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EUROPEAN DEFENCE FUND BENEFICIARIES

PRELIMINARY LESSONS LEARNED AND OPEN QUESTIONS

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ABSTRACT

By proposing the establishment of a European Defence Fund, the European Commission has, for the first time since 1957, decided to mobilise Community resources to support the development of the capabilities necessary for guaranteeing Europe's security and developing its strategic autonomy. This initiative, launched prior to the invasion of Ukraine, takes on a new dimension in light of the war in Europe and the decision taken by the Member States at the European Council in Versailles to develop their defence capacity. It is also clear that this strengthening of European capacity is contributing to global security within NATO. The provisions of the European Defence Fund are fully consistent with this imperative: they allow companies located in Europe but controlled by third countries to benefit from Community support subject to certain conditions. They are also consistent with the Union's security interests. The results of the calls for proposals for the first two years of the Fund demonstrate that the participation of companies controlled by third countries is indeed possible but their participation must be carefully verified by the Commission.

CONTENT

MINISTÈRE DES ARMÉES
Liberté
Égalité
Fraternité

INTRODUCTION

The adoption of Regulation 2018/1092 of the European Parliament and of the Council of 18 July 2018 establishing the European Defence Industrial Development Program to support the competitiveness and innovation capacity of the Union defence industry[1] (hereinafter EDIDP), followed by the European Defence Fund for the period 2021/2027[2] (hereinafter EDF) marked a new stage in the European Union's approach to defence.

The political context of the Commission's initiative is set out very clearly in the first recital of the EDF regulation: "The Union's geopolitical context has changed dramatically in the last decade. The situation in Europe's neighbouring regions is unstable and the EU faces a complex and challenging environment, combining the emergence of new threats, such as hybrid attacks and cyber-attacks, and the return of more conventional challenges. Given that context, both European citizens and their political leaders share the view that more has to be done collectively in the area of defence." This analysis from the first semester of 2021 remains fully accurate in 2022, as echoed in the Commission communication on European defence of 15 February 2022.[3]

Against this background, it should be recalled that the EDF Regulation does not fall directly within the scope of 'defence policy'. The legal basis for the regulation is Articles 173, 188, 182, 183 and 188 of the Treaty on the Functioning of the European Union (TFEU) which deal with the competitiveness of European industry and research policy.[4] The regulation is therefore in full compliance with the provisions of the Treaty on European Union (TEU) and with Article 41 in particular which states that "Administrative expenditure to which the implementation of this Chapter gives rise (Common Foreign and Security Policy) for the institutions shall be charged to the Union budget. Operating expenditure to which the implementation of this Chapter gives rise shall also be charged to the Union budget, except for such expenditure arising from operations having military or defence implications and cases where the Council acting unanimously decides otherwise."

Article 41 TEU is very clear and establishes an important general principle: the operational expenditure entailed by the implementation of the common foreign and security policy shall be borne by the Community budget. There is one exception to this general principle which, like any exception, must be interpreted strictly: expenditure on operations with military or defence implications is excluded. In the present case, the objective of EDF is to support research and development actions and not operations having military or defence implications.[5]

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1. OJ L 200 of 07.08.2019, p. 30.
2. OJ L 170 of 12.05.2021, p. 149.
3. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions, Commission contribution to European defence, p. 1, COM (2022) 60 final.
4. Since the EDIDP Regulation only supported development actions, its legal basis was limited to Article 173 TFEU.
5. See in particular Frédéric Mauro's exhaustive analysis: "Analysis of the legal basis of the European defence industrial development programme". https:/ /8d217603-baaf-4f6f-66b4b4f13862147.filesusr.com/ugd/18246a_2b3662e3c-40449c9a95d6f57599de283.pdf.

Article 3 EDF states that the general objective of the Fund is "to foster the competitiveness, efficiency and innovation capacity of the European defence technological and industrial base (EDTIB) throughout the Union, which contributes to the Union strategic autonomy and its freedom of action ...".[6] However, the political objective cannot be limited to the competitiveness of the industry. The Union needs a competitive industry to respond to more ambitious objectives, in particular the Union's strategic autonomy and freedom of action.

To respond to these objectives, the co-legislators have stipulated that the Programme can only support actions consistent with defence capability priorities agreed by the Member States within the framework of the Common Foreign and Security Policy. In the same vein, regional and international priorities may only be taken into account if they "serve the Union's security and defence interests."[7] Finally, Article 3.2 EDF calls for 'unnecessary' duplication with other initiatives to be avoided, implying that a certain level of duplication may be necessary, in particular when it contributes to strategic autonomy.

