

SSRO

Single Source
Regulations Office

Baseline Profit Rate (BPR) Activities Review consultation

Consultation responses

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1. Anonymous respondent

Overview

This response form should be read in conjunction with the consultation document.

The consultation will close on 16 August 2024.

Please respond by 5.00pm on Friday 16 August 2024.

Completed response forms should be sent.

- by email to: consultations@ssro.gov.uk (preferred)
- by post to: Baseline profit rate consultation responses, SSRO, G51/G52, 100 Parliament Street, London, SW1A 2BQ
- by telephone including arranging an appointment to speak to the SSRO about the consultation: 020 3771 4767.

Your details

Name:

Organisation:

Position:

Consultation responses

In our response to this working paper [REDACTED] wish to remain anonymous but are happy for the content to be published.

Question 1: Do you support the removal of rental and leasing activities from the types of activity included in the baseline profit rate assessment?

It is difficult to conclude as a categorical “yes” or “no” to this question. Though we are veering to “yes”, for the logic below:

We do not provide assets to MOD on a rental basis;

We assume SSRO is interpreting this category to be simply the provision of widely available assets (rather than bespoke assets which require a higher return to cover development/ R&D/IP), without accompanying technical support services;

There may well be a disproportionate number of such companies in the comparator group which is distorting comparability to ADS companies and their QDCs.

To better assess the question it would be helpful to have a list of all such companies currently in the comparator group which would become excluded under the proposed new methodology.

It would also be helpful to know if any QDCs (or proposed/likely QDCs in future) provide such services. If they don’t then we agree this category does not need to be included. But should be reconsidered annually as the population of QDCs changes.

██████████

Question 2; Do you support replacing the current distinct activity types of D&M and P&M with a new single 'Develop, Make and Support' (DM&S) activity type, if rental and leasing were removed from P&M?

Please add comments to support your answer:

Yes, we do support this.

The existing methodology added complexity and seemed to be a simple average of the two groups rather than a weighted average. Many companies, [REDACTED], provide both types of services and even within individual contracts there could be both. A company may only be able to provide P&M if it has done the D&M. Probably needs the skills/resources to do both. Makes sense to simplify and reflect a single activity of DM&S.

Question 3: Do you support technical support services being added in the DM&S activity type (subject to proposal 2) in the proposed manner?

Please add comments to support your answer:

Yes, we do support this, subject to the caveats below. [REDACTED]

If the proposal to combine D&M and P&M into a single DM&S category is not implemented then we would alternatively support including Technical Support services into the P&M category, subject to the caveats below:

Caveats:

Are there suitably comparable companies that are deemed to be Technical Support that can be included? Appendix 4 to the consultation document mentions 22 companies had been identified. Which ones?

NACE codes: codes 712, 749, 7112 would seem to be appropriate. We don't agree it would be appropriate to include 3820 and 8020. Though we appreciate the comment in footnote 22 to Appendix 4, hence our "yes" response is predicated on being able to assess the more detailed review when it is undertaken, prior to being implemented.

Question 4: Do you support labour outsourcing being added in the Ancillary Services activity type in the proposed manner?

Please add comments to support your answer:

No, we do not support this.

The evidence suggests this is a negligible proportion of qualifying contract activity and such activities do not represent activities provided by ADS companies. The consultation document quantifies this as only 7 QDCs providing such services. Fully or partially?

Additionally, the provision of office administration service activities is very different to the provision of skilled resources.

Hence, it would definitely be detrimental to comparability to include within either of the two existing activity groups (D&M and P&M) or the proposed new activity group (DS&M) used for BPR purposes [not that that is the proposal] but could also be distorting to include in the Ancillary Services activity type.

Further comments on the consultation paper

The consultation does not consider the activities of Information Technology Services companies. IT Services, along with Ancillary Services and Construction, are excluded from the BPR comparator groups.

██████████ Re: cyber security and secure communication networks. This covers (as quoted in Appendix A of the 2023, Phase 1, consultation) the “design, integration or operation of networks and computer systems or services used for military or defence purposes”. As such, consideration should be given to including [some] IT Services companies in the comparator group. ██████████. However, we note that whilst these companies may be comparable to QDCs delivered ██████████, SSRO’s analysis suggests they represent only a small minority of single-source contracts placed by MOD.

Feedback on our proposals as to how the SSRO will implement these proposed changes to the BPR methodology?

The approach seems sensible (though noting we disagree with proposal 4).

2. Babcock

SSRO Consultation – BPR Activities Review: proposed changes to the benchmark of activities.

