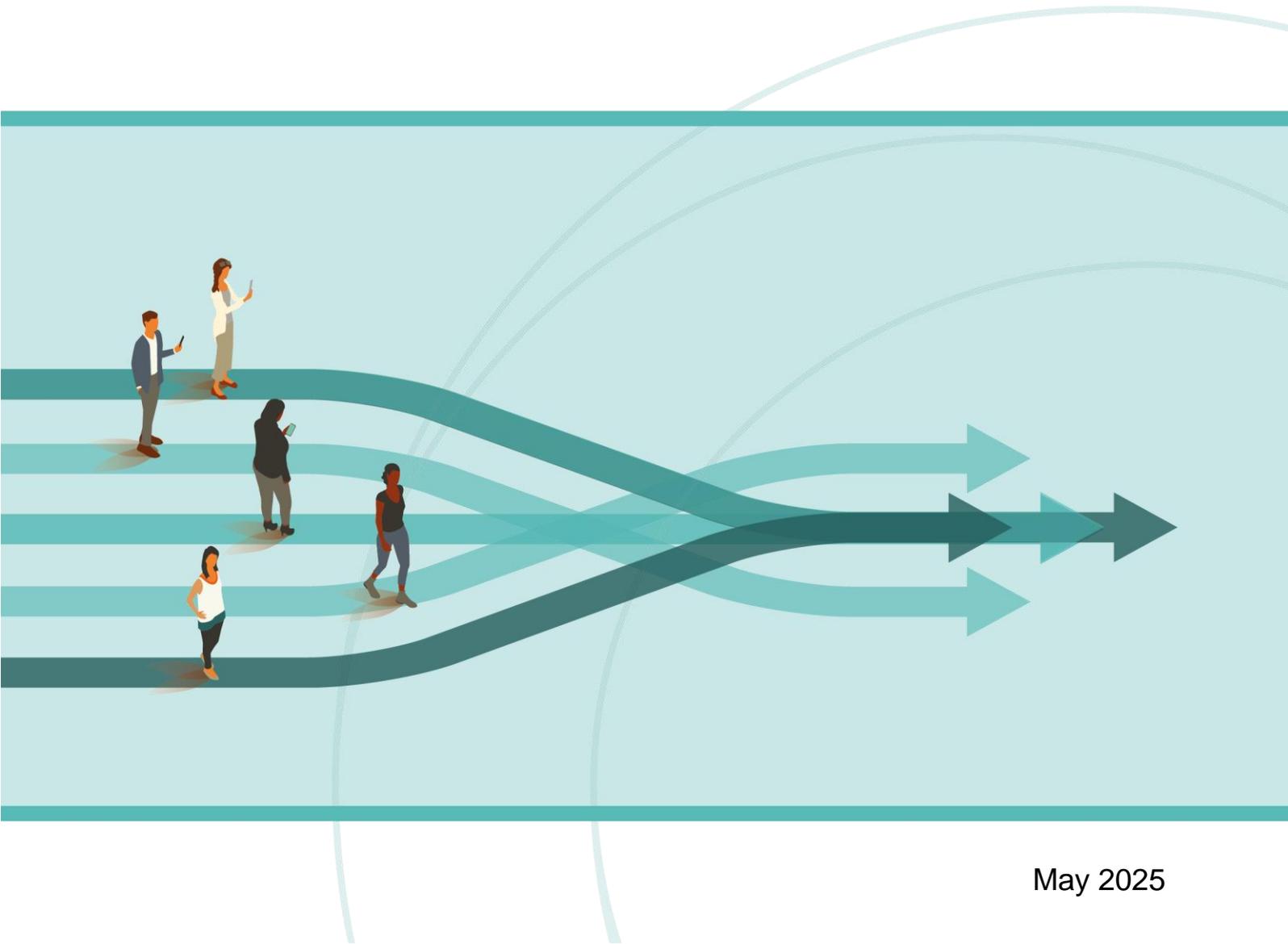




Guidance: Exempted Contracts



Guidance on Exempted Contracts

What is an exempted contract?

1. An exempted contract is a type of contract listed in [Schedule 2](#) to which the rules on covered procurement in the [Procurement Act 2023 \(Act\)](#) do not apply.
2. The exemptions ensure that contracting authorities have the freedom to carry out the most appropriate procurement where the rules in the Act would otherwise be inappropriate or unsuitable.

What is the legal framework that governs exempted contracts?

3. [Section 3](#) sets out the three types of contracts that are public contracts. These are contracts for the supply of: goods, services or works; frameworks; and concession contracts that have an estimated value above the applicable financial threshold and are not exempted contracts.
4. [Schedule 2](#) sets out the types of exempted contracts. It is split into two parts. Part 1 establishes which contracts are always exempted due to the nature of the relationship between the contracting authority and the other party to the contract, and Part 2 determines which contracts are exempted because of the nature of the subject matter of the contract.
5. Exempted contracts are not required to be procured in line with the provisions of the Act that relate to covered procurement. Exempted contracts are, however, bound by the provisions of the Act that relate to 'procurement'; for example in relation to the national procurement policy statement (NPPS) at [section 13](#) (which may or may not apply, depending on the requirements of the NPPS itself). In this guidance, references to contracts being exempted from the Act mean the general provisions of the Act i.e. those which relate to covered procurement.

What has changed?

6. The Act maintains the exemptions available in previous legislation (with a minor change to remove the political campaign services exemption that was relevant when the UK was a member of the EU where, in some states, political parties are contracting authorities, which is not the case in the UK), simplifies how those exemptions are framed and ensures the terminology used is more appropriate for domestic law.

Key points and policy intent

Part 1: Counterparty exempted contracts

7. Part 1 describes the contracts that are exempted from the Act due to the nature of the relationship between the contracting parties. These are referred to as counterparty exempted contracts and are set out below.

Vertical arrangements

8. The vertical arrangement exemption applies only to contracting authorities that are public authorities; it does not apply to public undertakings or private utilities. The exemption is available where a contracting authority (or two or more contracting authorities acting

together) (referred to in this guidance as the 'contracting authority owner') contracts with a person (referred to in this guidance as the 'controlled person') over which the contracting authority owner has the form of control set out in the Act. One example of a controlled person is a local authority trading company that the contracting authority owner has set up, either on its own or with other contracting authorities, to provide services.

