

QUESTIONS AND ANSWERS ABOUT INDUSTRIAL PARTICIPATION

What is industrial participation and why is it required?

Industrial participation promotes Finnish development work and security of supply. The aim of industrial participation is to develop and maintain production, technology and expertise in the defence and security industry critical in view of military defence, state security and the vital functions of society and to improve and secure the national security of supply.

Through industrial participation, it is possible to ensure that technology and expertise critical for security of supply and related to the defence equipment to be procured are also available to the Defence Forces in the time of crisis and in emergency conditions. Therefore, industrial participation is about securing technology of critical importance to key security interests and acquiring timely expertise for Finnish companies, research institutes, higher education institutions and Defence Forces to ensure that Finnish industry and other operators can also continue to produce critical products and services for Defence Forces in emergency conditions.

Close, long-term cooperation between Finnish and international defence industry secures the military security of supply and the availability of critical technology in all conditions.

Industrial participation has been defined e.g. in the document "Industrial Participation in Defence Procurements" (MoD 2017) and "Rules on Industrial Participation in Defence Procurement in Finland" (MEAE 2012). The requirements for industrial participation are part of the HX invitation to tender, in which direct and indirect industrial participation are official terms.

Is industrial participation the same thing as offsets?

Earlier, the purchasing party in defence acquisitions traditionally introduced a compensation clause in high-value acquisitions in cases when the procurement was made from an international supplier. Such compensation was earlier referred to as offsets. However, today the expression "industrial participation" (IP) is used in Finland, due to the fact that the focus in the scheme is on cooperation between the Finnish defence and security industry and an international supplier especially in order to secure the availability of critical technology in all conditions.

Thus the earlier term "offsets" is no longer in use in Finland and, besides, it is currently used to refer to a different thing, because industrial participation that may exceptionally be connected with defence procurements must be properly justified under Article 346 of TFEU (essential interests of state security). Industrial participation secures the military security of supply and, therefore, is not considered an offset.

Offset?

The term "offset" is still often used at the global level, and the national legislation of the relevant country is applied in such cases. National legislation can also be based on offsets in non-EU countries. A Finnish defence industry company, for instance, may have a valid offset obligation in some third countries. In the global context, offsets are thus a common precondition for agreements in large-scale defence procurements and more a rule than an exception. Their form, goals and methods of implementation vary considerably.

What is direct and indirect industrial participation?

Industrial participation can be direct or indirect. It must be targeted at performance and technology areas critical for Finland's defence and defined in Government Resolution on Securing the Finnish Defence Technological and Industrial Base published in spring 2016. Participation may only target the defence and security sector, and the inclusion of non-related civil products or services in the arrangements is not possible.

The question is of *direct industrial participation* when participation between Finnish and international industry is related to the system to be procured. Participation ensures that technology and expertise critical for the security of supply and related to the defence materiel to be procured are also available to Defence Forces in the time of crisis and in emergency conditions comparable to a crisis.

Indirect industrial participation, in turn, refers to participation that is not directly related to the defence materiel to be procured. The question is of indirect industrial participation when the object of the industrial participation is the transfer of technology and expertise important for the essential interests of state security to Finland. Therefore, industrial participation must focus on technologies of critical importance to national defence. Examples of indirect industrial participation include software, source codes, cyber security, research, internationalisation of SMEs, advanced materials and manufacture. The purpose of industrial participation is above all to seek for long-term partnerships between the Finnish industry and the international tendering candidate and its subcontracting chains.

The question is of indirect industrial participation when the object of the cooperation is the transfer of technology and expertise important for the essential interests of state security to Finland's defence and security industry, defence administration, research and science communities or universities and higher education institutions. The Ministry of Defence and Defence Command Finland are responsible for planning indirect industrial participation. Special attention in indirect industrial participation is paid to the extent to which the expertise and/or technology relates to critical performances in Finland's defence and to securing the technological and industrial base needed to secure them.

Indirect industrial participation must focus on the technology areas defined in the invitation to tender. It can only be targeted at some other area for a special reason, and even then indirect industrial

participation must be used as a means for securing the essential interests of state security. For strategic projects, Defence Command Finland has defined priority areas for indirect industrial participation, which are considered important for national defence and for independent operational capacity and security of supply in expertise in the future, also taking into consideration the existing national industrial base.

