

*Draft Order laid before Parliament under section 42(4) of the Defence Reform Act 2014, for approval  
by resolution of each House of Parliament.*

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DRAFT STATUTORY INSTRUMENTS

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**2014 No. 0000**

**PUBLIC PROCUREMENT**

**The Single Source Contract Regulations 2014**

*Made - - - - xx*

*To come into force in accordance with Regulation 1.*

A draft of these Regulations has been laid before Parliament and approved by a resolution of each House of Parliament.

The Secretary of State, in exercise of the powers conferred by sections 14(2)(b) and (c), (6) and (8), 15, 16(1), 17(1) and (2), 18(2)(c), (3) and (4), 21, 23(1), (4) and (5), 24(1) to (3) and (4)(a), 25(1), (2), (4) and (6), 27(1) and (3), 28(3)(c) and (d), (4)(c) and (d) and (5), 29, 30(2)(a) and (3) to (5), 31(3)(a) and (b) and (5), 32(5), 33(1) and (6), 35(1), 38, 41, 42(1) and (2), 43(2) of, and paragraph 1(1)(c) of Schedule 5 to, the Defence Reform Act 2014(1), makes the following Regulations:

**PART 1**

**General**

**Citation and commencement**

**1.** These Regulations may be cited as the Single Source Contract Regulations 2014 and come into force on the day after the day on which they are made.

**Interpretation**

**2.—(1)** In these Regulations—

“the Act” means the Defence Reform Act 2014, and references to sections and Schedules are references to sections of, and Schedules to, that Act;

“business unit” means either—

(a) a unit—

(i) which carries on any activities for the purposes of an undertaking; and

- (ii) for which separate financial accounting statements are produced; or
- (b) an undertaking, or group of two or more undertakings, for which a single set of financial accounting statements is produced which is separate from the financial accounting statements of each of those undertakings;

“contract completion date” has the meaning given by regulation 4;

“contract price” means—

- (a) the contract price determined in accordance with regulation 10; or
- (b) if the contract price has been re-determined in accordance with regulation 14, the price as re-determined;

“cost recovery base” means the unit of measure to which a cost recovery rate is applied in order to calculate a cost under a contract;

“cost recovery rate” means a rate calculated for a business unit that is used to determine a cost payable under a contract, being a rate per unit of a cost recovery base that is multiplied by the quantum of that cost recovery base to determine the cost;

“deliverable” means any goods, works or services which—

- (a) are provided under a contract; and
- (b) can be described using an output metric;

“further group sub-contract” has the meaning given by regulation 12(6);

“group sub-contract” has the meaning given by regulation 12(5);

“output metric” means a quantifiable description of any goods, works or services (including a number, weight, dimension, time or physical capability, but not including a monetary value);

“parent undertaking” has the meaning given by section 1162 of the Companies Act 2006<sup>(2)</sup>;

“regulated pricing method” means one of the six pricing methods described in paragraphs (4), (5), (6), (7) and (8), (9) and (10), or (11) of regulation 10;

“SME” has the meaning given in Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises<sup>(3)</sup>;

“TCIF adjustment” means an adjustment made under section 16(1)(b);

“the time of agreement” means—

- (a) in the case of a contract which is a qualifying defence contract by virtue of section 14(3), or a qualifying sub-contract—
  - (i) the date the contract is entered into; or
  - (ii) if the price payable under the contract is re-determined under regulation 14, the date of that re-determination;
- (b) in the case of a contract which is a qualifying defence contract by virtue of section 14(4) or (5)—
  - (i) the date of the amendment mentioned in section 14(4)(c) or (5)(b); or
  - (ii) if the price payable under the contract is re-determined under regulation 14, the date of that re-determination;

“undertaking” has the meaning given by section 1161(1) of the Companies Act 2006;

“working day” means any day excluding—

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(2) 2006 c.46.

(3) O.J. L 124, p. 36-41, of 20 May 2003.

- (a) Saturday, Sunday, Christmas Day, Good Friday or a bank holiday under the Banking and Financial Dealings Act 1971(4); and
- (b) where a person gives the Secretary of State and the SSRO no less than 30 days' written notice of its intention to treat a day as a holiday, that day.

(2) A reference to a report provided under Part 5 includes a contract pricing statement (regulation 23), a contract reporting plan (regulation 24), a contract costs statement (regulation 29), and information provided under regulation 30 (on-demand contract report).

### **Meaning of “defence purposes”**

3. ”Defence purposes” means the purposes of defence (whether or not of the United Kingdom), or related purposes.

### **Meaning of “contract completion date”**

- 4.—(1) The “contract completion date”, in relation to a contract, means—
- (a) the date described in the contract as the contract completion date; or
  - (b) if no such date is described in the contract, the date on which the contractor completes all obligations which entitle it to final payment under the contract;
  - (c) if the contract is terminated before the date described in sub-paragraph (1)(a) or (b) (as the case may be), the date on which the contract is terminated.
- (2) For the purposes of paragraph (1)(b), final payment under a contract does not include—
- (a) any payment relating to the effect of specified indices or rates (regulation 10(5) or (10));
  - (b) any TCIF adjustment;
  - (c) any payment under regulation 16 (final price adjustment); or
  - (d) any amount which is determined by the SSRO to be payable.

### **Calculating the value of a contract**

- 5.—(1) The value of a contract is to be determined—
- (a) by the contracting authority; and
  - (b) in accordance with this regulation.
- (2) For the purposes of the Act and these Regulations, the value of a contract means the consideration (net of value added tax) which the contracting authority expects will be payable under the contract.
- (3) The contracting authority must determine the value of a contract—
- (a) in the case of a proposed contract under regulation 12(1) (calculation of POCO adjustment) or 61 (assessing whether a contract would be a qualifying sub-contract), either—
    - (i) at the date of the assessment under regulation 12(1) or 61 (as the case may be), or
    - (ii) at any later date on which it is proposed to enter into the contract,whichever is the higher;
  - (b) in the case of a contract which is a qualifying defence contract by virtue of section 14(4) or (5), at the date of the amendment mentioned in section 14(4)(c) or (5)(b);
  - (c) in all other cases, the date the contract is entered into.

- (4) In making that determination, a contracting authority must—
- (a) where appropriate, take account of—
    - (i) any option contained in the contract and the likelihood that it will be exercised;
    - (ii) any effect which changes in the value of money are likely to have on the allowable costs it expects to be included in the contract price;
  - (b) exclude the value of any land, buildings, equipment, information, personnel or other resource that is provided by the Secretary of State;
  - (c) convert any amounts payable under the contract in a foreign currency to sterling, using a rate consistent with the contracting authority's accounting policies.
- (5) Subject to paragraphs (6) and (12), where—
- (a) the purpose of the contract is to fulfil a requirement for goods, works or services, and
  - (b) the contracting authority has also entered into, or proposes to enter into, one or more other contracts with the same person (or persons associated with that person) for the purpose of fulfilling that requirement,

the value of the contract is the aggregate of the consideration which the contracting authority has paid or expects to be payable under the contract and all of those other contracts or proposed contracts.