9. [Schedule 2, paragraph 2\(2\)](#) sets out the criteria that determine whether the person is 'controlled', all of which must be met in order for the exemption to apply. These are:
 - a. The contracting authority owner is a parent undertaking, as defined in [paragraph 2\(4\)](#) (which refers to the definition in [Section 1162 Companies Act 2006](#)). See Annex A for examples of the different types of relationships covered by this exemption;
 - b. No other person exercises (directly or indirectly) a decisive influence over the activities of the controlled person;
 - c. The controlled person carries out more than 80% of its activities for, or on behalf of, the contracting authority owner, or for or on behalf of other persons controlled by the contracting authority owner (see Annex B for calculation information); and
 - d. Where there is joint control by more than one contracting authority owner, each contracting authority owner is represented on the controlled person's board or equivalent decision-making body, and the controlled person does not carry out activities which are contrary to the interests of one or more of the contracting authority owners.
10. A person is not 'controlled' if another person who is not a public authority holds shares in that person.
11. This exemption applies to contracts awarded by the contracting authority owner to the controlled person and to contracts awarded by the controlled person to its contracting authority owner.

Horizontal arrangements

12. [Paragraph 3](#) sets out the exemption that applies only to contracts between contracting authorities (referred to in this guidance as the co-operating contracting authorities) and only where both of the co-operating contracting authorities are public authorities - it does not apply to public undertakings or private utilities.
13. A horizontal arrangement exists between co-operating contracting authorities when:
 - a. the arrangement is intended to achieve common goals in connection with the exercise of their public functions;
 - b. the arrangement is solely in the public interest;
 - c. no more than 20% of the activities envisaged by the arrangement are intended to be carried out for reasons other than for the purposes of their public functions. (See Annex B for calculation information.)

14. Public functions are activities contracting authorities carry out as a public authority - for example, local authorities are responsible for the disposal of household waste. Activities carried out for the purpose of a waste disposal function could be, for example, recycling or disposing of waste in landfill. Contracting authorities may also carry out activities that are not for the purpose of their public function, for example, local authorities disposing of commercial waste to create a profit.

Defence and security contracts

15. [Paragraph 4](#) sets out an exemption for defence and security contracts between a contracting authority and the government of another state or territory. Further details can be found in the guidance on [defence and security contracts](#).

Utilities contracts

16. [Paragraphs 5 and 6](#) set exemptions for utilities contracts. [Paragraph 5](#) exempts a contract between a utility and relevant joint venture to which the utility is a party. [Paragraph 6](#) exempts a contract awarded by a utility to a person affiliated with the utility or by a relevant joint venture to a person affiliated with any member of the joint venture. Further details can be found in the guidance on [utilities contracts](#).

Part 2: Subject matter exempted contracts

17. [Paragraph 7\(1\)](#) explains that exempted contracts are contracts of a kind listed in Part 2 and frameworks for the future award of contracts only of a kind listed in Part 2. If a framework also provides for the award of contracts of a kind not listed in Part 2, the exemption is not available. The exemptions in Part 2 are not mutually exclusive and a contract may be an exempted contract because it falls into more than one kind of exemption.
18. Where an exemption applies only to part of a contract, a reasonableness test applies (see [paragraph 7\(2\)](#)) to prevent the contract from being an exempted contract if the goods, services or works to be provided for the main purpose of the contract could reasonably be separated and supplied under a different contract, and that separate contract would not fall under one of the exemptions in Part 2.
19. [Paragraph 7\(3\)](#) provides that when considering whether it is reasonable to supply the goods, services or works under a separate contract, contracting authorities may take into account the practical and financial consequences of awarding more than one contract. This is not a finite list and other factors may be taken into account.

Land and buildings etc.

20. [Paragraph 8](#) exempts a contract for the acquisition (by whatever means) (or the acquisition of an interest in or right over) of land, buildings or any other complete work¹ or a contract concerning an interest or right over any such things. This would include, for example, contracts for the purchase or rental of parks or buildings.
21. The exemption allows contracting authorities to consider particular buildings or sites that meet their requirements, taking into account a range of factors - for example the need for a

¹ Defined by reference to [Schedule 1](#) as a functioning structure that results from the carrying out of works.

jobcentre, library or office accommodation to be in a particular location, of a particular design, and with particular facilities. In this example, it would be inappropriate for a contracting authority to be required to comply with the Act for the purchase of a specific, existing building or site; since only the owner of the building or site would be in position to respond to the tender.

Broadcasting

22. There are two exemptions for contracts relating to broadcasting. The exemption at [paragraph 9](#) exempts contracts entered into by contracting authorities (e.g. the BBC) for broadcast content. This would allow, for example, broadcasters to stimulate creativity by setting limits, within the legal framework they operate, on who can tender in order to increase competition between internal and external suppliers.
23. The exemption at [paragraph 10](#) exempts contracts for the right to broadcast (by any means) to the general public, material supplied by the supplier - this material would include, for example, a programme or advertisement supplied by the supplier.
24. These exemptions do not apply to the supply of technical equipment or services necessary for the production, co-production and broadcasting of such programmes, for example, camera, lighting, props.

Electronic communications services

25. [Paragraph 11](#) exempts contracts whose main purpose is to facilitate the provision by a contracting authority of an 'electronic communications service'² to the public. [Paragraph 12](#) exempts contracts whose main purpose is to permit a contracting authority to provide, maintain or use a 'public electronic communications network'³.
26. These contracts are exempted as contracting authorities participating in these areas are operating in a competitive market that is sufficient to ensure they achieve value for money without the need for regulation.

Alternative dispute resolution

27. [Paragraph 13](#) exempts contracts for the purchase of arbitration, mediation or conciliation services and other similar services. This is because such services are provided by bodies or individuals with particular expertise or reputation and are subject to agreement between the parties involved.

Legal services

28. Not all contracts for legal services are exempted under [Paragraph 14](#). The types of legal services that are exempted are those relating to judicial or other dispute resolution proceedings, notary services and services that must be carried out by a particular person

² An 'electronic communications service' is defined in [section 32 of the Communications Act](#) as: "a service consisting in, or having as its principal feature, the conveyance by means of an electronic communications network of signals, except insofar as it is a content service."