Why does the EU regulate defence procurements?

The statutes and procedures related to industrial participation in defence materiel projects (earlier offsets) have changed substantially after the EU's defence and security procurement directive (2009/81/EC) entered into force. In Finland, the Act on Public Defence and Security Contracts (1531/2011) entered into force on 1 January 2012. As a rule, no obligation for industrial participation can be placed on the supplier in procurement based on the act.

Therefore, the member states basically have the obligation to subject their defence and security procurements to competitive tendering pursuant to the EU's defence and security procurement directive. This principle can only be derogated from under the exceptions set out in Article 346 of the Treaty on the Functioning of the European Union (TFEU). However, the obligation for industrial participation can still be imposed in exceptional situations of this kind. In practice, the justifications in such cases in Finland are based on Government resolution on technologies critical for national defence (2016).

The necessity and scope for the industrial participation to be placed is always assessed case-specifically beforehand by the contracting authority and the justifications must fulfill the preconditions set out in Article 346 of TFEU. The rules for industrial participation from 2012 are applied to any agreements on industrial participation (rev. 25 April 2013, 11 May 2017, 25 June 2018).

What topical defence projects does industrial participation relate to?

The obligation for industrial participation is included in both the strategic projects i.e. Squadron2020 and HX Fighter Program. In both the above projects, the minimum share of industrial participation has been placed at 30% of the total project value. This amount of industrial participation basically serves to secure a high share of Finnish industry in carrying out the procurement, at the same time securing sufficient military security of supply and the possibility to strengthen Finland's defence technology and industrial base, taking into consideration the provisions of rules on industrial participation and Finnish defence industry base.

What are the goals of industrial participation in the HX project?

The purpose of the HX project of the Defence Forces is to replace the capabilities of the F-18 Hornet fleet with multi-role fighters. The following five fighter aircraft types are being considered: F-35 (Lockheed Martin, USA), F-18 Super Hornet (Boeing, USA), JAS Gripen (Saab, Sweden), Eurofighter (BAE Systems, Great Britain) and Rafale (Dassault, France).

The value of the deal in the procurement phase will be approximately EUR 7–10 billion, which makes it Finland's largest ever defence procurement and also arouses major international interest. The Government will make a resolution on the selected aircraft type during the next government term in 2021. Pursuing and defining industrial participation are part of the ongoing HX selection process, for which the Finnish Defence Forces Logistics Command is responsible. Industrial participation is one of the decision-making criteria in the HX project.

The question in the HX procurement is of strategic performance, which is vital for Finland's military defence capacity in general and especially for air defence. To ensure that the fighters are capable of carrying out the required missions in both normal conditions and emergency conditions, Finnish operators must have sufficient expertise and technology capability.

In the HX project, security of supply means that the combat system can be used and maintained without interruptions in emergency conditions. In practice, security of supply is already established through maintenance and training arrangements in normal conditions at all levels, building and training forces as required by the operations, and providing materiel resources as well as maintenance and repair capabilities based on functions used in normal conditions. In addition to the base required by the maintenance system in emergency conditions, the maintenance system used in normal conditions must be as cost-effective as possible.

The maintenance system must be capable of keeping the required number of fighters operable and produce air campaign capacity in the selected airbases. In terms of preparedness, this calls for an ability to operate in a logistically isolated environment in emergency conditions and to make independent decisions about airworthiness, mission suitability as well as fleet repair and maintenance.

The requirement for the military security of supply sets out from the ability to nationally fulfill the following requirements:

1. Operating in a logistically isolated situation in view of material and information flows,
2. Increasing the availability of the fleet to address the requirements for improved and elevated readiness, setting up airbases and decentralising fleet,
3. Furnishing airbases so as to generate the required operational tempo,
4. Making decisions about airworthiness and mission suitability,
5. Making fault and damage analyses, repair estimates and repair plans,
6. Adjusting the maintenance system to the operational environment and way of use, and
7. Assessing
 - system changes related to changes in the operational environment (system development),
 - the impacts of fleet use on structural integrity and lifecycle management, and
 - implementing changes and repairs owing to differences between the actual and planned usage profile.

Does the Finnish industry play an important role?

In order for the requirements to be fulfilled, Finnish industry must be involved in the planning, integration, building and reception phases of the procured system together with the system supplier and the sub-system suppliers. This involvement will be secured with the necessary industrial participation arrangements.