In this context, the list of entities potentially eligible for the programme requires careful attention. In the case of a Community programme financed from the EU budget, can the granting of financial support to 'non-European' companies be considered fully consistent with the objectives of the Programme? In its Proposal for a Regulation establishing the EDIDP, the Commission proposed a strict approach—without any possibility of derogations—excluding undertakings controlled by third countries or entities from third countries.[8] This approach has not been endorsed by the co-legislators who introduced the possibility of targeted derogations under the supervision of the Commission. The first years of the programme's implementation show that, while the provisions adopted are complex, they nevertheless allow companies controlled by third countries or entities from third countries to participate.

More generally, the establishment of a new Community programme in an area as sensitive as the defence industries inevitably raises a number of issues which cannot be dealt with in the context of this publication. The objective of this limited publication is only to address the more relevant aspects in the light of the first two years of experience. In the first chapter, we will examine general conditions applicable to the entities eligible for the EDF. In the second chapter, we will examine in more detail the conditions under which entities controlled by third countries or by the third country entities can actually participate in the Programme.

Preliminary Remarks

The eligibility criteria are laid down in both the EDF Regulation establishing the Programme and Regulation 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union (the Financial

6. Article 3.1 of Regulation 2021/697.
7. Article 3.2.b) Regulation 2021/697.
8. See recital 13 and article 7 of the Commission proposal to the European parliament and the Council. COM (2017) 294 final.

Regulation). The provisions of this Regulation, even if they are not included in the EDF Regulation, must be fulfilled.[9]

Verification of all eligibility criteria is the sole competence of the Commission, including in the case of indirect management provided for in Article 8 EDF. Article 9.4(c) EDF provides, inter alia, that the Commission shall communicate to the Member States Committee provided for in Article 34 EDF (hereinafter "the Member States Committee") the names of the entities controlled by third countries and declared eligible by the Commission. However, this communication is provided only for information.

In the same vein, the independent experts mentioned in Article 26 EDF have no role regarding the eligibility criteria. Their support is limited to the assessment of the award criteria and the ethical provisions. It should also be recalled that the nature and extent of the support provided by the experts for the assessment of the evaluation criteria are defined by the Commission. More specifically, the Regulation does not require all award criteria to be assessed by experts. The Commission may therefore limit support from experts to certain criteria and assess the other criteria itself.

GENERAL PROVISIONS APPLICABLE TO ELIGIBLE ENTITIES

From the concept of undertaking to the concept of legal entity

The EDIDP Regulation had retained the concept of undertaking, defined as "any entity, regardless of its legal status or its method of financing, which carries out an economic activity and which is established in the Member State in which it is incorporated in accordance with the national law of that Member State."[10] This concept has the advantage of relying on established case-law of the Court of Justice in competition matters, which takes as its essential criterion the existence of an economic activity.[11] In that context, the legal status of the entity in question is irrelevant, as is the pursuit or otherwise of profit. It follows that an entity, public or private, which is not generally intended to carry out economic activities, may nevertheless constitute an 'undertaking' for part of its activities, provided that those activities are of an economic nature.

This definition, which is considered to be strict in the field of competition since it makes it possible to apprehend many entities, is, on the contrary, very flexible in the context of the EDIDP by allowing many entities which are not necessarily intended to carry out an economic activity to participate. For the two financial years 2019 and 2020, nearly 50 research organisations, educational institutions, public organisations or non-governmental organisations, regardless of their legal status, have been selected as beneficiaries of the EDIDP.[12]

9. The importance of the eligibility criteria must be emphasised since, in the event of a dispute, a possible violation may be invoked not only by an undertaking whose proposal has not been declared eligible, but also by a competitor challenging the legality of the Commission's award decision.

10. Article 2.4 Regulation 2018/1092.

11. See notably ECJE, 23.4.1991, Höfner and Elser, case C-41/90.

12. https://ec.europa.eu/info/publications/european-defence-industry-results-calls.

As regards the EDF, the concept of undertaking has been substituted by the concept of 'legal entity', defined as "a legal person constituted and recognized as such under Union, national or international law, which has legal personality and the capacity to act in its own name, exercise rights and be subject to obligations, or an entity which does not have legal personality as referred to in point (c) of Article 197(2) of the Financial Regulation."[13]

Two comments can be made on this new definition.