³ A 'public electronic communications network' is defined in [section 151 of the Communications Act](#) as: "an electronic communications network provided wholly or mainly for the purpose of making electronic communications services available to members of the public".

under an order of a court or tribunal or enactment, e.g. legal services provided by appointed guardians. It would be inappropriate to open these contracts up to competition. Other legal services (i.e. those not listed in [Paragraph 14](#)) are not exempted, but instead will be subject to the special rules for light-touch services⁴ in the Act.

Financial services

29. The exemption for financial services contracts recognises that it would be inappropriate for contracting authorities to obtain loans or financial services by carrying out a procurement under the Act. The primary sources of finance for contracting authorities would be unlikely to respond to tender notices so the authority would be unlikely to acquire the best deal. Furthermore, the timescales and many of the other rules are unsuitable.
30. The exemption at [paragraph 15](#) allows contracting authorities to obtain loans from, for example, the Public Works Loan Board, when they require funding, for example, for capital projects such as new roads or school buildings.
31. [Paragraph 16](#) excludes contracts for an 'investment service or activity', or for an 'ancillary service' in relation to a 'financial instrument' where the service or activity is provided by an investment firm or a qualifying credit institution. These terms are defined in separate legislation (see [paragraph 16\(2\)](#)).
32. The exemption at [paragraph 17](#) makes it clear that contracts for services provided by the Bank of England fall outside the scope of the Act. The Bank of England supports the economic policies of the Government. It provides the Government with near risk-free wholesale sterling facilities, acts as execution agent for foreign exchange transactions, supports sterling as a global reserve currency and the reciprocal reserve management requirements of central banks and manages foreign currency reserves as agent for HM Treasury. As such, contracts with the Bank of England are not appropriate for procuring under the Act.

Employment

33. [Paragraphs 18 and 19](#) exempt employment contracts (which are defined by reference to relevant employment legislation at [paragraph 18\(2\)](#)) and other contracts with individuals appointed to a public office (which may include the appointment of non-executive directors of a public authority or members of a public enquiry).
34. The exemption for employment and other contracts does not cover service contracts for personnel placement, where, under the contract with the supplier, the supplier places personnel with the contracting authority.

Emergency services

35. [Paragraph 20](#) exempts contracts for emergency services, but only in relation to those services listed and only where the supplier appointed is a non-profit organisation or association. Contracts, for example, for non-emergency ambulance services (e.g.

⁴ Light touch services are set out in [Schedule 1 of The Procurement Regulations 2024](#) and include legal services not covered by this exemption.

ambulance services to pick up patients at home and take them to routine appointments) are not covered by this exemption.

Public passenger transport services

36. [Paragraph 21](#) exempts contracts for certain public passenger transport services that are awarded under separate legislation specified at [section 136\(11\) of the Railways Act 1993](#). (See paragraph 76 below which discusses [Schedule 2, paragraph 37](#) which also exempts concession contracts for public passenger transport services.)
37. The practical effect of this exemption is that the award of contracts for rail and metro, and bus and tram concessions, are exempt from the Act whilst contracts for tram and bus that are not concessions are not exempt and are therefore procured under the Act.

Research and development services

38. The exemption for contracts for research and development (R&D) services at [paragraph 22](#) applies where the services are intended to be for or result in a public benefit and provided the contract does not include goods or works.
39. The R&D services to be provided must comprise at least one of the following activities:
 - a. 'fundamental' research to acquire new scientific or technical knowledge without any particular application or use in view;
 - b. 'applied' research directed primarily at generating scientific or technical knowledge for a specific objective;
 - c. 'experimental' development which draws on existing knowledge to initiate the manufacture of new materials or products, establish new processes, systems or services; or to achieve a substantial improvement in existing materials, products, processes, systems and services;
 - d. the manufacture and testing of prototypes.
40. The scope of R&D services exemption is limited so it falls short of the commercial industrialisation of the goods and/or services. The exemption does not therefore apply if the contract includes:
 - a. the production of tools for manufacture; or
 - b. the development of industrial processes to manufacture goods or works arising from R&D, which would include, for example:
 - i. the making and qualification of pre-production prototypes used to develop the manufacturing processes; and
 - ii. industrial engineering, industrial design or manufacture.
41. The Act allows contracting authorities to choose how they conduct R&D and procure R&D services. The R&D services exemption gives contracting authorities the freedom to design R&D programs that could seek to develop products or technology for the benefit of the market as a whole, and for which the authority itself has no requirements. For example,

government contracts for research by public research institutions, universities or the private sector.

42. In addition to the exemption for R&D contracts, contracting authorities are able to directly award a contract where the direct award justification in [Schedule 5, paragraph 2](#) (Prototypes and development) applies. The grounds for direct award have a wider scope for R&D than this exemption; see guidance on [direct award](#) for further information.
43. Contracting authorities are also able to procure R&D under a competitive flexible procedure if, for example, the intention is to build an R&D phase into a procurement in order to be able to also purchase the resulting product.

International agreements and organisations

44. [Paragraphs 23 and 24](#) exempt contracts which the contracting authority is obliged to award in accordance with the procurement rules of an international agreement⁵ to which the UK is a party or an international organisation⁶ of which the UK is a member.
45. The exemption at [paragraph 23](#) applies only where an international agreement sets out a procurement procedure that the contracting authority must follow and only to contracts relating to:
 - a. the stationing of troops; or
 - b. the implementation of a joint project by the signatory countries.
46. The exemption at [paragraph 24](#) applies only when:
 - a. it is a requirement of an international organisation of which the UK is a member that the UK (and therefore contracting authorities) awards a contract in accordance with the procedure adopted by the organisation; and
 - b. that procedure is inconsistent in any material way with the procedure to be followed in the Act.
47. [Paragraph 24](#) does not apply to defence and security contracts (separate exemptions apply to defence and security contracts).