Babcock International Group Response.

We welcome the opportunity to engage in this process. Babcock is supportive [REDACTED] [REDACTED] response to this consultation but also adds its own interpretation as well.

The response is set out in the table below.

Question 1: Do you support the removal of rental and leasing activities from the types of activity included in the baseline profit rate assessment?
Yes. This is in line with our response to the baseline profit activities review consultation that preceded this process.
Question 2: Do you support replacing the current distinct activity types of D&M and P&M with a new single 'Develop, Make and Support' (DM&S) activity type, if rental and leasing were removed from P&M?
Yes. We are encouraged by the SSRO approach to future profit rate calculations.
Question 3: Do you support technical support services being added in the DM&S activity type (subject to proposal 2) in the proposed manner?
We broadly support the inclusion of technical support services but believe the NACE codes require further review. Codes 712, 749 and 7112 are appropriate for use. Code 3820 requires refinement when companies are assessed as the range is too broad. Nuclear waste disposal activities may be appropriate when considering defence procurement, but the descriptor refers to hospital waste. It is difficult to see the relevance of code 8020 as this relates to monitoring, installation and repair of security systems. This hardly embraces technical support. Security consultancy is already covered under code 749. The activities of this code relate primarily to physical security equipment. Electronic and cyber security are probably covered elsewhere.
Question 4: Do you support labour outsourcing being added in the Ancillary Services activity type in the proposed manner?
The small number of QDC's in this area indicate that these could be framework type contracts that MoD use to let specific tasks on a single source basis. These companies are unlikely to keep a pool of labour explicitly for MoD work as this would invite claims to maintain capacity requirements. The SSRO should consider the activities being requested as these could fall under the professional services banner which is covered elsewhere. The NACE codes basically cover short term recruitment solution that are already used by Industry to supplement their workforce. The MoD requirement is likely to be for staff that have some form of security clearance, but this will be dependent on the nature of tasks.

Classification: UNCLASSIFIED

It is not considered appropriate to include labour outsourcing in the Ancillary Services comparator group. MoD are more likely to compete their requirement in this area.

3. BAE Systems

BAE SYSTEMS

Consultation Response

August 2024

BPR Activities Review: proposed changes to the benchmark activities

In response to your invitation to comment on the SSRO's Consultation on 'BPR Activities Review: proposed changes to the benchmark activities' please see below BAE Systems' input.

In general BAE Systems [REDACTED] and the below response further highlights our specific areas of interest.

Question 1: Do you support the removal of rental and leasing activities from the types of activity included in the baseline profit rate assessment?

Yes, we do, on the basis that we do not believe that rental and leasing activities are representative of contracts let under the regime. The principle should be that the activities conducted by companies in the comparator groups should be as close as possible in nature to the work conducted under a typical Qualifying Contract. We accept that Qualifying Contracts can be diverse in nature, but an analysis conducted with data shared under a previous FOI requests would suggest that there are no QDCs/QSCs for rental or leasing services (as one would expect).

However, rather than look at this specific question of whether rental and leasing activities should be removed, we would welcome a wider review of whether the make-up of the activities and companies feeding into the comparator groups supports the objective of comparability on which the BPR setting methodology is based. We feel there are too many companies in the comparator groups that appear to conduct activities that are at best part of the scope of what a typical Qualifying Defence contract may cover, rather than companies that deliver requirements similar in complexity and technical expertise.

Question 2: Do you support replacing the current distinct activity types of D&M and P&M with a new single 'Develop, Make and Support' (DM&S) activity type, if rental and leasing were removed from P&M?

Yes, again we are supportive. We believe there are very few companies that conduct solely D&M or P&M contracts. The majority of companies that develop and make new products also provide maintenance and support. Therefore, it is not sensible to apply discrete benchmark profit rates for D&M and P&M activities.

Question 3: Do you support technical support services being added in the DM&S activity type (subject to proposal 2) in the proposed manner?

We can neither lend our support nor object to this proposal without further information. To be able to do so, we would find it helpful to understand whether there are Qualifying Contracts that are purely for Technical Support Services, as opposed to contracts that contain an element of Technical Support amongst a list of other complex, interrelated requirements. Therefore, when requesting this input from industry on the suitability of certain activities for inclusion in the comparator group, we would welcome it if the SSRO would share a supporting analysis showing statistics around qualifying contracts let to date purely for the activity proposed. Previous stats shared appear to be focussed on number of contracts and value where activities contribute to Qualifying Contracts.

