



Defence and Security Industrial Strategy: reform of the Single Source Contract Regulations.

GOVERNMENT CONSULTATION RESPONSE - 23 MAY 2022

CONTENTS	Page
1. Introduction	3
a. Consultation Approach	
b. Response Approach	
2. Choice and Flexibility	5
3. Speed and Simplicity	8
4. Stimulating Innovation and Exploiting Technology	13
5. Technical Changes	14
a. Command Paper annex C	
b. Command Paper annex D	
6. Conclusion	18

Introduction

1. The Government published its proposals for the reform of the Single Source Contract Regulations (SSCRs) on 4th April 2022. The reforms focus on three key themes from the Defence and Security Industrial Strategy (DSIS): Choice and Flexibility; Speed and Simplicity; and Stimulating Innovation and Exploiting Technology. The reforms will ensure that the MOD continues to pay fair prices for the goods and services it buys while delivering value for money for the taxpayer.
2. Seven responses to the consultation were received: one from the Single Source Regulations Office (SSRO), four from industry bodies or direct from supplier companies and two from other interested parties.

Consultation approach

3. In advance of the Command Paper¹, MOD conducted a detailed engagement exercise with key stakeholders over the full review period, starting with an initial call for comments in late 2019.
4. The Command Paper included a list of the workshops held with key stakeholders in 2021. This programme has continued up to and during the consultation period.
5. In addition to this bespoke programme of meetings, we have liaised with key stakeholders through the Defence Suppliers Forum (DSF) structure. The DSF includes all the main defence contractors as well as representatives from the SME community. We were grateful for the formal papers submitted by the Defence Single Source Advisory Group (DSAG). We have discussed each of these through the programme of workshops and they form a key part of the considerations that fed into the Command Paper. We have conducted a similar set of engagements with techUK and are grateful for their written input.
6. Many of the key policy areas in the Command Paper were covered as part of the SSRO's process in developing its recommendations to the Secretary of State. A formal consultation was published by the SSRO in December 2019 and stakeholders' views were covered in the recommendations they submitted to the Secretary of State and published in June 2020. The SSRO recommendations were subsequently revised and re-submitted in June 2021.
7. The body of the reforms will be delivered through secondary legislation. There will be an on-going programme of stakeholder liaison as this legislation is developed. This will include discussions with the SSRO on how their statutory guidance can be used to support the policy intent.

¹ [Defence and Security Industrial Strategy: reform of the Single Source Contract Regulations - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/defence-and-security-industrial-strategy-reform-of-the-single-source-contract-regulations)

Response Approach

8. This document is presented thematically by outlining the stakeholder input and Government response on each of the proposals under the three main themes as well as those included in the two Command Paper annexes on technical changes. This mirrors the presentation in the Command paper. There is also an overall Government conclusion.

Choice and Flexibility

PROPOSAL 1: We will change the primary legislation to allow the regulations to specify circumstances under which a fair price for the supplier and value for money in public expenditure for all or part of the contract may be demonstrated without using the pricing formula set out in Section 15(4) of the Act.

PROPOSAL 2: We will introduce a new regulation that specifies that where it can be demonstrated that a product or service has been sold in open markets and in comparable circumstances (volume, specification etc.), value for money may be demonstrated by reference to this price.

Stakeholder Responses

9. Stakeholders supported these proposals in principle. Some stakeholders raised concerns emphasising the need for clear, objective tests on when the pricing formula need not be applied. The same stakeholders said that consideration should be given to a phased roll-out to test safeguards and mitigate risks.

Government Response

10. The Government agrees that the secondary legislation needs to set out clear criteria on when contracts may be priced other than by use of the pricing formula, and how they should be priced in these circumstances. It will work with industry and the SSRO on how best to achieve this. It will also explore with stakeholders how a phased roll-out might work.