National security

48. The exemption at [paragraph 25](#) applies to contracts that a contracting authority considers, in the interests of national security, should not be subject to all or part of the Act.
49. National security is not defined in the Act to ensure that it is sufficiently flexible to protect the UK's national security interests. Neither does this guidance define national security. However, contracting authorities should recognise the concept of national security has evolved beyond sovereignty, national defence, intelligence and counterintelligence. It may include dimensions such as countering terrorism and organised crime, cyber security,

⁵ An international agreement may be, for example, a convention, treaty or other arrangement such as a memorandum of understanding between states.

⁶ An international organisation may be, for example, a permanent international institution with separate legal personality, set up by a treaty between states or intergovernmental organisations.

maintenance of public order, economic security, foreign relations, and environmental security.

50. A decision to apply the exemption can only be made in the interests of national security. Other interests are irrelevant. For example, a contracting authority cannot use the exemption to secure economic benefits for itself. That does not mean national security does not have an important economic dimension, as it can be understood as the protection of infrastructure and activities that are critical for the functioning or stability of the economy or financial system (including payment systems) or to the safety and soundness of financial institutions. So, the national security exemption may be necessary to protect such economic infrastructure and activities but not to secure an economic advantage for the authority.
51. For illustration only, the scenarios where the national security exemption could be used for critical economic and financial infrastructure, provided they are properly justified by the contracting authority, include but are not limited to:
- a. where the performance of the contract requires access to highly sensitive sites, e.g. access to sites used for confidential activities relating to Bank of England banknotes;
 - b. where the information required to be able to bid for and perform the contract requirement is highly classified, e.g. information related to sensitive aspects of banknote design and security features;
 - c. where confidentiality of the contract or identity of the provider is critical for the functioning or stability of the national economy or financial system (including payment systems) or to the safety and soundness of financial institutions, e.g.:
 - i. opening of accounts for, and/or maintaining of banking services by, the Bank of England; and
 - ii. legal or professional advice or appointments relating to market interventions, pre-resolution work, potential failure of a financial institution(s) or gilt operations.

52. The national security exemption is available to all contracting authorities. Contracting authorities know their own business best, including how national security risks are identified and managed to support their own operations and services and may wish to issue local guidance on how to address specific national security risks which are highly sensitive in nature, including who is the decision maker or needs to be consulted, and what factors must be considered.

53. Contracting authorities are strongly advised to keep a written record of their rationale for using this exemption. The contracting authority should, in broad terms, explain and justify what those national security risks are and the actions taken to mitigate the risks. This explanation needs to be a record of what was decided when the decision was made.

National security exceptions in international agreements

54. Where a contracting authority is seeking to rely on the national security exemption to award a contract that is covered by an international agreement that the UK has entered into with

another country, the contracting authority should satisfy itself that an exception in the international agreement applies in relation to the award.

55. The question of whether a contract is covered by an international agreement will depend on whether the works, services or goods to be provided are included in the UK's coverage schedules to the agreement. For example, the UK's coverage schedules to the WTO's Government Procurement Agreement (GPA) are set out in 7 Annexes.
56. The procurement chapters of most international agreements that the UK is party to contain a national security exception on the same or similar terms to that in Article III.1 of the GPA which states:

“Nothing in this Agreement shall be construed to prevent any Party from taking any action or not disclosing any information that it considers necessary for the protection of its essential security interests relating to the procurement of arms, ammunition or war materials, or to procurement indispensable for national security or for national defence purposes.”

57. A contracting authority seeking to rely on this exception must be satisfied that the requirements of the exception are met. The GPA exception permits contracting authorities “taking any action” or “not disclosing any information” where necessary to protect the UK's essential security interests. The application of the GPA exception is, however, significantly limited in that it can only be relied on in relation to three categories of procurement:

- a. procurement of arms, munitions or war material;
- b. procurement indispensable for national security; or
- c. procurement for national defence purposes.

58. For all other procurements, a contracting authority would need to consider other exceptions in the international agreement. For example, Article III.2 of the GPA provides an exception that:

“Subject to the requirement that such measures are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between Parties where the same conditions prevail or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent any Party from imposing or enforcing measures:

(a) necessary to protect public morals, order or safety;

(b) necessary to protect human, animal or plant life or health;

(c) necessary to protect intellectual property; or

(d) relating to goods or services of persons with disabilities, philanthropic institutions or prison labour.”

Again, contracting authorities wishing to rely on this exception must demonstrate that the requirements of the exemption are met. Article III.2(a) and (b) are potentially relevant to national security. The award of the contract must not constitute a means of arbitrary or unjustifiable discrimination between parties to the international

agreement, nor a disguised restriction on international trade. In other words, contracting authorities cannot rely on this exception in order to favour UK suppliers or UK-made products in a manner that is arbitrary or unjustified or in order to limit international trade. The award must also be connected to and address a particular interest specified in (a) or (b), e.g. public order and must be 'necessary' to protect that interest, e.g. countering large-scale public disorder such as arson and looting.

59. Where the national security exemption at [paragraph 25](#) applies, it is likely that an exception in an international agreement can also be invoked, but this requires separate and particular analysis on a case by case basis. Further details on the international agreements at [Schedule 9](#) can be found in the guidance on [treaty state suppliers](#).

Intelligence activities

60. [Paragraph 26](#) exempts contracts for the purposes of carrying out, facilitating, or supporting intelligence activities. The Act does not define intelligence activities, and it is for individual contracting authorities to determine whether it applies to their contractual requirement
61. [Section 2\(5\)\(b\)](#) sets out that the Security Service (MI5), the Secret Intelligence Service (MI6) and the Government Communications Headquarters (GCHQ) are excluded authorities and therefore are not covered by the definition of a contracting authority, which means that they are not covered by the Act, and therefore this exemption is not relevant. However, it may be relevant for other contracting authorities whose principal function is not intelligence, e.g. the Home Office, that enter into contracts which relate to intelligence activities.

Defence and security contracts

62. [Paragraphs 27-30](#) exempt defence and security contracts where:
- a. ([paragraph 27](#)) the supplier is located in an area outside of the UK where armed forces are deployed and operational needs require the contract to be awarded to that supplier.
 - b. ([paragraph 28](#)) the supplier is located in a state or territory outside the UK in which the armed forces maintain a military presence and the state or host nation requires that the supplier delivers the goods, services or work to which the contract relates.
 - c. ([paragraph 29](#)) contracts are awarded under a procedure adopted by an international organisation of which the UK is a member.
 - d. ([paragraph 30](#)) contracts are awarded under international arrangements to jointly develop new products or for the exploitation of those projects following development.
63. Further details can be found in the guidance on the [defence and security contracts](#).

