



Brussels, 22 November 2016
(OR. en)

14745/16

**Interinstitutional File:
2016/0276 (COD)**

LIMITE

JUR 571	EDUC 394
ECOFIN 1090	SOC 735
CODEC 1714	EMPL 497
POLGEN 147	EF 349
COMPET 611	AGRI 629
RECH 329	TELECOM 250
ENER 396	UEM 394
TRANS 453	JAI 980
ENV 732	

OPINION OF THE LEGAL SERVICE¹

From: Legal Service

To: Financial Counsellors

Subject: Proposal for a Regulation amending Regulations (EU) No 1316/2013 and (EU) 2015/1017 as regards the extension of the duration of the European Fund for Strategic Investments as well as the introduction of technical enhancements for that Fund and the European Investment Advisory Hub:

- legal feasibility of the provision of support by the Fund of investments in the defence industry

I. INTRODUCTION

1. On 14 September 2016, the European Commission adopted a proposal for a Regulation amending Regulations (EU) No 1316/2013 and (EU) 2015/1017 as regards the extension of

¹ This document contains legal advice protected under Article 4(2) of Regulation (EC) No 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents, and not released by the Council of the European Union to the public. The Council reserves all its rights in law as regards any unauthorised publication.

the duration of the European Fund for Strategic Investments as well as the introduction of technical enhancements for that Fund and the European Investment Advisory Hub ("the EFSI 2 proposal").²

2. The proposal extends the duration of the European Fund for Strategic Investments ("EFSI") beyond its initial three-year period, scales-up of the SME window within the existing framework, enhances the European Investment Advisory Hub ("EIAH") and aims to introduce a further reinforcement of additionality of the projects supported, as well as a number of technical enhancements for the EFSI and the EIAH, incorporating the lessons learnt in the first year of implementation of the EFSI.
3. In the course of the Financial Counsellors' working party meeting of 17 October 2016, the views of the Council Legal Service (CLS) were sought on the question whether the support granted to investments under the EFSI could include projects in the area of the defence industry. The present opinion summarises the views of the CLS on this issue.
4. However, since no specific suggestion for amendment was put forward in this regard, the analysis presented in this opinion is based on the current state of the text of the EFSI Regulation and EFSI 2 proposal and is of general nature and could therefore be adjusted accordingly to any subsequent and more detailed proposals.

II. LEGAL AND FACTUAL BACKGROUND

5. The purpose of the EFSI is to support, in the Union, through the supply of risk-bearing capacity to the EIB, the following: (a) investments; and (b) increased access to financing for entities having up to 3 000 employees, with a particular focus on SMEs and small mid-cap companies. It is established within the European Investment Bank (EIB).

² COM(2016) 597 final.

6. The EFSI Regulation is based on Articles 172 and 173, the third paragraph of Article 175 and Article 182(1) TFEU. Whereas Articles 172, 173 and 182(1) TFEU permitted the amendment of Regulation (EU) No 1291/2013 of the European Parliament and of the Council of 11 December 2013 establishing Horizon 2020³ and Regulation (EU) No 1316/2013 of the European Parliament and of the Council of 11 December 2013 establishing the Connecting Europe Facility⁴, Article 175 TFEU served as legal basis to establish the EFSI.
7. Article 175, third indent, TFEU read together with Article 174 TFEU, allows the Union to develop and pursue actions leading to the strengthening of its economic, social and territorial cohesion, in order to promote its overall harmonious development, including when necessary through specific actions outside the Structural Funds, the EIB and the other existing Financial Instruments.
8. The tasks of the EIB, defined by Article 309 TFEU, are to *"contribute, by having recourse to the capital market and utilising its own resources, to the balanced and steady development of the internal market in the interest of the Union. For this purpose the Bank shall, operating on a non-profit-making basis, grant loans and give guarantees which facilitate the financing of the following projects in all sectors of the economy: (a) projects for developing less-developed regions; (b) projects for modernising or converting undertakings or for developing fresh activities called for by the establishment or functioning of the internal market, where these projects are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States; (c) projects of common interest to several Member States which are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States."*

³ OJ L 347, 20.12.2013, p. 104.

⁴ OJ L 348, 20.12.2013, p. 129.