- (6) For the purposes of paragraph (5)(b)—
- (a) the contracting authority may disregard a contract if conditions A and B are met in relation to it;
  - (b) the contracting authority may disregard a proposed contract if, were it entered into on the terms proposed, conditions A and B would be met in relation to it.
- (7) Condition A is that the contract has a value of less than £1,000,000.
- (8) Condition B is that the aggregate value of—
- (a) that contract, and
  - (b) any other such contract within paragraph (5)(b), each of which has a value of less than £1,000,000,

is less than 20% of the aggregate of the consideration which the contracting authority has paid or expects to be payable under all contracts entered into, or to be entered into, for the purpose of fulfilling the requirement mentioned in paragraph (5)(a).

(9) Where the contract is one of a series of contracts entered into, or to be entered into, by the contracting authority with a person (or any person associated with that person) for the purpose of fulfilling a requirement over a period for goods, works or services, the contracting authority may determine the value of the contract in accordance with either paragraph (10) or paragraph (11).

(10) The contracting authority may determine the value of the contract by taking the aggregate of the consideration payable under the contract and all other contracts which—

- (a) have similar characteristics to the contract,
- (b) are for the purposes of the requirement mentioned in paragraph (9), and
- (c) have been entered into in the period of 12 months ending immediately before the time of agreement,

and adjusting that amount to take account of any expected changes in quantity and cost of the goods, works or services to be provided in the period of 12 months starting at the time of agreement.

(11) The contracting authority may determine the value of the contract by estimating the aggregate of the value of the consideration which the contracting authority expects to be payable under the contract and all other contracts, or proposed contracts, which—

- (a) have similar characteristics to the contract;
- (b) are for purposes of the requirement mentioned in paragraph (9); and
- (c) will be entered into in the period of 12 months starting at the time of agreement.

(12) Where—

- (a) the contract is for goods, works or services which are required for the sole purposes of a discrete operating unit within the contracting authority,
- (b) the discretion whether to procure those goods, works or services has been devolved to that unit, and
- (c) the decision to procure them is taken independently by that unit,

references in this regulation to other contracts and proposed contracts include only contracts entered into, or proposed to be entered into, for the sole purposes of that unit.

(13) In this regulation, “the contracting authority” means the party to the contract which is, or would be, liable to pay the contract price.

## PART 2

### Qualifying defence contracts

#### **Threshold value for qualifying defence contracts**

6.—(1) In the case of a contract to which section 14(3) applies, the amount specified for the purposes of section 14(2)(b) (threshold value for qualifying defence contracts) is—

- (a) if the contract is entered into before 31 March 2015, £500,000,000;
- (b) otherwise, £5,000,000.

(2) In the case of a contract to which section 14(4) or section 14(5) applies, the amount specified for the purposes of section 14(2)(b) is £5,000,000.

#### **Contracts that may not be qualifying defence contracts**

7. The contracts specified for the purposes of section 14(2)(c) (contracts that may not be qualifying defence contracts) are contracts—

- (a) to which the government of any country other than the United Kingdom is party;
- (b) made within the framework of an international cooperative defence programme; or
- (c) made wholly for the purposes of one or more of the following—
  - (i) the acquisition of land (including existing buildings or other structures, and land covered with water), and any estate, interest, easement, servitude or right in or over such land;
  - (ii) the management or maintenance of any land or buildings or other structures; or
  - (iii) intelligence activities.

#### **Competitive process for single contracts**

8.—(1) Where the Secretary of State enters into a contract with a primary contractor, the award of the contract is the result of a competitive process if—

- (a) the Secretary of State either—

- (i) published (in the Official Journal or elsewhere) a notice of intention to seek offers in relation to a proposed contract; or
  - (ii) invited one or more persons other than the primary contractor, and not associated with the primary contractor, to negotiate or provide offers in relation to a proposed contract;
  - (b) the material terms of the contract are wholly or substantially the same as were offered by the primary contractor in its tender for, or in negotiations relating to, that proposed contract; and
  - (c) at the time of making its offer, the primary contractor did not consider it likely, or could not reasonably have considered it likely, that its offer would be the only offer reasonably capable of acceptance by the Secretary of State.
- (2) Where the Secretary of State is party to a contract with a primary contractor the award of which is the result of a competitive process, any amendment to that contract is the result of a competitive process if—
- (a) the Secretary of State either —
    - (i) published (in the Official Journal or elsewhere) a notice of intention to seek offers in order to obtain the goods, works or services provided under the amendment or amended contract; or
    - (ii) invited one or more persons other than the primary contractor, and not associated with the primary contractor, to negotiate or provide offers in relation to those goods, works or services;
  - (b) the material terms of the amendment or amended contract are wholly or substantially the same as were offered by the primary contractor in its tender for, or in negotiations relating to, those goods, works or services; and
  - (c) at the time of making its offer, the primary contractor did not consider it likely, or could not reasonably have considered it likely, that its offer would be the only offer reasonably capable of acceptance by the Secretary of State.

### **Competitive process for contracts made under a framework agreement**

- 9.—(1) This regulation applies where the Secretary of State—
- (a) has either—
    - (i) published (in the Official Journal or elsewhere) a notice of intention to seek offers in relation to a proposed agreement or other arrangement (“framework agreement”) which establishes terms under which a person (a “framework contractor”) would enter into one or more contracts with the Secretary of State in the period during which the framework agreement applies; or
    - (ii) invited two or more persons to negotiate or provide offers in relation to the terms of a proposed framework agreement;
  - (b) has entered into a framework agreement with one or more framework contractors; and
  - (c) enters into a contract with a primary contractor.
- (2) The award of a contract is the result of a competitive process if—
- (a) the terms governing the price payable under the contract are determined by a framework agreement and the conditions in paragraph (3) are met; or
  - (b) the terms governing the price payable under the contract are determined by a competition between two or more framework contractors and the conditions in paragraph (4) are met.
- (3) The conditions mentioned in paragraph (2)(a) are—

- (a) the material terms of the framework agreement are wholly or substantially the same as were offered by the framework contractor—
    - (i) in a tender submitted in response to the notice mentioned in sub-paragraph (a)(i); or
    - (ii) in negotiations following the invitation mentioned in sub-paragraph (a)(ii);
  - (b) at the time of making that offer, the framework contractor did not consider it likely, or could not have reasonably considered it likely, that its offer would be the only offer reasonably capable of acceptance by the Secretary of State; and
  - (c) where this regulation applies by virtue of paragraph (1)(a)(ii), the persons mentioned in that paragraph included at least one person who was not the primary contractor (or a person associated with the primary contractor).
- (4) The conditions mentioned in paragraph (2)(b) are—
- (a) at least one of those framework contractors was not the primary contractor (or a person associated with the primary contractor);
  - (b) the terms governing the price payable under the contract are wholly or substantially the same as were offered by the primary contractor in its tender for the contract or in negotiations during that competition; and
  - (c) the primary contractor did not consider it likely, or could not have reasonably considered it likely, that its offer in respect of the contract would be the only offer reasonably capable of acceptance by the Secretary of State.

## PART 3

### Pricing of contracts

#### **Pricing of contracts**

**10.—**(1) The price payable under a qualifying defence contract to the primary contractor must be determined in accordance with the formula—

$$(CPR \times AC) + AC$$

Where

- (a) “CPR” is the contract profit rate for the contract, determined in accordance with regulation 11; and
- (b) “AC” means the primary contractor’s allowable costs (see section 20), determined in accordance with one of the six regulated pricing methods described in paragraphs (4) to (11) below.