First, this definition is largely based on the definition in the Horizon R&D Program,[14] but departs from it in an important way by excluding natural persons. This exclusion is specific to the EDF, since the EU's Space Program fully reproduces the definition of the Horizon Program by including natural persons.[15]

The actual impact of the exclusion of natural persons is difficult to assess at this stage. The overall balance of the Program is more focused on incorporated legal entities than on natural persons. Nevertheless, it cannot be excluded that natural persons with recognised expertise could usefully contribute to the Program, notably in the field of disruptive technologies or for support in the form of prizes. Such participation is excluded with the new definition.

Second, the existence or absence of a legal personality is likely to have significant legal implications. In this respect, two situations can be identified:

(1) The entity in question has legal personality.

This condition constitutes a prerequisite but is not sufficient to benefit from the Program. An entity shall also demonstrate that it has "the ability to act in its own name, to exercise rights and to be subject to obligations."

(2) The entity does not have legal personality.

Article 197(2) (c) of the Financial Regulation requires that two cumulative conditions be met:

- Entity representatives must have the capacity to make legal commitments on behalf of the entity.
- The entity must offer guarantees for the protection of the Union's financial interests equivalent to those offered by legal persons. In particular, the applicant shall have a financial and operational capacity equivalent to that of legal persons. This last point is particularly important in the context of the management of Community resources.

13. Article 2.1 regulation 2021/697.

14. Regulation (EU) 2021/695 of the European Parliament and of the Council of 28 April 2021 establishing Horizon Europe – the Framework Programme for Research and Innovation, laying down its rules for participation and dissemination, and repealing Regulations (EU) No 1290/2013 and (EU) No 1291/2013. OJ L 170, 12.05.2021, p. 1.

15. Article 2.28. Regulation (EU) 2021/696 of the European Parliament and of the Council of 28 April 2021 establishing the Union Space Programme and the European Union Agency for the Space Programme and repealing Regulations (EU) No 912/2010, (EU) No 1285/2013 and (EU) No 377/2014 and Decision No 541/2014/EU. OJ L 170; 12.05.2021, p. 69.

The burden of proof lies with the entity concerned which must demonstrate that the conditions of the EDF Regulation and the Financial Regulation are actually met. Non-compliance with a provision should necessarily imply the exclusion of the proposal.

As for any eligibility criteria, compliance is scrutinised by the Commission until the signature of the grant agreement. The preliminary selection of a proposal as a potential beneficiary of the Fund remains without prejudice to additional verifications of all eligibility criteria until the signature of the grant agreement.

Legal entity and conflict of interest

Article 61.1 of the Financial Regulation contains the following provision: "Financial actors within the meaning of Chapter 4 of this Title and other persons, including national authorities at any level, involved in budget implementation under direct, indirect and shared management, including acts preparatory thereto, audit or control, shall not take any action which may bring their own interests into conflict with those of the Union."

When implementing these provisions, the important role of Member States in the management of the Program must be taken into account. The Member States Committee, for example, delivers an opinion on the annual work program prepared by the Commission. In this context, Member States are invited to make proposals on the categories of projects or technologies they wish to see included in that program. At the end of the selection process, the Member States Committee is consulted a second time about the final list of projects the Commission intends to support. If the Committee does not express a positive opinion, the Commission cannot adopt the list of beneficiaries.

In addition, Member States are invited to approve guarantees provided by undertakings that are controlled by a third country or by a third country entity. For certain development actions, Member States also support the proposals by declaring their intention to acquire the final product or to use the technology in a coordinated manner, or by jointly defining the technical specifications.

In view of this decisive role for the Member States, it is necessary to consider the conditions under which a public legal entity falling within the 'State domain' could participate in the Program without giving rise to a conflict of interest within the meaning of Article 61.1 of the Financial Regulation. This analysis is necessary since Article 141.1(c) of the Financial Regulation requires the Commission to exclude from a particular award procedure a participant who "was previously involved in the preparation of documents used in the award procedure where this entails a breach of the principle of equality of treatment, including distortion of competition that cannot be remedied otherwise."[16]

16. In case of doubt, the procedure imposed by the Financial Regulation is cumbersome, since "the authorising officer responsible shall communicate to the other participants in the award procedure the relevant information exchanged in the context of the participation of the person concerned in the preparation of the award procedure, or resulting from this participation, as referred to in point (c) of the first subparagraph." Before being possibly excluded, the participant shall be given the opportunity to prove that his participation in the preparation of the award procedure does not constitute an infringement of the principle of equal treatment'.

As regards participation in the EDF, a distinction could be made depending on the degree of integration of a public entity in the State body.