Question 4: Do you support labour outsourcing being added in the Ancillary Services activity type in the proposed manner?

See response to Question 3 above.

In addition do you have any feedback on our proposals as to how the SSRO will implement these proposed changes to the BPR methodology?

Above we have provided feedback to the specific questions of this consultation. As per our response to last year's consultation and brought to the attention through engagement with DSAG over many years, we would still welcome a more fundamental review of the BPR setting methodology, given the 'comparability principle' based methodology as applied today is problematic for several reasons, some of which we outline below.

As contract-level profits are not readily available for comparison, the methodology relies on outturn company profits to set the baseline from which contract profit rates are calculated. These outturn company profits will be derived after all costs of 'running companies' are accounted for. This includes many of the types of costs, such as Sales & Marketing expenses, redundancy costs in excess of statutory levels etc that we generally cannot recover on Single Source work (and increasingly all MoD work, as they seek to apply SSCR principles to all contracts), thus reducing business profit levels significantly below the contract profit level. This is not corrected for in any of the other three steps in the CPR calculation. Therefore, comparability is not achieved, and in the long term profit levels of companies solely doing UK MoD single source business would be on a slow downward spiral, all things being equal.

As mentioned above, we also do not agree comparability in setting a contract profit rate is achieved by reference to activities that only contribute to smaller or larger extend to the delivery of Qualifying Contracts.

Lastly, 'Develop & Make' and 'Provide & Maintain' type activities are present in contracts across many market sectors. These contracts are not necessarily comparable across sectors. For example, a 'Develop & Make' contract in the car industry may have a very different risk profile to a 'Develop & Make' contract in Agricultural Vehicles, which in turn may have a very different risk profile to a 'Develop & Make' contract in Military Armoured Vehicles, and correspondingly these may all require different profit reward based on complexity of requirements and technological expertise. The fact MoD are having to single source Qualifying Contracts is usually due to requirements that are technically complex and integrated, for which no effective competition can be run. This suggests that on a scale of different types of 'Develop & Maintain' contracts they would probably sit at the more complex and risky end. The current SSRO defined 'activity types' are a mix of activity types (D&M and P&M) and market sectors (construction, IT). We would pose the question whether comparability might be better and more fairly established by looking solely through a market sector lens.

While this may not directly address the question of how changes should be implemented, we would once again call for a wider review of the methodology instead of focussing in on these relatively minor changes. The simple fact that the methodology has delivered stable BPRs over a number of years is in our opinion not enough proof that it delivers fair and reasonable returns to contractors.

4. Leonardo UK

Single Source Regulations Office
100 Parliament Street
London
SW1A 2BQ

Date 16th August 2024

For the Attention of:
consultations@ssro.gov.uk

cc.
Jo Watts
Ben Johnson
Lynn Hawkins

Dear Sir/Madam

Subject: BPR Activities Review Consultation

Leonardo UK Ltd [REDACTED] to this consultation and we are pleased to provide our own submission, [REDACTED], adding our own emphasis.

We continue to have concerns the SSRO's method for setting the BPR, based on comparable contract activity profits, cannot be realised. Our concern is based on:

- Contract profitability is not publicly available information.
 - Publicly available information is the profits of companies, generated from operating in market sectors, across a range of contract activity types.
- Qualifying contracts (the OECD "controlled transaction") are complex, bespoke and usually not capable of competition. Therefore, it is extremely difficult, if not impossible, to find companies conducting comparable competitive contracts, which by their nature are better defined in order to enable competition (OECD "uncontrolled transaction").

Notwithstanding these concerns, we provide, below, our response to the consultation paper.

"The SSRO invites stakeholder views, together with supporting evidence where appropriate, on matters raised above and specifically on the following consultation questions".

Our comments are referenced by consultation paragraph number.

Comparability

- 1.2 The SSRO's BPR methodology comparability definition should be changed to be based on the profits of comparable contracts, in comparable sectors, to qualifying contracts and not include activities that "contribute to" qualifying contracts as these lower level contracts are not comparable. Indeed, the Defence and Security Industrial Strategy (DSIS), paragraph 24, explains the activity type is the contract type.



The MOD and OECD approach both follow the logic of comparability at the level of the transaction between the two parties (i.e. the contract). They explain when pricing a non-competitive contract we have to identify a comparable “uncontrolled transaction” (contract between two unrelated parties) to the “controlled transaction”. In the case of the pricing formula and the profit rate we are seeking a comparable profit rate from “uncontrolled” comparable contracts to use in pricing qualifying contracts in a “controlled transaction”.

[OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 | READ online \(oecd-ilibrary.org\)](#)

The OECD methodology employs an “arm’s length principle” to set fair pricing of “goods transferred or services provided and the condition of the transfer or provision” by reference to the price of those same goods and services under an “uncontrolled transaction”.

[Reforms to the Single Source Contract Regulations.pdf \(publishing.service.gov.uk\)](#) Paragraph17

MOD when using market pricing follows the same comparability logic as OECD.

SSCR 2014 regulation 19A: for an alternative commercial price to be seen as fair and VFM, the price must be shown to have been determined through competition, or be a market price paid by others, and the “output” of goods, works or services, in terms of specification and T&Cs, must be the same as that for which the MOD are now contracting.

We propose the SSRO’s comparability definition should be:

- ***“companies whose contractual promises (and economic activities) are comparable to those of qualifying contracts...”***

1.4 We support the approach of developing methodology and improving comparability through a better understanding of contracts let since the regimes inception. But, as explained more fully by DSAG, we disagree with the SSRO’s current comparability principle for the reasons explained above.

1.5 We agree with the proposal to combine the current Develop and Make (D&M) and Provide and Maintain (P&M) CGs. Our logic for this, along with supporting evidence, was provided ██████ in phase 1 of this review, being it is not possible to support two separate comparator groups as 90% of companies in the two comparator groups perform both D&M and P&M contracts, not one or the other. So, it is not possible to provide two separate CGs and therefore necessary to combine the two comparator groups.

1.6 ██████ we see a number of other practical considerations in the application of comparability as a methodology:

- It is not possible to provide benchmark contract activity type profit rates, based on comparable contracts, as contract profitability is not publicly available information. What is publicly available is the profits of companies whose profits relate to market sectors within which they may perform a range of different contract activity types.
- We think Develop and Make (D/M) and Provide and Maintain (P/M) are activity types within the CADMID cycle. These activities exist in many market sectors, they are not sectors in themselves and they are not necessarily comparable across sectors (i.e. D&M in construction is different to D&M in IT and D&M in defence).
- It may not always be possible to support a defined comparator group with financial numbers. If there are very few companies substantially earning their profits from the specified/defined activity/contract type, then a comparator benchmark cannot be supported.
- We observe the range of SSRO defined “activity types” seem to be a mix of market sectors and contract activity types e.g. IT and Construction are sectors that may indeed include contractual activities of D&M and P&M.



Recognising both the practical constraints and towards a more consistent approach we recommend considering whether comparability with qualifying contracts can be better achieved by recognising the market sector the contract resides in and comparator companies who earn their profits from comparable contracts in comparable sectors, for example:

- Aerospace, Space and Defence
- IT
- Construction
- Ancillary services

Question 1:

Do you support the removal of rental and leasing activities from the types of activity included in the baseline profit rate assessment?

Yes

We would have appreciated the SSRO sharing analysis of qualifying contracts let showing the number and value that are pure rental, or leasing contracts, as compared to the total to support making a decision to exclude rental and leasing or not. In the absence of this we have relied on [REDACTED] a freedom of information (FOI) request number 58 where they did not identify any pure rental and/or leasing contracts.

Question 2:

Do you support replacing the current distinct activity types of D&M and P&M with a new single ‘Develop, Make and Support’ (DM&S) activity type, if rental and leasing were removed from P&M?

In response to the two elements of this question

Do you support replacing the current distinct activity types of D&M and P&M with a new single ‘Develop, Make and Support’ (DM&S) activity type?

Yes.

It is not possible to support two separate populations as analysis has shown 90% of companies included in the D&M and P&M comparator groups perform both contract activity types. We believe “The activity we are seeking” description in appendix 3 should capture the nature of the contract and the sector it relates to in order to understand the market and regulatory context. This description should also be used when seeking companies earning profits from conducting comparable contracts.

We are concerned the descriptions included in the “types of contractual relationships observed in defence procurement...” are not all comparable with qualifying contracts. Some are unrelated or too broad in description and likely to result in companies that are not performing comparable contracts being included e.g.: Structural metal goods, containers, general machinery, vessels. We think including such descriptors has led to companies who are not conducting comparable contracts being included in the comparator groups.

Do you support removal of rental and leasing from P&M?

Yes.

As explained in our response to question 1, we would welcome the SSRO sharing analysis of qualifying contracts with stakeholders. Subject to more complete analysis being shared by the SSRO, and relying on [REDACTED] where they did not identify any qualifying “pure” leasing or rental contracts, we agree that rental and leasing should be removed.