(2) The parties to a qualifying defence contract may agree which of the regulated pricing methods is to be used for that qualifying defence contract.

(3) The parties to a qualifying defence contract may agree that different regulated pricing methods are to be used for defined components of that contract.

#### *Firm pricing method*

(4) Under the firm pricing method, the allowable costs are the allowable costs as estimated at the time of agreement.

#### *Fixed pricing method*

(5) Under the fixed pricing method, the allowable costs are the allowable costs as—

- (a) estimated at the time of agreement; and
- (b) adjusted in accordance with changes in specified indices or rates between the time of agreement and a specified time (and different times, indices or rates may be specified in relation to different allowable costs).

*Cost-plus pricing method*

(6) Under the cost-plus pricing method, the allowable costs are the actual allowable costs determined during the contract or after the contract completion date.

*Estimate-based fee pricing method*

(7) Under the estimate-based fee pricing method, the allowable costs by which the CPR is multiplied are the allowable costs as estimated at the time of agreement.

(8) The allowable costs which are added to the product of the CPR and the allowable costs determined in accordance with paragraph (7) are the actual allowable costs determined during the contract or after the contract completion date.

*Volume-driven pricing method*

(9) Under the volume-driven pricing method, the allowable costs are the allowable costs per unit of volume multiplied by the actual volume of output of the contract.

(10) The allowable costs—

- (a) must be estimated at the time of agreement; and
- (b) may be adjusted in accordance with changes in specified indices or rates between the time of agreement and a specified time (and different times, indices or rates may be specified in relation to different allowable costs).

*Target pricing method*

(11) Under the target pricing method, the allowable costs are the allowable costs as estimated at the time of agreement.

(12) In this regulation, “specified” means specified in the contract at the time of agreement.

**Steps in determining contract profit rate**

**11.**—(1) The contract profit rate for any qualifying defence contract must be calculated by taking the following six steps.

*Step 1 – baseline profit rate*

(2) Take the baseline profit rate in force at the time of agreement, which is—

- (a) until 31 March 2015, 10.70%;
- (b) on or after 1 April 2015, the rate published in the London Gazette in accordance with section 19(4).

*Step 2 – cost risk adjustment*

(3) Adjust the baseline profit rate by an agreed amount which is within a range of plus or minus 25% of the baseline profit rate, so as to reflect the risk of the primary contractor’s actual allowable costs under the contract differing from its estimated allowable costs.

*Step 3 – profit on cost once*



(4) Deduct from the amount resulting from step 2 the adjustment determined in accordance with regulation 12 (“the POCO adjustment”), so as to ensure that profit arises only once in relation to those allowable costs under the contract that relate to the price payable under any group sub-contract (including any further group sub-contract).

*Step 4 – SSRO funding adjustment*

(5) Deduct from the amount resulting from step 3 the SSRO funding adjustment in force at the time of agreement, which is—

- (a) until 31 March 2017, zero;
- (b) on or after 1 April 2017, the rate published in the London Gazette in accordance with section 19(4).

*Step 5 – incentive adjustment*

(6) Where the Secretary of State determines that the amount resulting from step 4 should be increased so as to give the primary contractor a particular financial incentive as regards the performance of provisions of the contract specified by the Secretary of State, increase that amount by an amount (“the incentive adjustment”) specified by the Secretary of State, that amount not to exceed two percentage points.

*Step 6 – capital servicing adjustment*

(7) Take the amount resulting from step 5 and add to or subtract from it an agreed amount (“the capital servicing adjustment”), so as to ensure that the primary contractor receives an appropriate and reasonable return on the fixed and working capital employed by the primary contractor for the purposes of enabling the primary contractor to perform the contract.

(8) In agreeing the capital servicing adjustment, the primary contractor and the Secretary of State—

- (a) must have regard to the capital servicing rates in force at the time of agreement;
- (b) must not apply any adjustment in respect of any costs of the fixed and working capital employed by the primary contractor which are allowable costs under the contract; and
- (c) may use an average fixed and working capital for any business unit which is likely to be performing the primary contractor’s obligations under the contract.

(9) The capital servicing rates are—

- (a) until 31 March 2015—
  - (i) for fixed capital, 6.20%;
  - (ii) for positive working capital, 2.07%;
  - (iii) for negative working capital, 1.25%;
- (b) on or after 1 April 2015, the rate published in the London Gazette in accordance with section 19(4).

**Calculation of profit on cost once (“POCO”) adjustment**

**12.—**(1) This paragraph applies to a qualifying defence contract if, at the time of agreement, the primary contractor is party to, or proposes to enter into, a group sub-contract.

(2) Where paragraph (1) applies to a qualifying defence contract, and the Secretary of State is satisfied that—

- (a) the allowable costs of that qualifying defence contract that relate to the price payable under any group sub-contract have been decreased by an amount equal to the attributable profit on that group sub-contract, and
- (b) the allowable costs of that qualifying defence contract that relate to the price payable under any further group sub-contract which relates to the group sub-contract described in paragraph (a) have been decreased by an amount equal to the attributable profit on that further group sub-contract,

the POCO adjustment is zero.

(3) Where paragraph (1) applies to a qualifying defence contract, and the Secretary of State is not satisfied of the matters described in paragraph (2)—

- (a) the parties may agree an amount by which the contract profit rate for that qualifying defence contract must be decreased in order to exclude the attributable profit that has been included;
- (b) the POCO adjustment is the amount so agreed.

(4) Where paragraph (1) does not apply to a qualifying defence contract, the POCO adjustment is zero.

(5) “Group sub-contract” means a contract—

- (a) the price payable under which includes an amount of profit;
- (b) which is made between the primary contractor and any person associated with the primary contractor;
- (c) the value of which is no less than £100,000;
- (d) the award of which was not the result of a competitive process (as defined in regulation 59 or 60); and
- (e) where the goods, works or services to be provided under the contract are necessary to enable the performance of the qualifying defence contract.

(6) “Further group sub-contract” means a contract—

- (a) the price payable under which includes an amount of profit;
- (b) which is made between two or more persons, each of which is associated with the primary contractor or a group sub-contractor;
- (c) the value of which is no less than £100,000;
- (d) the award of which was not the result of a competitive process (as defined in regulation 59 or 60); and
- (e) where the goods, works or services to be provided under the contract are necessary to enable the performance of a group sub-contract or further group sub-contract.

(7) The attributable profit is—

- (a) where all of the output of a group sub-contract or further group sub-contract is necessary to enable the performance of the qualifying defence contract, all the profit element in the price payable under that group sub-contract or further group sub-contract;
- (b) where only part of the output of a group sub-contract or further group sub-contract is necessary to enable the performance of the qualifying defence contract, that part of the profit element in the price payable under that group sub-contract or further group sub-contract which relates to the output necessary for that performance.

(8) Attributable profit does not include—

- (a) any capital servicing adjustment made under step 6 of regulation 11;

(b) any profit which is received by a person which is not associated with the primary contractor.