In particular, it seems difficult to consider that an entity without legal personality which constitutes a simple department of a ministry may be eligible for the EDF. Such an entity cannot be dissociated from the 'State' participating in the Program Committee. In the same vein, it seems difficult to envisage that non-member-State entities participating in the work of the Program Committee could be beneficiaries of the Program.[17]

By contrast, a public entity with legal personality and broad managerial independence could probably be considered sufficiently distant from the State to avoid a significant risk of conflict of interest.

Clarity on these points will be provided by Commission practice.

Exclusion criteria from the Financial Regulation

Article 136 of the Financial Regulation essentially provides for five main categories of exclusions of entities from the procedures for the allocation of Union funds:

- Bankruptcy or insolvency.
- Non-compliance with tax obligations, including the setting up of an entity in a different jurisdiction with the intention of tax evasion
- Grave professional misconduct by having violated applicable laws or regulations or ethical standards. This may be the case, for example, if restrictive agreements on competition are concluded, intellectual property rights are infringed, or if there is an attempt to obtain confidential information that may grant the undertaking undue advantages in the award procedure.
- Acts of fraud, corruption, money laundering, child labour.
- Failure to fulfil essential obligations in the execution of a legal commitment financed by the Union budget, which has led, inter alia, to the early termination of a legal commitment.

With regard to the infringement of competition rules, Article 136.2(e) covers infringements of Community and national law. Moreover, while Article 136.1(c)(ii) refers only to agreements between entities to distort competition, Article 136.2(e) refers to all aspects of Union law in the field of competition, including State aid rules. It can therefore be considered that an entity receiving incompatible and non-refunded State aid should be excluded from the EDF.

The Commission may exclude an entity even if the wrongful conduct has not been the subject of a final judgment or administrative decision. In such a case, the Commission may exclude an entity on the basis of a preliminary classification in law of a conduct. This

17. See in particular Article 34 EDF.

preliminary exclusion does not prejudge the final position of the national authorities as to the conduct in question. It follows that if the final judgment or the final administrative decision overturns the conclusions of the preliminary analysis, the Commission shall terminate the exclusion. It should be noted, however, that preliminary analysis cannot stop the evaluation process of proposals submitted by legal entities for a specific year. Consequently, a final judgment or a final administrative decision, which would take place after the selection process conducted by the Commission, would have no concrete effect for the selection procedure for the current year. It is therefore important for companies to check the absence of exclusion criteria before submitting proposals.

One important issue for companies concerns the duration of the possible exclusion. Article 139.1(a) of the Financial Regulation provides that the duration of the exclusion decided by the Commission shall not exceed the duration, if any, provided for in the final judgment or administrative decision.

In the absence of an exclusion provided for in the final judgment or the final administrative decision, the Commission remains competent to provide for such an exclusion. Depending on the nature of the misconduct, the period of exclusion will be between 3 and 5 years. Entities subject to such exclusion may not participate in a selection procedure if the final date for submitting proposals is covered by the exclusion period.

The Financial Regulation also provides that the maximum period for excluding an entity cannot exceed 5 years from the date of the conduct giving rise to the exclusion or from the date of the final judgment, or the final administrative decision.

Entities benefiting from foreign subsidies: open question

The Commission proposal of 5 May 2021 for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market[18] constitutes an ambitious new instrument providing the Commission with the competence to control subsidies granted by third countries to companies active on the internal market. In particular, the Commission will have competence to balance the positive effects of the subsidy and its negative effects on the internal market and propose compensatory measures or possibly request reimbursement of the subsidy.

The Explanatory Memorandum accompanying the Proposal states in particular "The Commission will explore the possibility to propose to the co-legislators amendments to the Financial Regulation during the next revision, to take into account the impact of foreign subsidies. To the extent EU funding is distributed through public procurement under shared management, possible distortions would be addressed through the public procurement provisions of this proposal."[19] The Proposal is therefore not directly applicable, at this stage, to foreign subsidies granted to an undertaking applying for Community aid programs.

18. COM (2021) 223 final. https://ec.europa.eu/competition/international/overview/proposal_for_regulation.pdf.
19. Explanatory memorandum; p.3. https://ec.europa.eu/competition/international/overview/proposal_for_regulation.pdf.

However, the existence of incompatible foreign subsidies would be difficult to ignore in the context of the analysis of the exclusion criteria laid down in Article 136 of the Financial Regulation.

In the domain of State aid, it should be recalled that the Community rules prohibit the granting of new aid to an undertaking which has benefited from incompatible aid that has not been reimbursed. Similarly, Article 136(2)(e) of the Financial Regulation provides that, under certain conditions, an infringement of the competition rules constitutes an exclusion criterion for the benefit of Union funds.

