of dis-applying the DSPCR for that particular procurement.

3. You must only use an exclusion for the purpose that it is intended for, e.g. to protect the interests that it is designed to safeguard.

4. You should still look to advertise and compete exempt requirements, where appropriate.

5. The secrecy and security exclusion is set out in Regulation 7(1)(a) and (b) of the DSPCR.

6. You must consult your legal adviser if you are not clear whether you are allowed to use an exclusion for a specific procurement.

7. You must maintain an audit trail of any decision to use an exclusion in case of a legal challenge.

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