(9) In determining the value of a contract for the purposes of sub-paragraph (5)(c) or (6)(c) (as the case may be), paragraphs (5) to (12) of regulation 5 do not apply.

(10) In this regulation, “group sub-contractor” means a person with which the primary contractor makes a group sub-contract.

### **Rates agreed on a group basis**

**13.**—(1) This regulation applies where the Secretary of State proposes to enter into two or more qualifying defence contracts with the same primary contractor (“the prospective contractor”) within the period of one year (“the relevant year”).

(2) The prospective contractor and the Secretary of State may agree an amount which may be used as the cost risk adjustment (regulation 11(3)) for any qualifying defence contract entered into between the prospective contractor and the Secretary of State within the relevant year, so as to reflect the risk of the primary contractor’s actual allowable costs under any qualifying defence contract differing from its estimated allowable costs.

(3) An amount agreed under paragraph (2) must be within a range of plus or minus 25% of the baseline profit rate.

(4) The prospective contractor and the Secretary of State may agree an amount which may be used as the POCO adjustment (regulation 12(3)) for any qualifying defence contract entered into between the prospective contractor and the Secretary of State within the relevant year, so as to ensure that profit arises only once in relation to those allowable costs under any qualifying defence contract that relate to the price payable under any group-sub-contract (including any further group sub-contract).

(5) The prospective contractor and the Secretary of State may agree an amount which may be used as the capital servicing adjustment (regulation 11(7)) for any qualifying defence contract entered into between the prospective contractor and the Secretary of State within the relevant year, so as to ensure that the primary contractor receives an appropriate and reasonable return on the fixed and working capital employed by the primary contractor for the purposes of enabling the primary contractor to perform any qualifying defence contract.

(6) In agreeing a capital servicing adjustment under paragraph (5), the prospective contractor and the Secretary of State must—

- (a) have regard to the capital servicing rates in force at the date that the amount is agreed;
- (b) not apply any adjustment in respect of any costs of fixed and working capital which are expected to be included as allowable costs under any qualifying defence contracts to which the amounts agreed under this regulation will apply; and
- (c) use an average fixed and working capital for any business unit which is likely to be performing the primary contractor’s obligations under any such qualifying defence contracts.

### **Re-determination of contract price**

**14.**—(1) This regulation applies where the Secretary of State and the primary contractor propose to amend a qualifying defence contract (or a defined component of a qualifying defence contract) in a way that would affect the price determined under regulation 10 or this regulation.

(2) Where the allowable costs relating to the amendment are severable from the allowable costs under the contract before the amendment, the amended contract price is the total of—

- (a) the price payable under the contract before the amendment; and

- (b) any increase or decrease in the price payable under the contract which is attributable to the amendment.
- (3) Where paragraph (2) applies—
  - (a) the price payable in respect of the amendment must be determined in accordance with the formula in regulation 10(1);
  - (b) the parties to the contract may agree which of the regulated pricing methods is to be used.
- (4) Where paragraph (2) does not apply—
  - (a) the price payable under the amended contract must be re-determined in accordance with the formula in regulation 10(1);
  - (b) the parties to the amended contract may agree—
    - (i) which of the regulated pricing methods is to be used for the amended contract;
    - (ii) that defined components of the amended contract will be priced by different pricing methods.

#### **Target cost incentive fee (“TCIF”) adjustment**

15. The circumstances specified for the purposes of section 16(1) are that—
- (a) the qualifying defence contract—
    - (i) contains provision to the effect that the total price payable under the contract (or any defined component of the contract) is subject to adjustment in accordance with section 16(1)(b); and
    - (ii) specifies the matters which must be taken into account in determining the amount of that adjustment; and
  - (b) the price payable under the contract (or those defined components) was determined using the target pricing method.

#### **Procedure for determining final price adjustment**

16.—(1) The amount specified for the purposes of section 21(4)(b) (value of qualifying defence contract of or above which this regulation applies) is £5,000,000, and an adjustment may be made to the total price payable by the Secretary of State under a qualifying defence contract (“final price adjustment”) if either—

- (a) the price payable under the contract—
    - (i) has been determined by the firm pricing method, the fixed pricing method or the volume-driven pricing method; and
    - (ii) the total value of the contract is of or above that amount; or
  - (b) the price payable under one or more defined components of the contract—
    - (i) has been determined by the firm pricing method, the fixed pricing method or the volume-driven pricing method; and
    - (ii) the total value of the defined component or components the price of which has been so determined is of or above that amount.
- (2) The amount specified for the purposes of section 21(5)(b) (value below which direction excluding final price adjustment may be made) is £50,000,000.
- (3) The matter specified for the purposes of section 21(6) (matters to which the Secretary of State must have regard in deciding whether to make such a direction) is the effect that making a direction

might have on the terms of any subsequent contract that the Secretary of State expects to enter into with that primary contractor.

(4) A final price adjustment may only be made where the amount of the adjustment would be at least £250,000.

(5) The Secretary of State may, within—

- (a) three months after receiving a contract costs statement (regulation 29), or
- (b) 15 months after the contract completion date,

whichever is the sooner, notify the primary contractor that the Secretary of State intends to make a final price adjustment.

(6) The primary contractor may, within three months after providing a contract costs statement, notify the Secretary of State that it intends to make a final price adjustment.

(7) Where a notice is given under paragraph (5) or (6), the Secretary of State and the primary contractor must attempt to agree the amount of the final price adjustment, but if they are unable to reach an agreement either the Secretary of State or the primary contractor may refer the matter to the SSRO for determination.

(8) A reference under paragraph (7) may be made—

- (a) after the contract completion date; but
- (b) no later than two years after the contract completion date.

(9) In making a determination, the SSRO must have regard to—

- (a) the information that was available to each party at the time of agreement;
- (b) whether the parties disclosed, in a timely manner, the facts and assumptions they used to determine the allowable costs or the contract profit rate;
- (c) efforts made by the parties to determine whether any allowable cost included in the price payable under the contract met the requirements set out in section 20(2)(a) to (c);
- (d) any evidence that reductions in the actual costs under the contract are due to efficiency measures taken by the primary contractor.

### **Calculation of final price adjustment**

**17.**—(1) Where the outturn profit rate exceeds the contract profit rate, the final price adjustment is to be calculated in accordance with whichever of paragraphs (2) to (4) applies.

(2) Where the difference is at least 5% but less than 10%, the contract price is decreased by an amount equal to 25% of the outturn profit which exceeds excess level 1.

(3) Where the difference is at least 10% but less than 15%, the contract price is decreased by an amount equal to the total of—

- (a) 50% of the outturn profit above excess level 2; and
- (b) 25% of the outturn profit above excess level 1 (but excluding the outturn profit which is above excess level 2).

(4) Where the difference is at least 15%, the contract price is decreased by an amount equal to the total of—

- (a) 75% of the outturn profit above excess level 3;
- (b) 50% of the outturn profit above excess level 2 (but excluding the outturn profit which is above excess level 3); and
- (c) 25% of the outturn profit above excess level 1 (but excluding the outturn profit which is above excess level 2).