Utilities contracts

64. [Paragraphs 31-34](#) exempt utility contracts as follows:
- a. ([paragraph 31](#)) contracts awarded for the purpose of further sale or lease to third parties of the goods, works or services supplied under those contracts (except where the utility is a centralised purchasing authority).

- b. ([paragraphs 32 and 33](#)) contracts for the purchase of water or energy, or fuel for the production of energy, by utilities carrying out a relevant utility activity.
- c. ([paragraph 34](#)) contracts for the activities set out in [Part 2 of Schedule 4](#), which are exempted from the Act as they are exposed to competitive forces in an unrestricted market.

65. Further details can be found in the guidance on [utilities contracts](#).

Concession contracts

66. [Paragraphs 35-37](#) exempt concession contracts as follows:

- a. ([paragraph 35](#)) for the carrying out of a utility activity for certain water services.
- b. ([paragraph 36](#)) contracts giving an exclusive right to operate a relevant scheduled air service.
- c. ([paragraph 37](#)) contracts for public passenger transport services.

67. Further details can be found in the guidance on [concession contracts](#).

City of London

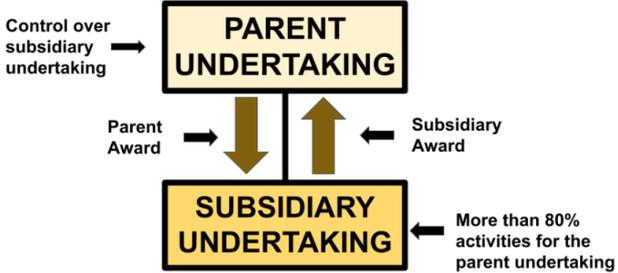
68. [Paragraph 38](#) exempts contracts entered into by the Common Council of the City of London Corporation other than for the purposes of its public functions. This allows the City of London to conduct procurements relating to its commercial trading activities without applying the Act and is necessary due to the unique structure of the City of London.

What other guidance is of particular relevance to this topic area?

Guidance on [covered procurement](#)

Family Analogy Examples of Vertical Arrangements (Schedule 2, paragraph 2)

The examples below illustrate how Schedule 2, paragraph 2(1) and 2(2) may be applied and assume that the requirements of Schedule 2, paragraphs 2(2)(b), (c), (d) and (3) are met in all scenarios.

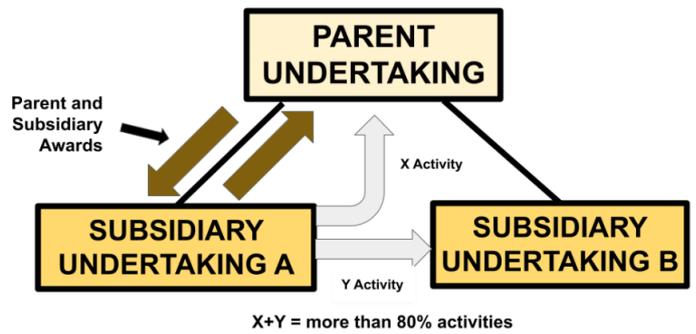
Examples ¹	Diagram showing contractual relationship
<p>1. Parent - Subsidiary Award (1)</p> <p>A contract between a contracting authority or a group of contracting authorities ('parent undertaking'), and a person ('subsidiary undertaking') controlled by the parent undertaking, applying:</p> <ul style="list-style-type: none"> • Schedule 2, paragraphs 2(1)(a)/(b) and 2(2)(a); and • Schedule 2, paragraph 2(4), and Section 1162(2) of the Companies Act 2006. 	

¹ Defined terms are the same throughout these examples (e.g. 'parent undertaking' is as defined in example 1)

2. Parent - Subsidiary Award (2)

A contract between a parent undertaking and subsidiary undertaking A where subsidiary undertaking A carries out some activities for another person ('subsidiary undertaking B') controlled by the same parent undertaking, applying:

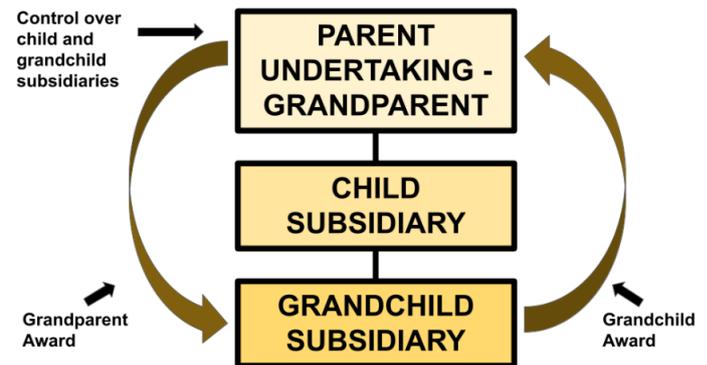
- Schedule 2, paragraphs 2(1)(a)/(b), 2(2)(a) and 2(2)(c);
- Schedule 2, paragraph 2(4); and
- Section 1162(2) of the Companies Act 2006.



3. Grandparent - Grandchild Award

A contract between a person ('grandchild subsidiary') controlled by a contracting authority that is a subsidiary undertaking ('child subsidiary') and the parent undertaking ('grandparent') of that child subsidiary, applying:

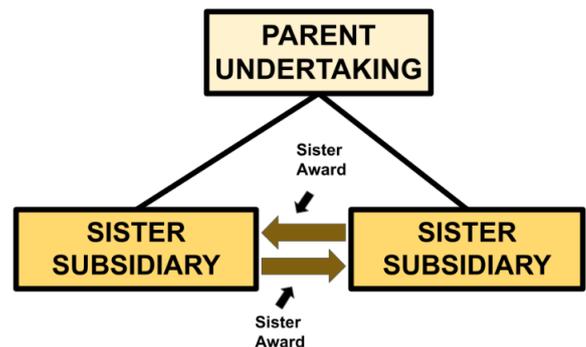
- Schedule 2, paragraphs 2(1)(a)/(b) and 2(2)(a);
- Schedule 2, paragraph 2(4); and
- Sections 1162(2) and 1162(5) of the Companies Act 2006.



