

## **The European Union Takes Steps to Facilitate the Transfer of Defense Equipment Between Member States**

On March 21, 2006, the European Commission ("Commission") issued a Consultation Paper on the "Intra-Community Circulation of Products for the Defence of Member States." Defense contractors involved in the European defense market should take note that the Commission is requesting comments on the consultation paper from interested parties by June 20, 2006 ([more details below](#)).

### **The State of Intra-Community Defense Equipment Transfers**

The Commission has recognized that Member States must be able to meet military needs under proper security conditions at a reasonable cost if the EU is to achieve the objectives of the European Security and Defense Policy ("ESDP"). The ESDP, developed since the Cologne European Council in June 1999, states that "the Union must have the capacity for autonomous action, backed up by credible military forces, the means to decide to use them, and a readiness to do so, in order to respond to international crises without prejudice to actions by NATO." The Helsinki Council established the Helsinki Headline in December 1999, the General Affairs and External Relations Council published the 2010 Headline Goal in May 2004, and the EU created the European Defense Agency as a Community institution on July 12, 2004 to develop defense capabilities, promote and enhance European armaments cooperation, strengthen the European defense industrial and technological base ("DITB"), and create a competitive European defense equipment market. As an additional step in furtherance of the ESDP, the Commission posits that it can contribute in developing a more co-coordinated EU defense equipment policy by improving the quality of the EU regulatory framework governing the treatment of armaments through the simplification of the intra-Community transfer of defense-related products.

Circulation of defense-related products is currently subject to administrative procedures established by each Member State. As a result, the defense industry, particularly the small and medium-sized enterprises ("SMEs"), incurs substantial expenses. Member States have justified their position on two bases: the lack of traceability once the product leaves its borders and the potential risk of a subsequent transfer to a third party outside the EU. In addition to the high costs, the defense industry faces heavy administrative burdens and long lead times, often several months, when they have to transfer equipment to another subsidiary or office within the EU.

Groups of Member States and the EU have attempted to face this challenge through ad hoc or partial arrangements. Two examples include: 1) the Letter of Intent ("LoI") and Farnborough Framework Agreement ("FA") and 2) the European Code of Conduct on Arms Export. On July 6, 1998, the Ministers of Defense of France, Germany, Italy, Spain, Sweden and the United Kingdom signed a LoI designed to facilitate the restructuring of the defense industry. The six Member States subsequently signed the Farnborough Framework Agreement outlining principles and policies that govern the cooperation between the six nations. The FA covers security of supply, export procedures, security of classified information, treatment of technical information, research and technology, and harmonization of military requirements. The Code of Conduct was adopted on June 8, 1998 as a nonbinding Council

---

### **CONTACTS**

If you would like more information, please contact any of the McKenna Long & Aldridge attorneys or public policy advisors with whom you regularly work. You may also contact:

**Allen B. Green**  
202.496.7523

**Claudio Mereu**  
011.322.278.1265

**Karri L. Garrett**  
202.496.7726

---

Declaration in the framework of the Common Foreign Security Policy. The main objective of the Code of Conduct is to achieve greater transparency in arms transactions and obtain an increasing convergence of the national export policies.

### **Unisys Study on Intra-Community Transfers of Defense Equipment**

The Commission engaged Unisys to analyze regulations of Member States focusing on obstacles created in order to evaluate earlier initiatives and recommend potential solutions. Unisys found at the most basic level that the very existence of specific licensing requirements in each country is by itself an obstacle to intra-Community trade. The differing licensing requirements for each Member State impose a significant administrative burden and long lead times that are out of proportion with the actual control needs considering the fact that applications for intra-community transfers are almost never rejected. Unisys also determined that other barriers include *juste retour* requirements and national practices that favor a national champion.

Unisys determined that Member States improperly relied upon Article 296 of the EC Treaty as the justification for imposing the rules. Unisys agreed with Member States that the traceability of the equipment may be an issue but noted that there is no increased security threat arising from an intra-Community transfer when compared to the long distance transfer within one Member State. Unisys opined that the FA would not provide a sufficient basis for the intra-Community transfer of defense equipment based upon the fact that the six nations have been slow to implement the FA and it would be cumbersome to expand the FA to all Member States in the EU.

After evaluating five possible scenarios, Unisys recommended the establishment of a unique enterprise certification system extended to all Member States and reinforced by product traceability. The proposed enterprise certification system includes four characteristics: 1) Offer a global license without discrimination to all European enterprises responding to set conditions; 2) Ensure traceability of movement; 3) Create a non-bureaucratic environment with a one-stop shop and approval in hours; and 4) Preserve the possibility for a Member State to invoke Article 296 for essential interest of national security.

### **Overview of the European Commission 2006 Consultation Paper**

[http://ec.europa.eu/enterprise/regulation/inst\\_sp/defense\\_en.htm](http://ec.europa.eu/enterprise/regulation/inst_sp/defense_en.htm)

Based upon the prior history of attempts to establish a common position for intra-Community transfers, the Commission determined that the establishment of an instrument at the Community level would provide the best solution. In accordance with Article 95 of the Treaty establishing the European Community ("TEC"), the Community has the right to approximate national provisions regarding export authorization systems to eliminate barriers to intra-Community trade. Neither Article 30 nor 296 restrict the European Community's legislative power in this area. The Commission is the only entity that has the ability to propose specific legislation for defense markets. The Commission recognizes that the legislation must accomplish five main objectives that would allow the Member States to come to an agreement while still protecting their own national security. The main objectives aim to:

- Provide guarantees for protection of national security while upholding the principle of free movement of defense equipment.
- Contribute to reassuring Member States and other purchasers of defense-related products of the security of supply in a timely manner and independent of crises or military action.
- Establish a procedure and simplified common criteria to guarantee national security through general transparency and specific controls on transfers which pose a serious risk to national security.
- Organize the traceability of transfers within the EU.
- Confirm that Member States may exempt themselves from these principles under specific conditions when it is necessary to protect essential interests of national security – a Safeguard

Clause.