- (5) Where the outturn costs exceed the contract price, the contract price is increased by the total of—
- (a) an amount equal to 25% of that excess up to the loss level; and
  - (b) an amount equal to 50% of any such excess above the loss level.
- (6) In this regulation—
- (a) “excess level 1” means the contract profit which would have been achieved under the contract (before the application of the final price adjustment) if—
    - (i) “AC” in the formula in regulation 10(1) were the outturn costs; and
    - (ii) the contract profit rate were 5 percentage points higher;
  - (b) “excess level 2” means the contract profit which would have been achieved under the contract (before the application of the final price adjustment) if—
    - (i) “AC” in the formula in regulation 10(1) were the outturn costs; and
    - (ii) the contract profit rate were 10 percentage points higher;
  - (c) “excess level 3” means the contract profit which would have been achieved under the contract (before the application of the final price adjustment) if—
    - (i) “AC” in the formula in regulation 10(1) were the outturn costs; and
    - (ii) the contract profit rate were 15 percentage points higher;
  - (d) “loss level” means the loss which the primary contractor would have made under the contract (before the application of the final price adjustment) had the outturn costs been 5% higher than the contract price;
  - (e) “outturn costs” means the amount of the primary contractor’s actual costs under the contract which meet the requirements set out in section 20(2)(a) to (c);
  - (f) “outturn profit” means the difference between the contract price and the outturn costs;
  - (g) “outturn profit rate” means the outturn profit, expressed as a percentage of the outturn costs;
  - (h) references to “the difference” are to the difference between the outturn profit rate and the contract profit rate;
  - (i) references to the contract profit rate or contract price exclude any amount resulting from step 5 of regulation 11 (incentive adjustment);
  - (j) references to actual costs or the contract price exclude any liquidated damages or interest on overdue payments payable under the terms of the contract.

### **Determination of contract profit rate adjustments**

**18.**—(1) This regulation applies to any adjustment that has been agreed under step 2, 3 or 6 in regulation 11 (including an adjustment agreed on a group basis under regulation 13).

(2) The SSRO may, on an application by the Secretary of State or the primary contractor made within two years after the contract completion date, determine whether the amount of the adjustment is appropriate.

- (3) In making a determination, the SSRO must have regard to—
- (a) the information that was available to each party, and
  - (b) the statutory guidance in place,

at the time of agreement.

(4) In making a determination that relates to the amount of an adjustment agreed under step 2 (cost risk adjustment), the SSRO must have regard to the terms of the contract.

(5) If the SSRO determines that the amount of the adjustment was not appropriate, it may determine that the contract price is to be adjusted by a specified amount.

#### **Determination of allowable costs**

**19.**—(1) The Secretary of State may not make an application under section 20(5) for a determination of the extent to which a particular cost is an allowable cost unless—

- (a) the Secretary of State has sent the primary contractor a written notice requiring the primary contractor to show that the requirements set out in section 20(2)(a) to (c) are met in relation to that cost;
  - (b) at least 20 working days have elapsed since the date of that notice; and
  - (c) no response, or no response which the Secretary of State considers to be satisfactory, has been received.
- (2) An application must be made within two years after the contract completion date.
- (3) In making a determination, the SSRO must have regard to—
- (a) the information that was available to each party at the time of agreement;
  - (b) the statutory guidance in place at the time of agreement;
  - (c) in the case of a contract which contains provision of the kind described in regulation 15 (TCIF adjustment), those provisions;
  - (d) whether the parties disclosed, in a timely manner, the facts and assumptions they used to determine the allowable costs or the contract profit rate.

## **PART 4**

### **Records**

#### **Duty to keep relevant records**

- 20.**—(1) Each of the following must keep relevant records, from the recording date—
- (a) in relation to a qualifying defence contract (including any report provided under Part 5 (reports on qualifying defence contracts) in relation to that contract), the primary contractor;
  - (b) in relation to any report provided under Part 6 (reports on overheads and forward planning etc), the designated person which is required to make that report.
- (2) In the case of a qualifying defence contract to which section 14(4) or (5) applies, the recording date is the earliest of—
- (a) the date the primary contractor received written notice from the Secretary of State that amendment negotiations had commenced;
  - (b) the date the contractor was invited to provide an offer to amend the contract;
  - (c) the date the contractor made an offer to amend the contract;
  - (d) the date of the amendment.
- (3) References in paragraph (2) to the amendment of the contract are to the amendment mentioned in section 14(4) or (5).
- (4) Where the award of a qualifying defence contract was the result of a process in which a notice of intention to seek offers was published (in the Official Journal or elsewhere), the recording date is the date of the publication of that notice.

- (5) For all other qualifying defence contracts, the recording date is the earliest of—
- (a) the date the primary contractor received written notice from the Secretary of State that contract negotiations had commenced;
  - (b) the date the Secretary of State published a voluntary transparency notice in relation to the contract;
  - (c) the date the primary contractor was invited to provide an offer;
  - (d) the date the primary contractor made an offer;
  - (e) the date on which the qualifying defence contract was entered into.
- (6) In the case of a report under Part 6, the recording date is the first day of the designated person’s accounting period relating to the relevant financial year for which that report is provided.
- (7) Subject to paragraph (8), the duty to keep a relevant record for a qualifying defence contract (including any report under Part 5 which relates to that contract) ends —
- (a) two years after the contract completion date, or
  - (b) six years after the end of the accounting period of the contractor in which the duty first arose,
- whichever is the earlier.
- (8) If at the time mentioned in paragraph (7) a reference, application or appeal to the SSRO in relation to the contract has been made but not yet determined, the duty to keep relevant records ends three months after the reference, application or appeal is determined.
- (9) The duty to keep a relevant record in relation to any report provided under Part 6 ends—
- (a) two years after the end of the designated person’s accounting period relating to the last relevant financial year in relation to which the ongoing contract condition is met, or
  - (b) six years after the end of the designated person’s accounting period in which the duty first arose,
- whichever is the earlier.
- (10) In paragraph (9)(a), the reference to the ongoing contract condition being met has the meaning given in regulation 31(3) (application of Part 6).
- (11) In this regulation, “voluntary transparency notice” has the meaning given by regulation 60(4) of the Defence and Security Public Contracts Regulations 2011(5).

### **Examination of relevant records**

- 21.**—(1) The Secretary of State is entitled to examine relevant records where reasonably required for a purpose listed in section 23(3).
- (2) The Secretary of State must give written notice to the person which is required to keep relevant records (“P”) which describes the purposes for which the examination is required.
- (3) P must permit the Secretary of State to examine the records—
- (a) on any working day between the hours of 9 a.m. and 5 p.m.; and
  - (b) at least 20 working days after the date on which P receives the notice described in paragraph (2).
- (4) The Secretary of State may require P to make available a copy of any specified relevant records (in hard or electronic form) for the purpose of enabling those records to be examined.



(5) The Secretary of State may request P to provide further information or explanation relating to any relevant records (whether after the examination of those relevant records or otherwise).

(6) An application under section 23(6) (review by SSRO of exercise of functions in relation to records) may not be made more than three months after P's duty to keep relevant records has ended.

## PART 5

### Reports on qualifying defence contracts

#### General requirements and interpretation

**22.**—(1) In relation to any qualifying defence contract, the primary contractor must provide the reports specified in this Part.