The existence of a sufficient technological and industrial base and its availability throughout the system's lifecycle requires the necessary knowhow, which is currently not available in the Finnish industry in all respects. Industrial participation arrangements between the selected system supplier and Finnish industry creates preconditions for generating the required expertise. Technology critical for military national defence must also be available and accessible in emergency conditions.

It is especially important that an ability is created during the procurement process for sustaining the planned lifecycle of the entire system. This allows the independent operation of the system as well as its further development.

In relation to the procurement, new technology expertise will be acquired in Finland in order to develop the overall capacities of the Defence Forces also in other respects than directly related to the system procurement. The question is then of indirect industrial participation, which will be targeted at the critical technology fields defined in the Government resolution. This will create critical technological expertise in Finnish industry in fields critical for national defence and state security.

The content of the industrial participation obligation placed in the procurement as well as the relation between direct and indirect industrial participation will be specified during the procurement negotiations.

What are the technologies critical for national defence?

Technologies critical for national defence are defined in the Government resolution "Securing the Finnish Defence Technological and Industrial Base" (7 April 2016).¹

- 1) C4ISTAR technologies
- 2) Material technologies and structural engineering
- 3) Technologies for multi-technology systems and systems engineering
- 4) Bio and chemical technologies and engineering

¹ http://www.defmin.fi/files/3402/PUTE_strategia_fi_010416.pdf

When does industrial participation begin and when does it end?

Industrial participation with the winning tenderer will begin after the procurement contract and the industrial participation agreement have been signed. Projects can then be implemented for the period defined in the agreement, approximately 10 years. The industrial participation agreement is attached to the main procurement contract.

Is it possible to start industrial participation before the winning tenderer has been selected?

As an exception and only in strategic projects in view of the national defence it may be agreed that the tenderer launches transactions before the procurement contract has been concluded, if considered necessary separately for each case. This requires contractual arrangements between the tenderer and the Ministry of Defence. The Ministry of Economic Affairs and Employment administers these Pre-Performance arrangements.

How effective has earlier industrial participation been and how does the HX procurement differ from the procurement of the Hornet fleet, for example?

The content and impacts of industrial participation have been assessed e.g. by the National Audit Office of Finland in its report of 12/2016² as well as Jukka Anteroinen and Juha-Matti Lehtonen in their survey (National Defence University 12/2017³).

In procuring the Hornet fleet, for instance, industrial participation was considered extremely important for Finland, as it allowed creating a maintenance capacity covering the system's whole lifecycle as well as expertise that would not have been available otherwise. According to the National Defence University's investigation, the turnover generated from industrial participation exceeds the invested amount many times over. In addition, the capability of the Finnish industry has produced at least EU 1.7 million savings in the maintenance of the Hornet and Hawk fleets.⁴

However, it should also be noted that the starting points for the industrial participation in new strategic procurements in the future will be different than before so that the export of civil products, for instance, can no longer be part of industrial participation. Industrial participation may not distort the operation of free markets and thereby violate the EU's Basic Treaty.

² https://www.vtv.fi/julkaisut/tuloksellisuustarkastuskertomukset/teollinen_yhteisty_o_hx-havittajahankkeessa.xhtml

³ <http://www.doria.fi/handle/10024/147740>

⁴ <https://www.eduskunta.fi/FI/vaski/JulkaisuMetatieto/Documents/EDK-2017-AK-111036.pdf>

What are the roles of the Ministry of Defence and the Defence Forces in industrial participation?

The Ministry of Defence is a contractual party in defence procurements and has the main responsibility for whether an industrial participation obligation for an international supplier company is included in the procurement. The decision to place the obligation is made on case-by-case basis before submitting the invitation to tender.

The purpose of the Finnish Defence Forces Logistics Command is to ensure that direct industrial participation is properly taken into consideration in the negotiations. The objects of direct industrial participation are defined through cooperation with the HX material project, strategic partners and tendering parties in connection with the process of determining security of supply and maintenance and support functions. Correspondingly, indirect industrial participation is defined between the tendering parties and Finnish defence and security companies, research and science communities, universities and higher education institutions or defence administration organisations under the Ministry of Defence and Defence Command Finland.