The scope of the legislative proposal will include all products currently covered in a Member State by a requirement for an export, import or transit authorization. The products covered could be defined: 1) by a list of products similar to the Wassenaar Arrangement; 2) in broad terms for all defense-related equipment; or 3) by Member States under the principle of subsidiarity within a framework of mechanisms to guarantee mutual confidence. The Commission also recognized that the legislative proposal will undoubtedly impact extra-Community export of defense-related products. Therefore, a common export policy may be required to compensate for the increased risk of re-exportation of materials outside the Community. Based on past experience, the Commission believes that the European Union Code of Conduct must be considered because it has already provided sufficient consistency among arms export policies. The end result may be that each Member State may have to authorize the export of any product freely transferred within the Community to any third country.

Another goal of the Commission legislation will be to ensure transparency of the process. To this end, the establishment of a list of qualified countries and the assignment of a Movement Reference Number ("MRN") are two concepts to be considered. Each Member State would approve each company established on their territory as a qualified company consistent with agreed upon conditions. The MRN is actually a simplified electronic license that would be assigned by national administrations of each Member State for products to be traced during transport.

### **Solicitation of Comments from Interested Parties**

In formulating the legislative proposal, the Commission is soliciting comments from interested parties by June 20, 2006 to the questions below:

- Under what conditions could a Community measure add value to the current system of checks on transfers from the point of view of the security of commercial transactions, the protection and safeguarding of the public interest and the simplification of procedures for businesses?
- Is defining a common export policy a prerequisite for abolishing intra-Community controls or would it be possible to set up a transitional system until such a policy is defined?
- Could the common list of military goods covered by the EU Code of Conduct serve as a reference for applying the arrangements governing the movement of defense-related products? Are all the products on the list authorized to circulate on the national market?
- Should sensitive transfers at Community level be identified through a positive list of products, or would it be sufficient to determine common criteria (e.g., conventional weapons, nuclear weapons, cryptographic products) with several examples and leave the details of individual cases up to the Member States? Taking another approach, would it be possible to consider transfers which are government purchases by an EU Member State as transfers which are, in general, not sensitive?
- Do the special arrangements governing movement force businesses that are interested in following them into a situation which would give the public authorities guarantees? What guarantees would be necessary insofar as security confidentiality, etc. requirements are concerned? Can certification systems (ISO 9000) provide these guarantees?
- In such a situation, how should the situation of SMEs be considered? Is it possible to have specific arrangements for SMEs without affecting the confidence between Member States?
- Should a product monitoring system for the exporting Member State be paper- or computer-based? Is the common list enough to ensure that Member States of transit will ensure compliance with the Member State of origin's export policy?
- Should the Member States of transit be required to check the agreement of the Member State of origin in the file which the exporting company must submit?
- Should the arrangements be simplified by introducing a white list of authorized exporting countries?
- Is it possible to move towards arrangements similar to those for dual-use products?

- Managing the instrument will call for specific expertise and confidentiality requirements (updating lists, dealing with unusual cases, etc.). What role should the European Defense Agency play?
- Do the specific constraints justify drawing up a directive or regulation?

With government contracts, government affairs, and EU/Member State law practitioners based in our Brussels and Washington, DC offices, we will continue to monitor these and other EU defense procurement issues. Should you have any questions regarding the Commission's consultation paper, please contact [Allen Green](mailto:agreen@mckennalong.com) at [agreen@mckennalong.com](mailto:agreen@mckennalong.com), [Claudio Mereu](mailto:cmereu@mckennalong.com) at [cmereu@mckennalong.com](mailto:cmereu@mckennalong.com), or [Karri Garrett](mailto:kgarrett@mckennalong.com) at [kgarrett@mckennalong.com](mailto:kgarrett@mckennalong.com).

### About Us

McKenna Long & Aldridge LLP is a full-service law firm of approximately 400 lawyers and public policy advisors. The firm provides business solutions in the areas of corporate law, government contracts, intellectual property and technology, complex litigation, public policy and regulatory affairs, international law, real estate, environmental, energy and finance.

### Subscription Info

If you would like others to receive future mailings of the Government Contracts Advisory, please email their contact information to us at [information@mckennalong.com](mailto:information@mckennalong.com)

If you would like to be removed from the Government Contracts Advisory mailing list, please email [information@mckennalong.com](mailto:information@mckennalong.com)

---

\*This **Government Contracts Advisory** is for informational purposes only and does not constitute specific legal advice or opinions. Such advice and opinions are provided by the firm only upon engagement with respect to specific factual situations. This message is intended as a transactional message for clients of the Firm. If you are not a client of the Firm, you have received it for informational purposes only and should not consider it an advertisement or solicitation.

© Copyright 2006, [McKenna Long & Aldridge LLP](http://www.mckennalong.com), 1900 K Street, NW, Washington DC, 20006

**ATLANTA BRUSSELS DENVER LOS ANGELES PHILADELPHIA SAN DIEGO SAN FRANCISCO WASHINGTON DC**