(2) Every report provided under this Part must contain the following information—

- (a) the name, position and contact details of—
  - (i) the individual submitting the report;
  - (ii) an individual to be notified if any compliance notice or penalty notice is given in relation to the contract to which the report relates; and
  - (iii) the civil servant who is responsible for managing the contract on behalf of the Secretary of State;
- (b) the date the report is due;
- (c) the date the report is submitted;
- (d) any unique identifying number allocated to the contract by the contractor;
- (e) any unique identifying number allocated to the contract by the Secretary of State;
- (f) any contract title set out in the contract;
- (g) a brief description of the goods, works or services that are to be provided under the contract;
- (h) the date on which the contract was entered into;
- (i) the contract completion date (or, if that date is not known, the expected contract completion date);
- (j) the date and reference number of the most recent amendment which affects the price payable under the contract (if any);
- (k) the regulated pricing method or methods used in determining the price payable under the contract, and the amount of the price resulting from each method (if known); and
- (l) any business unit in relation to which a cost recovery rate has been used in determining the price payable under the contract.

(3) Every report provided under this Part by a contractor which is a registered company must contain the following information—

- (a) the registered name and company number of the contractor, and the address of its registered office;
- (b) any trading name which the contractor uses (if that is different from its registered name);
- (c) whether the contractor is an SME; and
- (d) the registered name and company number of any immediate parent undertaking of the contractor, and the address of its registered office.

- (4) Every report provided under this Part must—
- (a) be provided in electronic form; and
  - (b) be provided to the Secretary of State and to the SSRO.
- (5) Where a regulation requires an annual profile, that annual profile must be presented in a tabular format, with columns representing a continuous range of financial years from that in which the contract was entered into until that in which the contract completion date falls or is expected to fall.
- (6) Subject to regulation 29(3) and (4), where a regulation requires a statement of actual costs, nevertheless—
- (a) up to 5% of the costs may, without any explanation, be estimated costs;
  - (b) 5% or more of the costs may be estimated costs, if an explanation is given of—
    - (i) why it is not possible to provide actual costs at the time the report is provided; and
    - (ii) when actual costs will be available.
- (7) Where a regulation requires a breakdown of costs by defined pricing structure, that breakdown must be presented as a list of cost categories describing key components of the deliverables to be provided under the contract.
- (8) Except where otherwise provided in this Part, any reference to money in a report must be expressed in sterling.
- (9) In preparing a report, a contractor must have regard to any relevant guidance issued by the SSRO.
- (10) In this Part—
- (a) a reference to a contract reporting plan includes any information which has been provided in response to a written direction made under regulation 30(3)(b);
  - (b) “calendar quarter” means any of the following periods—
    - (i) 1 January to 31 March;
    - (ii) 1 April to 30 June;
    - (iii) 1 July to 30 September; and
    - (iv) 1 October to 31 December;
  - (c) “the initial reporting date” means—
    - (i) in the case of a contract which is a qualifying defence contract by virtue of section 14(4) or (5), the date of the amendment mentioned in section 14(4)(c) or (5)(b);
    - (ii) in all other cases, the date the contract was entered into.

### **Contract pricing statement**

**23.—**(1) The primary contractor must provide a contract pricing statement for the qualifying defence contract within one month of the initial reporting date.

- (2) A contract pricing statement must—
- (a) set out any allowable costs and the contract profit rate used to determine the contract price;
  - (b) set out the date and version of any statutory guidance made under section 18(1) or 20(1) in force at the time of agreement;
  - (c) describe any known deviation from that statutory guidance made in determining the contract price;

- (d) describe the calculation that was made under regulation 11 to determine the contract profit rate, including all adjustments that were made under steps 1 to 6;
- (e) describe—
  - (i) the contractor's facts, assumptions and calculations relevant to each element of the allowable costs (including those relevant to any risk or contingency included in the allowable costs);
  - (ii) any facts or assumptions provided by the Secretary of State and used by the contractor in those calculations;
- (f) describe any other information which was material to the pricing of the contract.

### **Contract reporting plan**

**24.**—(1) The primary contractor must provide a contract reporting plan for the qualifying defence contract within one month of the initial reporting date.

- (2) The contract reporting plan must contain the following information—
  - (a) the value of the contract;
  - (b) a list of—
    - (i) every quarterly contract report (regulation 26), interim contract report (regulation 27), contract completion report (regulation 28) and contract costs statement (regulation 29) which will be required for the contract;
    - (ii) the dates on which those reports will be due;
  - (c) if the contractor has agreed that it will provide any of the information described in regulation 30(3) (on-demand contract reports) without a written direction, a description of what it has agreed to provide;
  - (d) a description of the defined pricing structure that the contractor will use in providing the reports required by this Part;
  - (e) a list of the output metrics that will be used to describe deliverables in the reports required by this Part; and
  - (f) a list of the cost recovery bases—
    - (i) that were used, or are expected to be used, in the determination of the contract price; and
    - (ii) that the contractor will use in making the reports required by this Part.

### **Contract notification report**

**25.**—(1) The primary contractor must provide a contract notification report for the qualifying defence contract within one month of the initial reporting date.

- (2) The report must contain the following information—
  - (a) a list of the key deliverables specified in the contract, with a brief description of each;
  - (b) the estimated quantum of those deliverables, expressed using the output metrics set out in the contract reporting plan;
  - (c) an annual profile (or, if the contractor is of the view that it is not possible to express these matters in an annual profile, the total amount) of the following matters which have been taken into account in determining the contract price—
    - (i) any risk contingency element included in the allowable costs;

- (ii) planned amounts of profit, excluding any amount resulting from an adjustment determined under step 5 of regulation 11; and
  - (iii) the maximum amount of profit resulting from an adjustment determined under step 5 of regulation 11;
- (d) an annual profile of any estimated costs (split by the defined pricing structure) at the initial reporting date;
- (e) the total amount of those allowable costs (split by the defined pricing structure) that are non-recurring;
- (f) an annual profile of the estimated amount of each cost recovery base set out in the contract reporting plan;
- (g) a list of all payments exceeding £100,000 or 1% of the contract value (whichever is the greater) expected to be made by the Secretary of State under the contract, including—
  - (i) the expected amount of each payment;
  - (ii) the date on which each payment is expected to fall due; and
  - (iii) if the contract requires the payment to be made in any currency other than sterling, the currency in which the payment is to be made;
- (h) if the contract requires payment to be made in sterling, an annual profile of all such payments which the contractor expects the Secretary of State will make;
- (i) if the contract requires payment to be made in any currency other than sterling, an annual profile for each such currency of all payments which the contractor expects the Secretary of State will make;
- (j) a list of—
  - (i) all delivery milestones set out in the contract; and
  - (ii) where the contract sets an expected date for a delivery milestone to be completed, that date;
- (k) a description of any actual or intended sub-contracts which the primary contractor has entered into, or intends to enter into, for the purposes of enabling it to perform its obligations under the qualifying defence contract (including the total proportion of the value of the qualifying defence contract which the primary contractor expects to sub-contract); and
- (l) in relation to each such sub-contract into which the primary contractor has entered or intends to enter, and which has or is expected to have a value of not less than £1,000,000 (or, if there are more than 20 such sub-contracts, each of the 20 which have or are expected to have the highest value)—
  - (i) if the sub-contractor is a registered company, its registered name and company number, and the address of its registered office;
  - (ii) if the sub-contractor is not a registered company, its name;
  - (iii) whether the sub-contractor is associated with the primary contractor;
  - (iv) whether the sub-contractor is an SME;
  - (v) a brief description of the goods, works or services that will be provided under the sub-contract;
  - (vi) the date on which the sub-contract was, or is expected to be, entered into;
  - (vii) the contract completion date (or, if that date is not known, the expected contract completion date);
  - (viii) the (actual or estimated) price payable under the sub-contract; and

- (ix) if an assessment has been made under regulation 61(1) or (4), the outcome of that assessment.