PROPOSAL 3: We will introduce a new regulation that says that where a contract is converted to come under the regulations by amendment, the pricing formula need not be applied to work where the scope and price were agreed prior to conversion. We will also consider whether there is merit in specifying other cases where the pricing formula need not be used, such as when prices are already regulated.

PROPOSAL 4: we will amend the wording of step 2 to ensure that the adjustment reflects all the financial risks taken on by a contractor and to explicitly state that activity type can be taken into account when calculating this step.

Stakeholder Responses

11. All stakeholder responses to these proposals were positive.

Government Response

12. The Government welcomes stakeholder support for these proposals and will work with interested parties on implementation.

PROPOSAL 5: We will amend the wording of step 5 to allow regulations to set out how and when the incentive fee can be used and to give the SSRO the power to issue statutory guidance and take referrals where necessary.

Stakeholder Responses

13. Some stakeholders expressed a general concern around the extension of the SSRO's legal powers and how they are used in practice. There was also one request for more clarity around this proposal.

Government Response

14. The Government recognises the need for clarity around how the SSRO's powers are used in practice. It will work with the SSRO and other stakeholders to provide reassurance on this as we work through implementation.

PROPOSAL 6: We will change the legislation to allow for a contract to be split into different segments, each of which can have its own approach to pricing, profit rate and calculation of final price. We will also define how the various segments must be aggregated. We will include safeguards to ensure that this can be done in a proportionate and pragmatic way.

Stakeholder Responses

15. Stakeholders responded positively to these proposals.

Government Response

16. Government welcomes stakeholder support for these proposals and will work with interested parties on implementation.

PROPOSAL 7: We will change the legislation to ensure that for contracts where a rate has been competed, but a volume has not, the reasonableness test required by the legislation need only be applied to the volume.

Stakeholder Responses

17. While many stakeholders were in favour of this proposal some expressed concern about unintended consequences.

Government Response

18. The Government acknowledges these concerns and will work with stakeholders and the SSRO to understand the nature of these consequences and ensure that they are taken into account in the drafting of the secondary legislation that will implement this proposal.

PROPOSAL 8: We will change the legislation to ensure that profit is not paid on costs more than once where the prime contractor has a significant interest in the sub-contractor, or vice-versa.

Stakeholder Responses

19. Some stakeholders expressed concerns that the proposed approach could lead to other parties to joint ventures being adversely affected. There was also a request for “significant interest” to be clearly defined to avoid potential conflicts with accounting practices.

Government Response

20. The Government will ensure that “significant interest” is clearly defined in the draft legislation. We will work closely with stakeholders to ensure that the policy intent is achieved without adversely affecting parties who are not paid profit on costs more than once. The Government is keen to avoid creating extra work for suppliers but does not believe that companies’ accounting practices should prevent the regulations from requiring unfair costs to be removed.

Speed and Simplicity

PROPOSAL 9: We will abolish the current step 3 of the contract profit rate. We will continue to apply the principles of POCO through allowable costs to ensure we do not pay too much profit on contracts under the SSCRs. We will simplify the mechanism, addressing inter-group profits where they arise in costs, rather than making compensating adjustments to the contract profit rate. This will require some change to the costs section of primary legislation.

Stakeholder Responses

21. Some stakeholders raised concerns that this proposal might conflict with other regulatory regimes (citing Ofcom and energy rules).

Government Response

22. The Government will work with all relevant stakeholders to ensure the legislation and guidance avoids any such conflicts.

PROPOSAL 10: We will abolish the step 4 of the contract profit rate, the SSRO Funding Adjustment.

PROPOSAL 11: We will change the regime to make sure that the DPS is only used for those contracts where the data collected is likely to be useful for long-term 'should-cost' calculations. This will be done primarily through changes to statutory guidance.

PROPOSAL 12: Where reporting by DPS is valuable, this will be done at the outset of the contract through the Contract Notification Report, the end of the contract through the Contract Completion Report, and at a frequency of no more than once every three years in between, as required by the MOD.