9. Article 346(1)(b) TFEU contains a specific provision concerning industries with defence aspects. It states that *"any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the internal market regarding products which are not intended for specifically military purposes."*
10. Article 40 TEU states that *"[t]he implementation of the [CFSP] shall not affect the application of the procedures and the extent of the powers of the institutions laid down by the Treaties for the exercise of the Union competences referred to in Articles 3 to 6 of the [TFEU]. Similarly, the implementation of the policies listed in those Articles shall not affect the application of the procedures and the extent of the powers of the institutions laid down by the Treaties for the exercise of the Union competences under [the CFSP Chapter of the TEU]."*
11. Article 42(1) TEU states that *"the common security and defence policy shall be an integral part of the common foreign and security policy. It shall provide the Union with an operational capacity drawing on civilian and military assets. The Union may use them on missions outside the Union for peace-keeping, conflict prevention and strengthening international security in accordance with the principles of the United Nations Charter."*
12. These tasks include *"joint disarmament operations, humanitarian and rescue tasks, military advice and assistance tasks, conflict prevention and peace-keeping tasks, tasks of combat forces in crisis management, including peace-making and post-conflict stabilisation. All these tasks may contribute to the fight against terrorism, including by supporting third countries in combating terrorism in their territories"* (Article 43(1) TEU).

13. Further, still within the CFSP part of the TEU, Article 42(3) TEU states that "*[t]he Agency in the field of defence capabilities development, research, acquisition and armaments ('the European Defence Agency') shall identify operational requirements, shall promote measures to satisfy those requirements, shall contribute to identifying and, where appropriate, implementing any measure needed to strengthen the industrial and technological base of the defence sector, shall participate in defining a European capabilities and armaments policy, and shall assist the Council in evaluating the improvement of military capabilities.*"
14. According to Article 45(1) TEU, the European Defence Agency (a) contributes to identifying the Member States' military capability objectives and evaluating observance of the capability commitments given by the Member States; (b) promotes harmonisation of operational needs and adoption of effective, compatible procurement methods; (c) proposes multilateral projects to fulfil the objectives in terms of military capabilities, ensure coordination of the programmes implemented by the Member States and management of specific cooperation programmes; (d) supports defence technology research, and coordinate and plan joint research activities and the study of technical solutions meeting future operational needs; (e) contributes to identifying and, if necessary, implementing any useful measure for strengthening the industrial and technological base of the defence sector and for improving the effectiveness of military expenditure.

III. LEGAL ANALYSIS

15. This opinion will examine in turn whether the extension of the scope of the EFSI to defence-related projects a) would be consistent with the powers of the EIB as laid down in the Treaty; b) would be in conformity with the legal basis of the Fund; c) would not encroach upon the CFSP provisions in the TEU.

(a) *Consistency with the powers of the EIB*

16. The system of the Treaties does not exclude the defence industry in general from the rules of the internal market. This is evident from the wording of Article 346(1)(b) TFEU which allows derogations in relation to arms production in certain circumstances.⁵ It is also well-established case law that the derogations provided for in this Article must be interpreted strictly.⁶ This case-by-case restrictive approach towards the exception in this provision is also evidenced by the Directive 2009/81/EC on the award of contracts in the fields of defence and security, while the default rule is that the defence industry is part of the European internal market.⁷ This legal act, together with another legislative instrument concerning defence-related products,⁸ has been adopted on internal market legal basis.
17. On the basis of the above, because the objective of the EIB is to contribute to the "*balanced and steady development of the internal market in the interest of the Union in all sectors of the economy*" nothing could prevent it from carrying out its activities in relation to the defence sector.

(b) *Conformity with the legal basis of the EFSI*

18. The TFEU provisions which are the legal basis of the EFSI Regulation equally do not exclude the defence industries as such from their scope.

⁵ This is without prejudice to the application of Article 42 TEU which establishes that national security remains the sole responsibility of each member State.

⁶ Judgment in *Commission v Italy*, Case C-239/06, EU:C:2009:784, paragraph 47 and case-law cited.

⁷ OJ L 216, 20.8.2009, p. 76. See, in particular, recital (7) to the Directive: "*Nevertheless, in accordance with the case-law of the Court of Justice of the European [Union], the possibility of recourse to [exception on grounds of public security or necessary for the protection of essential security interests of a Member State] should be interpreted in such a way that their effects do not extend beyond that which is strictly necessary for the protection of the legitimate interests that [Articles 36, 51, 52, 62 and 346 of the Treaty] help to safeguard. Thus, the non-application of this Directive must be proportionate to the aims pursued and cause as little disturbance as possible to the free movement of goods and the freedom to provide services.*"

⁸ Directive 2009/43/EC of 6 May 2009 simplifying terms and conditions of transfers of defence-related products within the Community, OJ L 146, 10.6.2009, p. 1.