### **Quarterly contract report**

**26.**—(1) Subject to paragraphs (2) to (5), the primary contractor must provide a quarterly contract report for the qualifying defence contract within one month of the end of each calendar quarter from the initial reporting date until the contract completion date.

(2) No report is required for the calendar quarter in which the initial reporting date falls.

(3) The first report must be for the period from the initial reporting date to the end of the next calendar quarter.

(4) No report is required for the calendar quarter in which the contract completion date falls.

(5) No report is required for a contract if the value of the contract is less than £50,000,000.

(6) The report must contain the following information—

(a) an annual profile (or, if the contractor is of the view that it is not possible to express these matters in an annual profile, the total amount) of the following matters which have been, or are expected to be, taken into account in determining the contract price—

(i) any risk contingency element included in the allowable costs;

(ii) planned amounts of profit, excluding any amount resulting from an adjustment determined under step 5 of regulation 11; and

(iii) the maximum amount of profit resulting from an adjustment determined under step 5 of regulation 11;

(b) an annual profile of the estimated costs (split by the contractor reporting structure) at the time of agreement;

(c) an annual profile (or, if the contractor is of the view that it is not possible to express these matters in an annual profile, the total amount) of the following matters—

(i) any risk contingency element,

(ii) planned amounts of profit, excluding any amount resulting from an adjustment determined under step 5 of regulation 11, and

(iii) the expected maximum amount of profit resulting from an adjustment determined under step 5 of regulation 11,

that reflect the costs already incurred and the forecast costs which are expected to be incurred, indicating for each year whether those costs have been incurred, are forecast, or a combination of both;

(d) an annual profile of the costs already incurred and the forecast costs which are expected to be incurred, split by the contractor reporting structure and indicating for each year whether those costs have been incurred, are forecast, or a combination of both;

(e) a breakdown of the costs already incurred and the forecast costs by reference to the calendar quarters of each of—

(i) the financial year in which the calendar quarter to which the report relates falls,

(ii) the previous financial year, and

(iii) the next financial year,

split by the contractor reporting structure;

- (f) a quantified analysis of the causes of variance (explaining not less than 90% of the total variance) between any estimated costs used to determine the contract price and the total actual and forecast costs;
  - (g) a forecast of any TCIF adjustment or any final price adjustment (regulation 16) which the contractor expects will be made;
  - (h) a description of any event that has occurred, or circumstances which have arisen, since the contract was entered into, that have had or are likely to have a material effect in relation to the contract, including—
    - (i) the date on which the contractor became aware of the event or circumstances;
    - (ii) whether the event or circumstances are covered by any contingency element of the contract price;
    - (iii) the effect that the event or circumstances have had on the costs already incurred; and
    - (iv) the forecast effect that the event or circumstances will have on the forecast costs which it is expected will be incurred;
  - (i) a list of—
    - (i) all delivery milestones set out in the contract;
    - (ii) where the contract sets an expected date for a delivery milestone to be completed, that date; and
    - (iii) the actual or expected delivery date for each delivery milestone;
  - (j) a description of any actual or intended sub-contracts which the primary contractor has entered into, or intends to enter into, for the purposes of enabling it to perform its obligations under the qualifying defence contract (including the total proportion of the value of the qualifying defence contract which the contractor expects to sub-contract); and
  - (k) in relation to each such sub-contract into which the primary contractor has entered in the period covered by the report, or intends to enter in the calendar quarter following the period covered by the report, and which has or is expected to have a value of not less than £1,000,000 (or, if there are more than 20 such sub-contracts, each of the 20 which have or are expected to have the highest value)—
    - (i) if the sub-contractor is a registered company, its registered name and company number, and the address of its registered office;
    - (ii) if the sub-contractor is not a registered company, its name;
    - (iii) whether the sub-contractor is associated with the primary contractor;
    - (iv) whether the sub-contractor is an SME;
    - (v) a brief description of the goods, works or services that will be provided under the sub-contract;
    - (vi) the date on which the sub-contract was, or is expected to be, entered into;
    - (vii) the contract completion date (or, if that date is not known, the expected contract completion date);
    - (viii) the (actual or estimated) price payable under the sub-contract; and
    - (ix) if an assessment has been made under regulation 61(1) or (4), the outcome of that assessment.
- (7) In this regulation, “contractor reporting structure” means the breakdown of contract costs into the categories used by the contractor for its own internal contract management purposes.

### **Interim contract report**

27.—(1) The primary contractor must provide an interim contract report for the qualifying defence contract within two months after each reporting date.

(2) If the value of the qualifying defence contract is less than £50,000,000, the reporting dates are—

(a) either—

- (i) a date agreed between the primary contractor and the Secretary of State at the time of agreement which is no more than five years following the time of agreement; and
- (ii) such further dates before the expected contract completion date as may be agreed between them, each date to be no more than five years after the previous reporting date; or

(b) if no agreement is made under sub-paragraph (a)—

- (i) the date which is three years after the last day of the calendar quarter during which the initial reporting date fell; and
- (ii) the date which is each third anniversary of that date.

(3) Otherwise, the reporting dates are—

(a) either—

- (i) a date agreed between the primary contractor and the Secretary of State at the time of agreement which is no more than three years following the time of agreement; and
- (ii) such further dates before the expected contract completion date as may be agreed between them, each date to be no more than three years after the previous reporting date; or

(b) if no agreement is made under sub-paragraph (a)—

- (i) the date which is 12 months after the last day of the calendar quarter during which the initial reporting date fell; and
- (ii) the date which is each anniversary of that date.