Stakeholder Responses

23. Stakeholders responded positively to these proposals.

Government Response

24. The Government welcomes stakeholder support for these proposals.

PROPOSAL 13: The Interim Contract Report will be split by the data categories used in the Contract Pricing Statement, which will generally follow the contractor's work breakdown structure.

Stakeholder Responses

25. A few stakeholders commented on this proposal. Some expressed concern about how it would work in practice and called for further clarification as it was developed.

Government Response

26. The Government acknowledges these concerns and will work with stakeholders and the SSRO as the secondary legislation and statutory guidance implementing this proposal is developed.

PROPOSAL 14: The requirement to include output metrics as part of the DPS reporting will be removed. Requirements to report against milestones and key indicators for performance of the contract (as opposed to the equipment) will remain, but as part of the standard reporting by Work Breakdown Structure.

Stakeholder Responses

27. Stakeholders responded positively to this proposal.

Government Response

28. The Government welcomes stakeholder support for these proposals.

PROPOSAL 15: We will simplify the definition in the legislation of a Qualifying Business Unit (QBU).

Stakeholder Responses

29. Some stakeholders sought further clarification on what the Government is trying to achieve.

Government Response

30. The Government has found that there is some confusion over the definition of a QBU. Moreover, as the current definition captures some Business Units for which the MOD does not require the reports and misses others where the information is required to assure the costs included in the contract. The Government will work with stakeholders to ensure that the changes to the definition set out in the regulations will address these issues.

PROPOSAL 16: We will remove the requirement to complete the Rates Comparison Report.

Stakeholder Responses

31. Some stakeholders argued that that the Rates Comparison Report had potential value, and therefore should not be removed.

Government Response

32. The MOD's experience is that the Rates Comparison Report has not been widely used in practice. While the Government agrees that this report does have some potential value, this does not justify the increased complexity that arises from its inclusion in the regulations.

PROPOSAL 17: We will introduce a new requirement that Estimated and Actual Rates Claims Reports (ERCR and ARCR), and the Estimated Rates Agreement Pricing Statement (ERAPS), must be resubmitted to reflect the rates that the MOD and the contractor have agreed will be used in the pricing of contracts.

PROPOSAL 18: We will amend the legislation to allow the Secretary of State to agree that the SICR can be produced at a level below ultimate parent undertaking.

PROPOSAL 19: We will amend the legislation to allow the Secretary of State to exempt a supplier from the requirement to provide a Strategic Industry Capacity Report (SICR), but not the other supplier level reports.

Stakeholder Responses

33. Stakeholders responded positively to these proposals.

Government Response

34. The Government welcomes stakeholder support for these proposals.

We will change the legislation to allow the SSRO to issue guidance on all aspects of the regime and to:

PROPOSAL 20: give opinions upon request about the operation of the regulatory framework without the need for the referral to be made jointly with the other interested party or parties or for the referral to identify a specific contract to take these recommendations forward.

PROPOSAL 21: make a determination in relation to all of the contract profit steps.

PROPOSAL 22: make a determination in relation to whether a contract or proposed contract meets the conditions to be a QDC or QSC.

PROPOSAL 23: make a determination in relation to the agreement of rates that may be used in the pricing of QDCs or QSCs.

PROPOSAL 24: reform MOD policies and procedures to deliver the changes in paras 61-62 above.

Stakeholder Responses

35. Some stakeholders were concerned that these proposals could lead the SSRO to become the ultimate pricing authority. Concerns were also raised about the SSRO's capacity to take on these additional powers.

Government Response

36. The Government believes these changes do not significantly alter the nature of the role of the SSRO in pricing contracts. It simply extends that role to some additional steps in the profit setting process and simplifies the process by which disputes about overhead recovery rates can be resolved. It addresses a problem that has frequently occurred when there is doubt about whether a contract should fall under the regulations. The Government will continue to work closely with the SSRO to ensure it has the necessary capacity to make determinations or give opinions on matters referred to it.