The legal basis for the Proposal for a Regulation on foreign subsidies is Articles 114 TFEU (approximation of laws) and 207 TFEU (trade policy), and not the competition articles in the TFEU. Nevertheless, it would be difficult to justify that an undertaking which has benefited from incompatible and not reimbursed foreign subsidy could be eligible for a Community program, whilst an undertaking which has benefited from incompatible and not reimbursed State aid would not be eligible for the same Community program. Consistency would plead for the exclusion from EDF's support, undertakings which have benefited from incompatible foreign subsidies which have not been reimbursed.

LEGAL ENTITIES CONTROLLED BY THIRD COUNTRIES OR BY THIRD COUNTRY ENTITIES

Scope

Article 9 EDF reproduces the provisions of Article 7 EDIP and limits the beneficiaries of the Program to legal entities established in the Union or in an associated country and not controlled by a third country or a third country entity, unless a derogation is accepted by the Commission pursuant to the provisions of Article 9.4 EDF.

These conditions apply to beneficiaries and three categories of subcontractors:

- Subcontractors who have a direct link with a recipient.
- Other subcontractors to whom at least 10% of the total eligible costs of the action are allocated.
- Subcontractors who may need access to classified information to perform the action.

As a result, subcontractors allocated less than 10% of eligible costs of the action and who do not need access to classified information in order to carry out the action may be controlled by third countries or by third country entities.

In this context, the specific situation of the project manager should be highlighted.

The EDF Regulation does not require Member States to appoint a project manager. However, where appointed, the project manager must be consulted by the Commission on the progress of the action before any payment is made.

Article 2.18 EDF requires that the project manager is established in a Member State or an associated country and designated by a Member State or an associated country or group of Member States or associated countries. However, the provisions of Article 9 EDF concerning the absence of control do not apply. As a consequence, a project manager could be controlled by a third country or a third country entity.

In such a case, an open question concerns the possibility for the Commission to consult the project manager on the progress of the action before the payment is made, while complying with the classified information obligations laid down in Article 27 EDF. Compliance with these provisions may actually prevent the Commission to consult a project manager controlled by a third country or a third country entity.

The concept of control

Article 2(6) of the EDF Regulation defines the notion of control as "the ability to exercise a decisive influence on a legal entity, directly or indirectly through one or more intermediate legal entities." This concept is not new in Community law but is directly inspired by a long-established practice in the field of competition. However, it should be recognised that the analysis is complex, even if detailed explanations have been provided by the Commission in particular in Annex 6 to the Guide for Applicants of 4 October 2021.[20]

In this respect, three comments can be made.

First, the notion of control referred to in Article 9.3 EDF refers to the possibility for a third country or an entity of a third country to exercise decisive influence over a legal entity. The fact that the power of influence is not actually exercised is irrelevant for the purpose of the eligibility analysis. This may be the case, for example, in the case of control by a Pension Fund which does not actually exercise its influence.

Second, each undertaking is responsible for carrying out an analysis of its situation and providing information to the Commission when submitting its proposal. However, this analysis is not binding for the Commission, which may carry out further investigations, in particular on the basis of public information or the information at its disposal. In this connection, the question arises as to the extent to which the Commission can rely on information provided by undertakings in other Community procedures.

A distinction could be made between, on the one hand, the procedures conducted in the field of competition and, on the other hand, the other Community programs, in particular in the field of civil research and the space program.

Article 17 of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings[21] provides, inter alia, that "information acquired as a result of the application of this Regulation shall be used only for the purposes of the

20. https://ec.europa.eu/defence-industry-space/calls-tenders/european-defence-fund-edf-2021-calls-documentation-submission-forms-and-guidance_en.

21. OJ L 24 of 29.1.2004, p. 1.

relevant request, investigation or hearing." Similar provisions exist as regards antitrust procedures.[22] As a consequence, information provided in the context of merger or antitrust procedures cannot be used by the Commission when analysing EDF proposals.

Such limitations are not provided for in Regulation 2021/696 establishing the Space Program[23] or in Regulation 2021/695 establishing the Horizon Program.[24] Furthermore, Article 128 of the Financial Regulation provides that "in order to avoid asking persons and entities receiving Union funds for the same information more than once, information already available at Union institutions, managing authorities or other bodies and entities implementing the budget shall be used to the extent possible." Consequently, information collected by the Commission under the Horizon Program and the Space Program can be used under the EDF to assess the eligibility of proposals.[25]

Finally, it should be noted that the EDF Regulation is silent on the consequences to be drawn from the absence of guarantees provided by an undertaking controlled by a third country or a third country entity. The situation arises in particular when an undertaking has wrongly considered that it is not controlled by a third country.