19. While, as explained above in point II, the EFSI 2 proposal is based on several TFEU provisions, Article 175 TFEU is the one that is directly relevant to the establishment of the Fund, the guarantee, and the scope of its activities. Thus, projects that aim at strengthening the economic, social and territorial cohesion in order to promote the overall harmonious development of the Union should be considered as being eligible for EFSI-supported investment. The scope of this provision is not limited to specific sectors and is defined functionally, rather than organically.
20. The broad and inclusive scope of this provision is, accordingly, reflected in Article 3 of the EFSI Regulation which also does not restrict the purpose of the Fund to specific industrial sectors.
21. Therefore, if a specific project, including one belonging to or involving the defence industry, does contribute to strengthening the economic, social and territorial cohesion of the Union, it should be considered compatible with the relevant legal basis of the EFSI under the TFEU. Conversely, projects that do not fulfil this objective, even if they might pursue other important strategic goals cannot be considered eligible under the EFSI rules. In other words, the defence sector taken as a whole would not qualify for the investments under EFSI on account of its overall strategic importance. Investments in that sector should comply with the eligibility criteria so that each project would contribute to the cohesion objectives pursued by Article 175 TFEU.
22. On this basis, it should be concluded that nothing in the legal basis of the EFSI Regulation or in its current provisions would preclude the support of investments in the defence sector, as long as these investments would meet all the other criteria governing eligible EFSI investments in any other sector of the economy.

(c) *CFSP provisions in the TEU*

23. As the CLS has recalled in the past, the Union's competence in the field of the CFSP, which is "*subject to specific rules and procedures*" (Article 24(1) TEU), must not affect its competences in respect of other Union policies and vice versa (Article 40 TEU).⁹
24. Therefore, any action by the EFSI in the defence sector cannot encroach on the specific mandate of the European Defence Agency as defined in Article 45(1) TEU and further detailed in Article 5(3) of Council Decision (CFSP) 2015/1835 of 12 October 2015 defining the statute, seat and operational rules of the European Defence Agency.¹⁰ Any specific proposal for amendment that aims to include the defence sector in the scope of the EFSI Regulation would need to be assessed with regard to any possible overlap.

⁹ CLS Opinion on Capacity building in support of security and development, document 15040/15 of 7 December 2015, point 18.

¹⁰ OJ L 266 of 13.10.2015, p. 55. According to this provision, the Agency, subject to the authority of the Council, shall, *inter alia*:

- propose multilateral projects to fulfil the objectives in terms of military capabilities, ensure coordination of the programmes implemented by the Member States and management of specific cooperation programmes, in particular by: (i) promoting and proposing new multilateral cooperative projects; (ii) identifying and proposing collaborative activities in the operational domain; (iii) working for coordination of existing programmes implemented by Member States;

- support defence technology research, and coordinate and plan joint research activities and the study of technical solutions meeting future operational needs, in particular by: (i) promoting, in liaison with the Union's research activities where appropriate, research aimed at fulfilling future security and defence capability requirements and thereby strengthening Europe's industrial and technological potential in this domain; (ii) promoting more effectively targeted joint defence R&T; (iii) catalysing defence R&T through studies and projects; (iv) managing defence R&T contracts; (v) working in liaison with the Commission to maximise complementarity and synergy between defence and civil or security-related research programmes;

- contribute to identifying and, if necessary, implementing any useful measure for strengthening the industrial and technological base of the defence sector and for improving the effectiveness of military expenditure, in particular by: (i) contributing to the creation of an internationally competitive European defence equipment market, without prejudice to the internal market rules and the competences of the Commission in this field; (ii) developing relevant policies and strategies in consultation with the Commission and, as appropriate, industry; (iii) pursuing, in consultation with the Commission, EU-wide development and harmonisation of relevant procedures, within the tasks of the Agency.

25. Equally action by EFSI in the defence sector must not encroach on the exercise of other competences exercised in the field of CFSP including those in Articles 42 and 43 TEU cited above. It follows that the exclusion, under Article 41(2) TEU, of the funding of EU operations with defence or military implications through the Union budget - which applies to Crisis Management Operations conducted by the Union within the framework of the Common Security and Defence Policy - is not relevant to EFSI-eligible defence-related investments.¹¹

IV. CONCLUSION

26. In the light of the above, the Legal Service is of the opinion that:

- the support to investments in the defence sector falls within the powers and objectives of the EIB as laid down in the Treaties;
- there is nothing in the legal basis of the EFSI Regulation or in its current provisions that would preclude the support of investments in the defence sector; such investments should, nevertheless, verify all the criteria governing eligible EFSI investments on the same basis as investments in any other industrial sector;
- EFSI-supported investments and policies and operations should not encroach on the mandate of the European Defence Agency or on the CFSP provisions of the TEU more generally.

¹¹ See CLS Opinion on Capacity Building In Support of Security and Development, document 15040/15, 7 December 2015, points 22 and 26.