PROPOSAL 25: We will change the legislation to enable Regulations to set out the conditions under which a cross-Government contract that is partially for defence purposes may become a QDC subject to the legislation.

Stakeholder Responses

37. Some stakeholders were concerned that this proposal could create unnecessary complexity. Concerns were also raised about what thresholds would be applied for such contracts to be brought under the SSCRs.

Government Response

38. The Government acknowledges the concerns about complexity but believes that, for larger contracts, they are outweighed by the need to ensure that fair prices are paid for defence work in the absence of competition. The Government recognises that striking this balance requires thresholds to be set at an appropriate level. The MOD will work with other Government Departments and industry to ensure that this happens.

PROPOSAL 26: We will clarify where necessary when and how Government credits should be netted off from allowable costs.

Stakeholder Responses

39. Some stakeholders said that this may deter investment in research and development. They also said this Command Paper was not the place to attempt to change the legislation relating to Government credits.

Government Response

40. Any changes in this area would carefully balance the need to promote investment in research and development with the need to achieve fair prices on defence contracts. They would be developed in consultation with all the relevant policy leads in Government.

PROPOSAL 27: We will make all necessary changes to address the technical changes identified in the Annex to this Command Paper.

Stakeholder Responses

41. Stakeholders responded positively to this proposal, although there are some further comments in the technical changes section below.

Government Response

42. The Government welcomes stakeholder support for these proposals.

Stimulating Innovation and Exploiting Technology

PROPOSAL 28: We will ensure that costs incurred in pursuit of the Government's innovation and technology aims can be allowable in single-source contracts, subject to appropriate safeguards. We currently believe that this is achievable within the current legislation, and we will work with the SSRO and our suppliers to update the relevant statutory guidance.

PROPOSAL 29: We will make any necessary changes to the legislation and Statutory Guidance to allow the MOD and the contractor to enter into joint funding for innovation without quantifying the financial benefits each party expects to accrue. We currently believe that this is achievable within the current legislation, and we will work with the SSRO and our suppliers to update the relevant statutory guidance.

PROPOSAL 30: If necessary, we will introduce sufficient flexibility to the legislation to ensure it can take account of new ways of funding innovation.

Stakeholder Responses

43. Stakeholders responded positively to these proposals.

Government Response

44. The Government welcomes stakeholder support for these proposals.

Technical Changes

45. Stakeholders commented on some of the individual changes proposed in the “technical changes” annexes in the Command Paper. The comments and the Government’s response set out below only relate to those proposals in the annexes where feedback was received. In all other cases the Government has assumed that the generally positive comments against proposal 27 in the Speed and Simplicity chapter means that there is overall support for the proposed approach.

Command paper Annex C

Change the Act so that only amendments to the requirements of the contract are priced in accordance with subsection 15(2), and that the price for deductive work is based on its original pricing.

Stakeholder Responses

46. This proposal was raised by some suppliers, who were concerned that the current regulations could result in unfair prices.

Government Response

47. The Government acknowledges that there could be circumstances where the application of section 15(2) would lead to an unfair price, but these circumstances are likely to be rare, and when they do arise there is no requirement for the contractor to agree to the proposed amendment. The Government therefore does not believe that the risk warrants the extra complexity required to deal with this issue.

Confine QSCs to subcontracts that arise from a QDC and that but for the QDC would not be required. Amend definition of a QSC in DRA subsection 28(3)(a). These amendments would apply in the following subsections: S28(3)(a), 28(4)(a), s29(1)(b), 29(3)(c).

Confine QSCs to subcontracts that arise from a QDC and that but for the QDC would not be required. Amend definition of a QSC in DRA subsection 28(3)(a). These amendments would apply in the following subsections: S28(3)(a), 28(4)(a), s29(1)(b), 29(3)(c).