4. Sister - Sister Award

A contract between subsidiaries undertakings of the same parent undertaking ('sister subsidiaries'), applying:

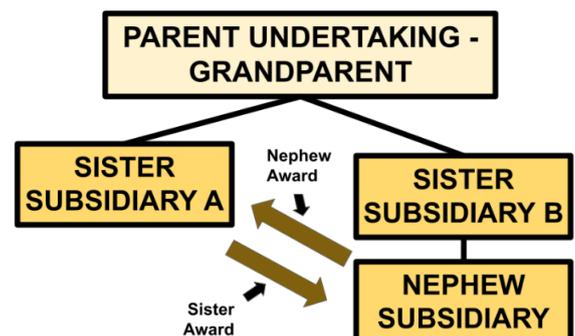
- Schedule 2, paragraphs 2(1)(c)/(d) and 2(2)(a);
- Schedule 2, paragraph 2(4); and
- Section 1162(2) of the Companies Act 2006.



5. Sister - Nephew Award

A contract between a sister subsidiary ('sister subsidiary A') and a person ('nephew subsidiary') controlled by sister subsidiary B, applying:

- Schedule 2, paragraphs 2(2)(1)(c)/(d) and 2(2)(2)(a);
- Schedule 2, paragraph 2(4); and
- Sections 1162(2) (sister controlled by parent) and Section 1162(5) (nephew controlled by grandparent) of the Companies Act 2006.



Calculation of activities for vertical and horizontal arrangements

Vertical arrangements

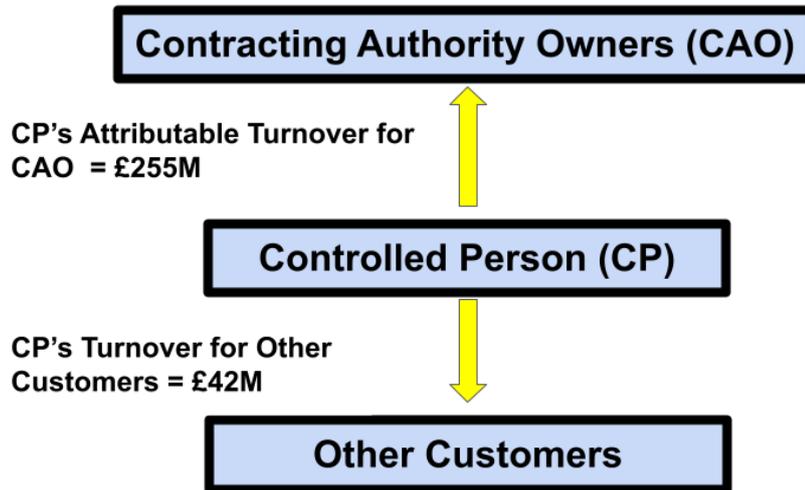
1. The purpose of the 80% activity test in respect of vertical arrangements at [Schedule 2, paragraph 2\(2\)\(c\)](#) is to establish that the controlled person performs the essential part of its activities for its contracting authority owner(s). The test therefore limits the ability of a controlled person to trade for a profit with third parties when they are benefiting from the award of exempted contracts that may distort the market.
2. [Regulation 42A⁷ of the Procurement Regulations 2024](#) (Regulations) requires that the activity test be calculated using the controlled person's 'attributable turnover' (over a specified 'relevant period') as a percentage of their 'total turnover' (over the same specified 'relevant period').
3. The controlled person's 'attributable turnover', as set out in [regulation 42A\(3\)](#), is turnover⁸ derived from activities that the controlled person undertakes for its contracting authority owner(s) or other persons controlled by its contracting authority owner(s). The controlled person's 'total turnover' is all turnover derived from any source.
4. The 'relevant period' is defined in [regulation 42A\(9\)](#) as:
 - (a) the period of three years ending with the date of contract award⁹, or
 - (b) where, due to the timing of the preparation of the person's accounts, information relating to turnover for the period in sub-paragraph (a) is not available as at the date of contract award, a period of three years ending with the date the last accounting period¹⁰ before the date of contract award for which such information is available ends.
5. In accordance with the definition, the default relevant period is three years ending with the date of contract award, and the alternative relevant period provided for in sub-paragraph (b) should only be used where turnover information is not available up to the date of contract award. It should also be noted that the definition of relevant period means that the date at which the turnover test must be met for the contract to be an exempted contract is the date of contract award (under sub-paragraph (a) of the definition) or the date when the last accounting period before the date of contract award ends (under sub-paragraph (b) of the definition).
6. The method of calculating turnover smooths out such work done over a three-year period. So even if in one year, the controlled person's attributable turnover is 80% or less of their total turnover, the test may still be satisfied, and the contract accordingly considered an exempted contract, as long as over the three years the 80% threshold is exceeded.
7. The calculation is summarised below with an example of a controlled person's activity test calculation. The outcome is 86%, which passes the activity test.

⁷ As inserted by [regulation 8\(12\) of the Procurement Act 2023 \(Consequential and Other Amendments\) Regulations 2025](#).

⁸ 'Turnover' is not defined and has its usual meaning in a commercial context, i.e. income or gross revenue received from the sale of goods, services or works.