In this respect, two options are open for the Commission.

The first option could be to apply the regulation strictly and consider that in the absence of the guarantee required by the EDF Regulation, the undertaking in question is not eligible. The consortium should therefore take the necessary steps to find a new partner to ensure the viability of the project. This option would be legally in line with the text of the Regulation.

A second option, more flexible, could be to invite the undertaking concerned to provide the guarantees within a period which would necessarily be limited. This second option has been retained by the Commission for the time being,[26] without any guarantee that the same 'flexible' approach will be pursued in the future. The consequence of this flexible approach is to provide additional time for the companies concerned, which could be challenged by competitors, including before the Court of Justice.

The derogation from the principle of prohibition of supervision

In accordance with Article 9 EDF, an entity established in the Union or in an associated country and controlled by a third country or a third country entity may nevertheless be eligible for the Program if guarantees approved by the Member State or associated country in which it is established in accordance with its national procedures are made available to the Commission. These provisions are particularly important and inevitably raise many questions of application.

22. See Article 28 of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty. OJ L 1 of 4.1.2003, p. 1.
23. OJ L 170 of 12.5.2021, p. 69.
24. OJ L 170 of 12.5.2021, p. 1.
25. Conversely, information provided in the context of EDF can be used in other EU programmes.
26. See Guide for Applicants, 4.10.2021, p. 56.

• ***Who should provide the guarantees?***

The absence of control by a third country constitutes an eligibility criterion, and Article 9.7 EDF states in particular that "applicants shall provide all relevant information necessary for the assessment of the eligibility criteria." The guarantees, including the approval by the Member State, must therefore be provided by the applicants when submitting their proposals.

With regard to the role of Member States, Article 9.4 EDF requires entities to provide "guarantees approved by the Member State or associated country in which it (the entity) is established in accordance with its national procedures." These provisions call for two comments.

- While Member States and associated countries have the possibility of approving guarantees, the Commission has sole competence to monitor compliance with the eligibility criteria. It follows that the guarantees provided by undertakings and approved by the Member States remain subject to the assessment of the Commission.[27]

- The EDF Regulation, taking into account in particular its legal basis, does not impose any obligations on Member States or associated countries. The latter are therefore not obliged to take position on the guarantees of undertakings established in their territory.

• ***Consequences of non-approval***

An open question concerns the consequences to be drawn from the absence of approval by the Member State or associated country in which an undertaking is established. This situation may result either from a 'negative opinion' on the guarantees offered by the undertaking or from the decision of the Member State or associated country not to take a position.

In such a case, two options can be considered.

The first option could consider that, in the absence of explicit approval, the eligibility conditions are not met. Such an approach would be consistent with the objective of strict application of the derogations but would give the Member States a decisive role in the assessment of the eligibility criteria which normally falls under the exclusive competence of the Commission. The approach might also lead to discrimination for undertakings depending on the place of establishment.[28]

The second option could consider that the approval of the guarantees by the Member State or associated country constitutes a 'favourable opinion' in the context of the Commission's analysis, but the absence of opinion does not prevent the Commission from conducting its own analysis and deciding on the acceptability of the guarantee. This approach would be

27. Regulation (EU) 2021/696 of the European Parliament and of the Council of 28 April 2021 establishing the Union's space programme stipulates in particular that guarantees are to be provided in the event of the participation of entities controlled by third countries or third country entities. Article 24.5 states that the Commission shall comply with the assessment of the Member States. This latter clarification does not exist in the EDF. OJ L 170 of 12.5.2021, p. 69.

28. This situation can notably arise when a Member State or Associated country does not have a national procedure to approve the guarantees.

consistent with the principle that approval by the Member State or associated country is not binding on the Commission.

- ***The content of the guarantees***

Article 9.4 EDF requires guarantees to provide assurance on three essential points: (a) the participation of the entity is not contrary to the security and defence interests of the Union and the Member States; (b) the participation of the entity is not contrary to the objectives of the Program; and (c) provisions are in place to ensure compliance with Articles 20 and 23 on property rights, and in particular the absence of third-country control of the results of the action. These conditions are cumulative and must be demonstrated by the applicants. The guarantees cannot be limited to a mere declaration by national authorities but must be supported by sufficiently detailed evidence, in particular that appropriate measures are in place to meet the requirements referred to in points (a), (b) and (c) of Article 9.4. EDF.