Stakeholder Responses

48. Some stakeholders commented that the current approach led to sub-contracts in which the MOD only had a marginal interest (such as those for corporate IT systems) falling under the regulations.

Government Response

49. The Government considers that the requirement in Regulation 58 that a contract can only be a QSC if over 50% of the value of the subcontract is required for the performance of other contracts under the regulations, combined with the requirement that only single-source sub-contracts with the £25M are caught, means that only sub-contracts in which the MOD has a substantial interest can become QSCs.

Schedule 5 should not be disapplied for a request under the Freedom of Information Act.

Stakeholder Responses

50. This proposal was raised by some suppliers, who were concerned that the protection from prosecution provided by this disapplication would apply to unsuccessful requests.

Government Response

51. The Government has taken internal legal advice on this issue and does not consider the suggested change to be necessary to achieve the intended policy effect.

Command Paper Annex D

**Section 14(1): add at end “and parts of qualifying defence contracts”.
Section 14(2)(b) and section 17(2) Step 2: after “contract” add “or the relevant part of it”.
Section 21(4)(a) after “contracts” add “and elements of them”.**

Stakeholder Responses

52. These proposals were raised by suppliers to ensure that proposals 1, 2 and 6 could be properly enacted.

Government Response

53. The Government accepts the rationale behind these points and will make any changes to the regulations necessary to ensure proposals 1, 2 and 6 are properly enacted.

Section 22(1)(a) add sections 16(2)(b), 23(6) and 35(4) to the list.

Stakeholder Responses

54. This proposal was raised by some suppliers, who were concerned that the legislation did allow the SSRO to direct a payment should be made through a particular procedure.

Government Response

55. The Government has considered this proposed change but continues to regard it as unnecessary and does not propose to take it forward.

Section 30(1), exclude section 14 from this provision.
Regulation 25(2)(k), replace “purposes of enabling it to perform its obligations under” with “performance of”.
Regulation 32(3)(c), (4)(d), replace “purposes” with “performance”
Regulation 32(6)(a)(ii), replace “purpose of enabling” with “performance of”, and delete “, to be fulfilled”.
Regulation 40(3)(b), replace “purposes” with “performance”.
Regulation 58(3)(a) and (4)(a), replace “to enable the contractor to perform” with “for the performance”. Regulation 58(3)(b) and (4)(b), replace “to enable” with “for”.

Stakeholder Responses

56. These proposals were raised by some suppliers, who were concerned that section 28 covers the same ground as section 14 for sub-contracts and was therefore unnecessary duplication. There were similar concerns with the other proposals suggesting that for the relevant subcontracts, QBUs are only those required for the performance of the QDC.

Government Response

57. The Government has considered these proposed changes but considers that they would have no legal effect and are therefore unnecessary.

Several cases where the word “value” is used when “contract price” or “proposed contract price” (or similar words) would be more appropriate.

Stakeholder Responses

58. This proposal was raised by some suppliers, who were concerned that, notwithstanding changes previously made to the regulations, this issue was causing confusion.

Government Response

59. The Government agrees that there might be a case for using different terms. It will work with industry and the SSRO to assess whether the problem is sufficiently serious to warrant changes in the legislation.

Regulation 10, after paragraph (11) insert an italicised title “Interpretation”.

Stakeholder Responses

60. This proposal was raised by some suppliers, who were concerned that the current wording risks paragraph (12) as part of the Target pricing method under paragraph (11).

Government Response

61. The Government has considered this proposed change but does not regard it as necessary.

Conclusion

62. The Government was grateful to all stakeholders for taking the time and trouble to respond to this Command Paper. The support for most of the proposals was welcome and reflects the amount of consultation with key stakeholders as they were developed into the full Command Paper. The Government acknowledges those concerns and questions that were raised and will continue working closely with stakeholders and the SSRO as the legislation and guidance is developed that will deliver the changes is developed.