In the tendering phase, supplier-specific industrial participation plans are assessed in the IP assessment group (security of supply and industrial participation working group), which is led by the Ministry of Defence. The Ministry of Defence also negotiates and signs the industrial participation agreement with the winning tenderer. The Ministry of Economic Affairs and Employment and the Finnish Committee on Industrial Participation operating under it are responsible for the practical administration of the industrial participation agreement and for monitoring the industrial participation obligations.

For the strategic defence projects, Defence Command Finland has defined, in its decisions dated 3 May 2017, 21 February 2018 and 24 October 2018, priority areas for indirect industrial participation, which are considered important for national defence, for independent operational capacity and for competence-based security of supply in the future, also taking into consideration the existing national industrial base.

What is the role of the Ministry of Economic Affairs and Employment in industrial participation?

The Ministry of Economic Affairs and Employment and the Finnish Committee on Industrial Participation are responsible for the practical administration of industrial participation with international defence equipment contractors, i.e. international companies that have a valid industrial participation obligation in Finland. A separate agreement on industrial participation is attached to the procurement contract. The contracting party in both the above agreements is the Ministry of Defence.

The rules of industrial participation entered into force on 1 January 2012. They were prepared by the Finnish Committee for Industrial Participation and confirmed by the Ministry of Economic Affairs and Employment. The rules were most recently amended in June 2018. After the entry into force of the EU's defence and security directive, Finland has not concluded a single new agreement on industrial participation (situation in January 2019).

The Secretariat of the Committee at the Ministry of Economic Affairs and Employment is responsible for the practical arrangements of the committee meetings and for matters related to the administration of industrial participation. The Committee systematically monitors the implementation and progress of the obligations for industrial participation as well as possible Pre-Performance arrangements. It also discusses claims and keeps accounts of projects that have already been accepted. In addition, the committee outlines policies related to dealing with matters concerning industrial participation in order to ensure the consistent and equal treatment in processes.

The Committee has members from the Ministry of Defence, the Ministry for Foreign Affairs and the Ministry of Economic Affairs and Employment. The committee is summoned about six times a year. Matters are presented in the Committee meetings by its Secretary-General or Deputy-Secretary General. The Ministry of Economic Affairs and Employment approves the decisions of the Committee. The term of the current Committee will last until the end of September 2021.

Further information:

Rules on industrial participation in defence procurement in Finland and composition of the committee www.tem.fi/industrial-participation

What is the role of Business Finland's HXIP project?

Business Finland's HXIP project supports for its part the cooperation related to the HX project. The key task of the project is to help Finnish companies and scientific communities and research institutes as well as international tendering parties and their subcontractors in indirect industrial participation.

In addition, it helps in forming consortia as well as arranges different types of events about the opportunities of industrial participation and practical questions, for instance.

Business Finland can also be contacted for opportunities to receive funding for research, product development and business development needs.

Further information: <https://www.businessfinland.fi/suomalaisille-asiakkaille/etusivu>

What is the role of the Association of Finnish Defence and Aerospace Industries (AFDA) in industrial participation in HX?

AFDA represents the Finnish defence, aviation, space and security industry. Its duty is to involve its members in industrial participation in projects launched by the Defence Forces. Among others, AFDA has been engaged in dialogue with HX supplier candidates for several years and arranged meetings with them. It has also actively contributed to arranging industrial participation in the HX project. Furthermore, it assists Business Finland in its HXIP project.

Further information: www.defenceindustries.fi

Is the Global Innovation Partnerships programme also related to industrial participation?

The Global Innovation Partnership Program (GIPP) programme is not part of industrial participation. Participation related to the program may not be confused with actual eligible industrial participation under any circumstances. The basic points of departure in the HX project and EU legislation require that these two things are kept completely separate.

GIPP is a program run by Business Finland, and it is not part of the official strategic defence procurement process to which industrial participation is related. Approving projects for industrial participation always requires an official process in the Ministry of Economic Affairs and Employment and the Finnish Committee for Industrial Participation, which operates under the ministry. In particular, the GIPP program focuses on global cooperation, such as dismantling barriers to trade and attracting investments in Finland, which from Finland's point of view are important issues considering international cooperation.

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HX-project:

https://www.defmin.fi/en/administrative_branch/strategic_capability_projects/hx_fighter_program/hx_fighter_program

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