(a) The security and defence interests of the Union and the Member States

Article 9.4 EDF refers to the security and defence interests as defined in the CFSP framework under Title V of the Treaty on European Union (TEU). In particular, Article 21 TEU sets out important principles: "The Union's action on the international scene shall be guided by the principles which have inspired its own creation, development and enlargement, and which it seeks to advance in the wider world: democracy, the rule of law, the universality and indivisibility of human rights and fundamental freedoms, respect for human dignity, the principles of equality and solidarity, and respect for the principles of the United Nations Charter and international law."

This article must be read in conjunction with Article 2 TEU, which stresses in particular respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights.[29]

Similar provisions have been adopted by the Council to accept the participation of third States in Permanent Structured Cooperation projects (hereinafter referred to as PESCO). Council Decision 2020/1639 of 5 November 2020 laying down the general conditions under which third States could be invited exceptionally to participate in particular PESCO[30] projects requires those third States to share the values on which the Union is founded, in accordance with Article 2 TEU, and the principles referred to in Article 21(1) TEU as well as the objectives of the CFSP set out in Article 21(2)(a), (b), (c) and (h) TEU.

Decision 2020/1639 does, however, contain three additional important conditions, not explicitly included in the EDF Regulation:

- First, the concept of respect of security and defence interests of the Union and its Member States also includes respect for the principle of good neighbourly relations with the Member States.

29. "The Union is founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities. These values are common to the Member States in a society in which pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men prevail."

30. OJ L 371 of 6.11.2020, p. 3.

• Second, the concept implies the existence of a political dialogue with the Union, which should also cover security and defence aspects.

• Finally, in order to participate in a PESCO project, a third State must have an agreement with the Union on information security.

The EDF Regulation and Decision 2020/1639 have different objectives: the first concerns cooperation between undertakings, while the second concerns cooperation between Member States and third States. However, it would be difficult to justify two different notions of the security and defence interests of the Union and its Member States. It should be recalled in this respect that, pursuant to Article 9.4(c) EDF, the results of an action financed by the EDF, containing very sensitive information as regards security and defence, may be transferred to a third State with the agreement of the Member State or associated country in which the undertaking in question is established.[31] Therefore, an option could be to adopt in the context of the EDF, all the criteria set out in Decision 2020/1639.

(b) The participation of the entity is not contrary to the objectives of the Program

According to Article 9.1 EDF, the participation of an entity controlled by a third country or a third country entity cannot be contrary to the objectives set out in Article 3 of the Regulation. The condition covers not only the general objective referred to in Article 3.1, but also the specific objectives referred to in Article 3.2.

Demonstrating that the participation is not contrary to the objective of the Program implies to demonstrate the "absence of a problem", which is always complicated. However, the consortium has the obligation to provide evidence establishing that this condition is met.

The risk that the participation of an entity controlled by a third country or a third country entity would be contrary to the objectives of Article 3 is mitigated by the fact that such an entity will generally be integrated into a consortium with at least two European companies.[32] There is clearly no incentive for European companies to set up a consortium with an entity whose participation would be contrary to the objectives of the Program. However, it should be recalled that the EDF Regulation does not preclude the possibility of a consortium composed exclusively of entities controlled by third countries or third country entities.

On this aspect, the Council has adopted much stricter conditions for the participation of third countries in the PESCO projects. Article 3 of Decision 2020/1639 requires that the third State asking to participate in a PESCO project "provides substantial added value to the project and contributes to the achievement of its objectives." Furthermore, "its participation contributes to strengthening the Common Security and Defence Policy (CSDP) and the level of ambition of the Union as defined in the Council conclusions of 14 November 2016, including in support of CSDP missions and operations."

31. The list of 10 entities controlled by a third country or a third-country entity and selected as beneficiaries under the EDIDP, shows that some of the 'parent companies' are established in third countries that do not have a security agreement with the Union. https://ec.europa.eu/defence-industry-space/eu-defence-industry/european-defence-industrial-development-programme-edi.

32. The derogation to the general rule of minimum 3 entities only applies to disruptive technologies and studies.

For the future, an open question is whether the conditions for participation of entities controlled by third countries or third country entities in the EDF Program and in the PESCO projects should not be aligned.

(c) Compliance with Articles 20 and 23 EDF

Articles 20 and 23 EDF lay down the conditions under which the results of research or development actions supported by the Fund may be the subject of a transfer of ownership or an exclusive license (only for research) to a third country or a third country entity. These provisions are complex and need to be assessed in conjunction with other provisions of the EDF Regulation, in particular Article 9 thereof.