Question 3:

Do you support technical support services being added in the DM&S activity type (subject to proposal 2) in the proposed manner?

No.

We are unsure why this question is predicated on proposal 2.

Recognising Phase 1 of the review explained the SSRO “identified 34 qualifying contracts (6 per cent) that undertake technical support services. They account for 10 per cent of the qualifying contracts’ total contract price.” We believe this is explaining there are relatively few purely technical support services qualifying contracts.

We again would find it helpful if the SSRO shared analysis of qualifying contracts let to date and the number and value that were pure technical support contracts as compared to the total population of qualifying contracts let. Without that information and again [REDACTED] review of FOI 058 we believe there are relatively few technical support contracts. [REDACTED] they were placed with contractors who have other D&M/P&M contracts and whose parent companies already form part of the SSRO’s D&M/P&M comparator groups.

Therefore, we see no reason to make any changes for technical support services as NACE codes 712 and 749 already form part of the D&M/P&M comparator group search criteria and we do not agree with the NACE codes 3820 or 8020 being included as this will likely result in companies who are not conducting comparable contracts, to qualifying contracts, being included in the D&M/P&M CGs. As regards NACE code 7112 we have not seen evidence of the activities under this code being let as qualifying contracts, but are open to such evidence being provided.

It would be helpful, in making a considered response, if the details of the 22 companies mentioned in the SSRO initial review were shared.

Question 4:

Do you support labour outsourcing being added in the Ancillary Services activity type in the proposed manner?

No.

Phase 1 of the review explained “The review identified seven qualifying contracts (one per cent) which undertake labour outsourcing activities. They account for less than one per cent of the qualifying contracts’ total contract price. The activities undertaken by the qualifying contracts under this category mainly relate to provision of a labour pool to undertake tasks as directed by the MOD”. This suggests labour outsourcing was immaterial (1%) and to the extent it happened it was part of a larger qualifying contract. The activity itself does also not seem consistent with the current ancillary services definition of being output based and self-directed and we would imagine such activities would normally be through competition. Therefore, we do not support the inclusion of labour outsourcing and NACE code series 78 to Ancillary Services.

We note the NACE codes 821 and 811 are already included in Ancillary Services (i.e. there is no change) and for the reasons explained above we do not agree with the proposed inclusion of NACE codes 781, 782, or 783 to Ancillary Services.



In addition, do you have any feedback on our proposals as to how the SSRO will implement these proposed changes to the BPR methodology?

██████████ we request the SSRO consider focusing comparability at the level of the contract, as that is the transaction between the two parties being priced and the attributes of the market sector the contract is let with (as per DSIS paragraph 24).

We agree the SSRO should combine D&M and P&M, focused on the AS&D sector in the 2025/26 assessment.

We don't agree with:

- The inclusion of technical support services and the proposed NACE codes – 3820, 8020 or 7112 (we would reconsider 7112 if further information is provided)
- The inclusion of labour outsourcing and the proposed associated NACE codes to Ancillary Services

We agree with the methodology maintaining the three year rolling average.

Yours sincerely

J A Schofield

VP Finance

5. MBDA

I am writing to confirm that MBDA are supportive [REDACTED] on the above consultation as set out within the [REDACTED] response.

6. Ministry of Defence (MOD)

General Points

The MOD supports the methodology used by the SSRO to calculate the Baseline Profit Rate. The regulations have now been in place for a decade and we support the SSRO decision to review the methodology to ensure it continues to provide a fair return to industry while balancing value for money for the taxpayer.

Question 1: Do you support the removal of rental and leasing activities from the types of activity included in the baseline profit rate assessment?

Yes.

Question 2: Do you support replacing the current distinct activity types of D&M and P&M with a new single 'Develop, Make and Support' (DM&S) activity type, if rental and leasing were removed from P&M?

Yes. Consolidating the groups is a pragmatic change to streamline the process.

Question 3: Do you support technical support services being added in the DM&S activity type (subject to proposal 2) in the proposed manner?

Yes.

Question 4: Do you support labour outsourcing being added in the Ancillary Services activity type in the proposed manner?

Yes.

In addition do you have any feedback on our proposals as to how the SSRO will implement these proposed changes to the BPR methodology?

We note that the SSRO intend to bring in the changes over a two year period to align with their review cycle. The MOD would suggest that making changes 1-3 in the 25/26 cycle would be a more efficient way to adjust the groups in one go, but also accept the SSRO's point that gradually changing the comparator might result in less volatility to the rate.