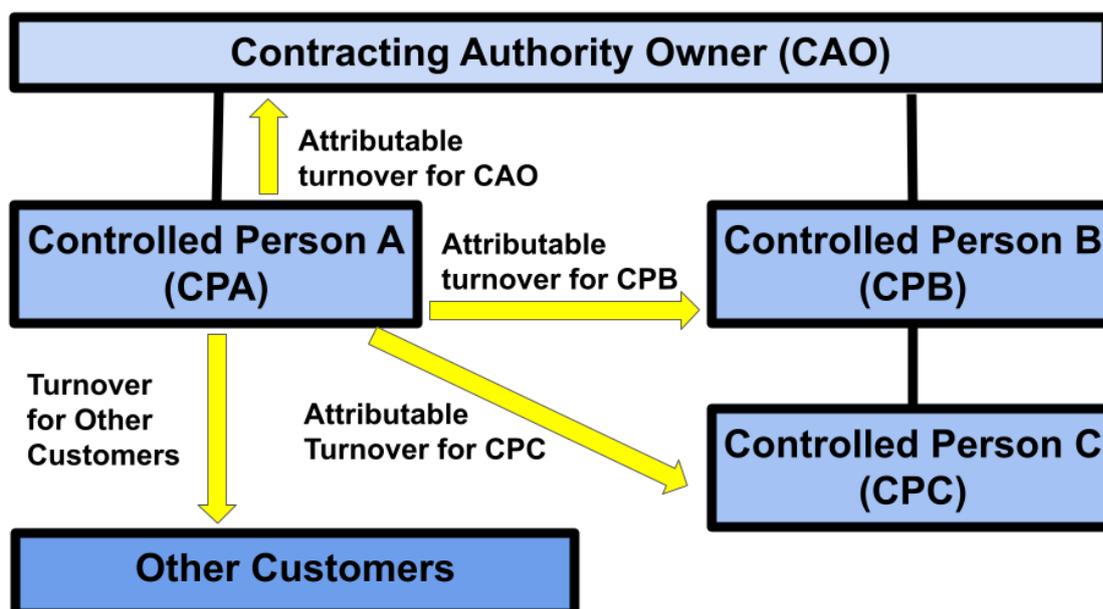
⁹ [Regulation 42A\(9\)](#) defines 'date of contract award' as the date when the contracting authority decided to award the contract.

¹⁰ [Regulation 42A\(9\)](#) defines 'accounting period' as a period in respect of which accounts are prepared in relation to the affiliated person.



$$\begin{aligned}
 \text{Activities \%} &= \left(\frac{\text{Attributable Turnover}}{\text{Total Turnover}} \right) \times 100 \\
 &= \left(\frac{\text{Attributable Turnover}}{\text{Attributable + Customer Turnover}} \right) \times 100 \\
 &= \left(\frac{255}{255 + 42 = 297} \right) \times 100 \\
 &= 86\%
 \end{aligned}$$

8. The calculation is likely to become more complicated if the contracting authority owner has more than one controlled person and they have subsidiaries. The diagram below illustrates the calculation of an activities test for Controlled Person A that needs to ensure its in-house work is above 80% of turnover.



9. For the calculation of activities for Controlled Person A:
 - a. the 'attributable turnover' for Controlled Person A is the sum of turnover attributable to activities for its contracting authority owner and for that contracting authority owner's subsidiaries - Controlled Person B and Controlled Person C;
 - b. the 'total turnover' for Controlled Person A is the sum of the attributable turnover, and turnover for all its other activities for other customers; and
 - c. to benefit from the exemption, Controlled Person A's 'attributable turnover' must be more than 80% of its 'total turnover'.
10. A similar calculation for Controlled Person B needs to take account of Controlled Person B being the parent company of its subsidiary Controlled Person C - not shown in the diagram. Thus for the calculation for Controlled Person B:
 - a. the 'attributable turnover' for Controlled Person B is the sum of turnover attributable to activities by Controlled Person B and Controlled Person C for their contracting authority owner and for that contracting authority owner's subsidiary A;
 - b. the 'total turnover' for Controlled Person B is the sum of the attributable turnover, and turnover for all of Controlled Person B and Controlled Person C's activities for other customers; and
 - c. to benefit from the exemption, Controlled Person B's 'attributable turnover' must be more than 80% of its 'total turnover'.
11. Contracting authorities must also comply with the [Procurement Act 2023 \(Consequential and Other Amendments\) Regulations 2025](#), which set out, at [Regulations 42A and 42B](#), the rules for the calculation of percentage of activities for vertical and horizontal arrangements.

Horizontal arrangements.

12. The activities test in respect of horizontal arrangements ensures that the majority of the activities carried out by a person as part of the arrangement relate to the public functions of the co-operating public authorities. Accordingly, the test limits the ability of the co-operating

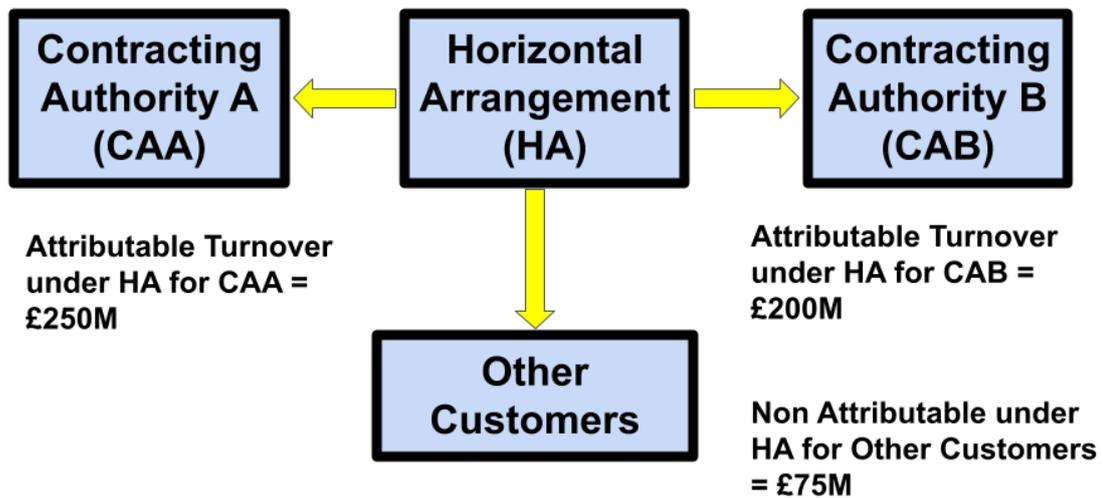
public authorities to use the arrangement in respect of other functions when they are benefiting from the award of exempted contracts that may distort the market.