Article 9 EDF provides that an entity controlled by a third country or a third country entity may, by way of derogation, participate in the Fund if guarantees prove, inter alia, that:

- The participation of the entity is not contrary to the security and defence interests of the Union and its Member States.
- Control over the entity does not restrict its ability to carry out the action and to deliver results.
- Access by a third country or a third country entity to sensitive information relating to the action is prevented.
- Ownership of the intellectual property arising from and results of the action remain within the recipient during and after completion of the action and are not subject to control or restriction by a third country or a third country entity.
- Intellectual property rights arising from the action and the results of the action shall not be exported outside the Union or associated countries without the approval of the Member State or associated country in which the entity is established.

Under Article 9 EDF, intellectual property rights and results may therefore be transferred to a third country or a third-country entity with the agreement of the Member State concerned. It follows that, in such a case, a third State or a third-country entity may have access to, but cannot exercise control over, sensitive information relating to the action. Article 9 EDF does not provide for any role for the Commission in this context.

Articles 20 and 23 EDF set out the conditions under which the results of research and development activities may be transferred to third countries. These provisions shall apply to all entities, and not only to entities controlled by a third country or a third country entity.

For results regarding research action, the Commission must be informed in advance of transfer of ownership or grant of an exclusive license to a third country or a third country entity. The procedure provided for is only an information procedure and not an authorization procedure, fully in line with the Member States' discretion as regards their policy on the export of defence-related products. However, the Commission remains competent to examine whether such transfer is compatible with the security and defence interests of the Union and its Member States and the objectives of the Program. If the Commission considers that these conditions are not respected, the support granted by the Fund must be reimbursed.

These provisions call for three main remarks.

• Although the criteria in Articles 20 and 23 EDF for assessing the compatibility of the transfer are identical to those laid down in Article 9.4 EDF, the assessment of Article 9 EDF is the sole competence of the Commission, without any approval by the Member State in which the entity concerned is established.

• If the Commission concludes that the transfer is not compatible with the criteria laid down in Article 20.4 EDF, the Commission must request reimbursement of the support granted by the Fund.[33] The reimbursement shall relate to the support granted to the action, and therefore to all the recipients.

• When analysing the compatibility of the transfer with the security and defence interests of the Union and its Member States and with the objectives of the Program, two situations can be identified.

– The first concerns the transfer of ownership of the results or the granting of an exclusive license to a third country or a third country entity controlling a consortium entity, for which the Commission has already considered that the conditions for the derogation of Article 9.4 EDF are met. In such a case, the Commission has already considered that the participation of that entity in the Program, controlled by the third country in question, is not contrary to the security and defence interests and the objectives of the Program. This is undoubtedly a positive signal. However, this signal is not sufficient and further analysis should be carried out in the context of Article 20.4 EDF. This analysis should in particular check that the transfer of ownership of the results or the granting of an exclusive license is compatible with the objectives of Article 3 EDF, which are aimed at the competitiveness of European industry and the improvement of the performance of future capacities in the Union.[34]

– The second concerns the transfer of ownership or the granting of an exclusive license to a third country or a third country entity, different from the third country or third country entity controlling entities which have benefited from the derogation provided for in Article 9.4 EDF. This may also be the case where a consortium does not include an entity controlled by a third country or a third country entity. In such a case, the Commission's control should be stricter, both as regards the compatibility with the security interests of the Union and the Member States and compliance with the objectives of the Fund.

33. The wording of Article 29.4 EDF does not give any flexibility to the Commission.

34. Decision 2020/1639 is much stricter in this respect and Article 3.d provides, inter alia, that the third State participating in a PESCO project, "must finalise an agreement at an appropriate level on conditions for the further sharing outside the PESCO framework on a case-by-case basis of capabilities and technology to be developed within that project, in order to prevent those capabilities from being used against the Union and its Member States."

CONCLUSION

The Conclusions of the European Council of 10 and 11 March 2022 recall in particular that "A stronger and more capable EU in the field of security and defence will contribute positively to global and transatlantic security and is complementary to NATO, which remains the foundation of collective defence for its members."[35]

The results of the EDIDP calls for proposals have demonstrated that the participation of undertakings controlled by third countries or third country entities is possible while also respecting the objective of contribution to European strategic autonomy. In an increasingly uncertain geopolitical context, strengthening capabilities must be a priority for the Union and its Member states. The EDF, with a small budget compared to the Commission's proposals, nevertheless opens up new opportunities and allows for the development of structural capabilities essential for the future. In this context, innovation must remain the top priority and resources must not be dispersed.

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35. Point 8. https://www.consilium.europa.eu/media/54773/20220311-versailles-declaration-en.pdf.