13. [Regulation 42B\(2\)](#)¹¹ requires that the activity test be calculated using the 'non-attributable turnover' generated by the horizontal arrangement's activities (over a specified 'relevant period') as a percentage of the 'total turnover' generated by the arrangement's activities (over the same specified 'relevant period').
14. The horizontal arrangement's 'non-attributable turnover', as set out in [regulation 42B\(3\)](#), is turnover derived from the horizontal arrangement's activities that relate to purposes other than the co-operating contracting authorities' public functions.
15. The 'relevant period' is defined in [regulation 42B\(9\)](#) as:
 - (a) the period of three years ending with the date of contract award¹², or
 - (b) where, due to the timing of the preparation of the accounts related to the horizontal arrangement's activities, information relating to turnover for the period in sub-paragraph (a) is not available as at the date of contract award, a period of three years ending with the date the last accounting period¹³ before the date of contract award for which such information is available ends.
16. In accordance with the definition, the default relevant period is three years ending with the date of contract award, and the alternative relevant period provided for in sub-paragraph (b) should only be used where turnover information is not available up to the date of contract award. It should also be noted that the definition of relevant period means that the date at which the turnover test must be met for the contract to be an exempted contract is the date of contract award (under sub-paragraph (a) of the definition) or the date when the last accounting period before the date of contract award ends (under sub-paragraph (b) of the definition).
17. The calculation is summarised in the example below, where the non-attributable turnover accounts for 14% of the horizontal arrangement's total turnover, satisfying the test.

¹¹ As inserted by [regulation 8\(12\) of the Procurement Act 2023 \(Consequential and Other Amendments\) Regulations 2025](#).

¹² [Regulation 42B\(9\)](#) defines 'date of contract award' as the date when the contracting authority decided to award the contract.

¹³ [Regulation 42B\(9\)](#) defines 'accounting period' as a period in respect of which accounts are prepared in relation to the horizontal arrangement's activities.



$$\begin{aligned}
 \text{Activities \%} &= \left(\frac{\text{Non-Attributable Turnover}}{\text{Total Turnover}} \right) \times 100 \\
 &= \left(\frac{\text{Non-Attributable Turnover}}{\text{Attributable + Customer Turnover}} \right) \times 100 \\
 &= \left(\frac{75}{250 + 200 + 75} \right) \times 100 \\
 &= 14\%
 \end{aligned}$$

Business projections

18. Contracting authorities are to use 'credible business projections' of turnover where there is no turnover for either all or part of the relevant period due to a start-up or reorganisation. See [regulation 42A\(4\)-\(7\)](#) and [regulation 42B\(4\)-\(7\)](#) for vertical and horizontal arrangements respectively.
19. Business projections might be quite different from reality, once in operation. However, to be considered 'credible business projections' they should reflect the likely outcome at the time the contracting authority owner or co-operating contracting authorities applied the exemption.
20. 'Reorganisation' is defined in [regulation 42A\(9\)](#) (as respects vertical arrangements) as a "change, other than a minimal or incidental change, to a person's structure, operations, funding or ownership". [Regulation 42B\(9\)](#) defines 'reorganisation' for horizontal arrangements similarly, although also includes a change in respect of the horizontal arrangement's activities. Reorganisation can take many forms. It may involve a merger or

demerger and separating streams of income, moving assets within a group, re-allocating resources or consolidating aspects of the business.

21. Credible business projections of turnover should take account of any historical information for the work to be done from any predecessor to the controlled person or earlier iterations of the horizontal arrangement. They should also take account of the financial consequences of the costs of disruption to operations during reorganisation, changes to income streams from customers, reallocating resources and consolidating the business.
22. To illustrate the use of credible business projections of turnover and expanding on the example of a controlled person in respect of vertical arrangements above, the contracting authority owner - Council X - sets up a controlled person in the form of a Local Authority Trading Company (LATC) as follows:
 - a. At the start, the LATC in its initial stage of development only provides Service A. For the calculation for activities, there will be no attributable or total turnover figures available for Service A. The LATC is likely to have access to information from Council X - if they previously delivered Service A - in drawing up its work plan. It may also have data from other LATCs that have ceased business. The activities test will therefore be solely based on credible business projections of attributable and total turnover.
 - b. After two years, the LATC has proven its worth so Council X requires the LATC to also deliver Service B on its behalf. For the calculation for activities, there will be turnover figures for the two years of Service A. Business projections could be drawn from the LATC's work plan which will reflect the LATC growing knowledge and expertise in the market. The activities test will therefore be based on:
 - i. attributable and total turnover figures for the first and second years generated in respect of Service A;
 - ii. credible business projections of turnover for the third year of turnover for Service A; and
 - iii. credible business projections of attributable and total turnover for three years of Service B.
 - c. After five years, Council Y becomes a co-owner of the LATC alongside Council X, and in doing so requires the LATC to deliver Services A, B and C on its behalf. The activities test will therefore be based on:
 - i. attributable and total turnover figures for the three years of the relevant period for Services A and B provided to Council X; and
 - ii. credible business projections of attributable and total turnover for three years for Services A, B and C to be provided to Council Y.

Alternative to turnover or business projections

23. [Regulations 42A\(8\)](#) and [42B\(8\)](#) provide alternative methodologies for the percentage of activities where attributable and total turnover or credible business projections do not satisfy the activity tests set out in [Schedule 2, paragraph 2\(2\)\(c\) or paragraph 3\(2\)\(b\)](#). Instead of actual turnover or business projections of turnover, it allows the calculation to be based on costs, time spent, or value of goods, services or works supplied where that may be a better indication of the controlled person's or horizontal arrangement's activities than turnover.

24. A potential source of any cost, time or supply data used in these alternative methods is likely to be a work schedule that is used by the controlled person or in relation to the horizontal arrangement to facilitate the management of both human and material resources. A typical schedule would break down workload into tasks with costs, time and resources allocated to it. In-house activities would be integrated into the work schedule in order to ensure data reliability for the calculation.
25. Alternatively, contracting authorities using the 'time spent' method may survey employees to estimate the percentage of time they spend or expect to spend on activities carried out for or on behalf of the contracting authority owner(s) or other persons controlled by its contracting authority owner(s) versus other customers, in respect of a vertical arrangement, or on activities carried out for the purposes of the co-operating contracting authorities' public functions versus other functions, in the case of a horizontal arrangement. Time spent on overhead activities that support day-to-day running would need to be factored into the average percentages obtained from the survey.

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