(4) The report must contain the following information—

- (a) a list of the key deliverables specified in the contract, with a brief description of each;
- (b) the estimated quantum of those deliverables, expressed using the output metrics set out in the contract reporting plan;
- (c) an annual profile (or, if the contractor is of the view that it is not possible to express these matters in an annual profile, the total amount) of the following matters which have been, or are expected to be, taken into account in determining the contract price—
  - (i) any risk contingency element included in the allowable costs;
  - (ii) planned amounts of profit, excluding any amount resulting from an adjustment determined under step 5 of regulation 11; and
  - (iii) the maximum amount of profit resulting from an adjustment determined under step 5 of regulation 11;
- (d) an annual profile of any estimated costs (split by the defined pricing structure) at the time of agreement;
- (e) the total amount of those allowable costs (split by the defined pricing structure) that are non-recurring;
- (f) an annual profile of the estimated amount of each cost recovery base set out in the contract reporting plan;

- (g) an annual profile (or, if the contractor is of the view that it is not possible to express these matters in an annual profile, the total amount) of the following matters—
- (i) any risk contingency element,
  - (ii) planned amounts of profit, excluding any amount resulting from an adjustment determined under step 5 of regulation 11, and
  - (iii) the expected amount of profit resulting from an adjustment determined under step 5 of regulation 11,
- that reflect the costs already incurred and the forecast costs which are expected to be incurred, indicating for each year whether those costs have been incurred, are forecast, or a combination of both;
- (h) an annual profile of the costs already incurred and the forecast costs which are expected to be incurred, split by the defined pricing structure and indicating for each year—
- (i) whether the costs have been incurred, are forecast, or a combination of both; and
  - (ii) the amount of each cost recovery base set out in the contract reporting plan;
- (i) a quantified analysis of the causes of variance (explaining not less than 90% of the total variance) between any estimated costs used to determine the contract price and the total actual and forecast costs;
- (j) a list of all payments exceeding £100,000 or 1% of the contract value (whichever is the greater) that have been or are expected to be made by the Secretary of State under the contract, including—
- (i) the amount, or expected amount, of each payment;
  - (ii) the date on which each payment did or is expected to fall due; and
  - (iii) if the contract requires the payment to be made in any currency other than sterling, the currency in which the payment was or is to be made;
- (k) if the contract requires payment to be made in sterling, an annual profile of all such payments made, or which the contractor expects the Secretary of State will make; and
- (l) if the contract requires payment to be made in any currency other than sterling, an annual profile for each such currency of all payments made, or which the contractor expects the Secretary of State will make.
- (5) If the value of the qualifying defence contract is less than £50,000,000, the report must also contain the following information—
- (a) a forecast of any TCIF adjustment or any final price adjustment (regulation 16) which the contractor expects will be made;
  - (b) a description of any event that has occurred, or circumstances which have arisen, since the contract was entered into, that have had or are likely to have a material effect in relation to the contract, including—
    - (i) the date on which the contractor became aware of the event or circumstances;
    - (ii) whether the event or circumstances are covered by any contingency element of the contract price;
    - (iii) the effect that the event or circumstances have had on the costs already incurred (paragraph (4)(h)); and
    - (iv) the forecast effect that the event or circumstances will have on the forecast costs which it is expected will be incurred (paragraph (4)(h));
  - (c) a list of—
    - (i) all delivery milestones set out in the contract;



- (ii) where the contract sets an expected date for a delivery milestone to be completed, that date; and
- (iii) the actual or expected delivery date for each delivery milestone;
- (d) a description of any actual or intended sub-contracts which the primary contractor has entered into, or intends to enter into, for the purposes of enabling it to perform its obligations under the qualifying defence contract (including the total proportion of the value of the qualifying defence contract which the primary contractor expects to sub-contract); and
- (e) in relation to each such sub-contract which has or is expected to have a value of not less than £1,000,000 (or, if there are more than 20 such sub-contracts, each of the 20 which have or are expected to have the highest value)—
  - (i) if the sub-contractor is a registered company, its registered name and company number, and the address of its registered office;
  - (ii) if the sub-contractor is not a registered company, its name;
  - (iii) whether the sub-contractor is associated with the primary contractor;
  - (iv) whether the sub-contractor is an SME;
  - (v) a brief description of the goods, works or services that will be provided under the sub-contract;
  - (vi) the date on which the sub-contract was, or is expected to be, entered into;
  - (vii) the contract completion date (or, if that date is not known, the expected contract completion date);
  - (viii) the (actual or estimated) price payable under the sub-contract; and
  - (ix) if an assessment has been made under regulation 61(1) or (4), the outcome of that assessment.

### **Contract completion report**

**28.**—(1) The primary contractor must provide a contract completion report within six months after the contract completion date of the qualifying defence contract.

(2) The report must contain the following information—

- (a) a list of the key deliverables specified in the contract, with a brief description of each;
- (b) the actual quantum of those deliverables, expressed using the output metrics set out in the most recent contract reporting plan;
- (c) an annual profile (or, if the contractor is of the view that it is not possible to express these matters in an annual profile, the total amount) of the following matters—
  - (i) any risk contingency element included in the allowable costs;
  - (ii) any actual risk contingency element;
  - (iii) the maximum amount of profit that could have resulted from the incentive adjustment (step 5 of regulation 11) at the time of agreement;
  - (iv) the actual incentive adjustment;
  - (v) the planned amount of profit, excluding any amount resulting from the incentive adjustment; and
  - (vi) the actual amount of profit, excluding any amount resulting from the incentive adjustment;

- (d) an annual profile of any estimated costs (split by the defined pricing structure) at the time of agreement;
- (e) the total amount of those allowable costs (split by the defined pricing structure) that are non-recurring;
- (f) an annual profile of the estimated amount of each cost recovery base set out in the contract reporting plan at the time of agreement;
- (g) an annual profile of the actual costs (split by the defined pricing structure);
- (h) an annual profile of the actual amount of each cost recovery base set out in the contract reporting plan;
- (i) a quantified analysis of the causes of variance (explaining not less than 90% of the total variance) between any estimated costs used to determine the contract price and the total actual and forecast costs;
- (j) a description of any event that has occurred, or circumstances which have arisen, since the contract was entered into, that have had or are likely to have a material effect in relation to the contract, including—
  - (i) the date on which the contractor became aware of the event or circumstances;
  - (ii) whether the event or circumstances were covered by any contingency element of the contract price; and
  - (iii) the effect that the event or circumstances have had on the costs already incurred or forecast to be incurred under the contract;
- (k) a forecast of any TCIF adjustment or any final price adjustment (regulation 16) which the contractor expects will be made;
- (l) a list of all payments exceeding £100,000 or 1% of the contract value (whichever is the greater) that have been or are expected to be made by the Secretary of State under the contract, including—
  - (i) the amount, or expected amount, of each payment;
  - (ii) the date on which each payment did, or is expected to, fall due; and
  - (iii) if the contract requires the payment to be made in any currency other than sterling, the currency in which the payment was or is to be made;
- (m) if the contract requires payment to be made in sterling, an annual profile of all such payments made, or which the contractor expects the Secretary of State will make;
- (n) if the contract requires payment to be made in any currency other than sterling, an annual profile for each such currency of all payments made, or which the contractor expects the Secretary of State will make;
- (o) a list of—
  - (i) all delivery milestones set out in the contract;
  - (ii) where the contract sets an expected date for a delivery milestone to be completed, that date;
  - (iii) the actual or expected completion date for each delivery milestone; and
  - (iv) a description of the causes of any variance between the expected date for a delivery milestone set out in the contract, and the actual or expected completion date; and
- (p) in relation to each sub-contract which the primary contractor has entered into for the purposes of enabling it to perform its obligations under the qualifying defence contract which has or is expected to have a value of not less than £1,000,000 (or, if there are more

than 20 such sub-contracts, each of the 20 which have or are expected to have the highest value)—

- (i) if the sub-contractor is a registered company, its registered name and company number, and the address of its registered office;
- (ii) if the sub-contractor is not a registered company, its name;
- (iii) whether the sub-contractor is associated with the primary contractor;
- (iv) whether the sub-contractor is an SME;
- (v) a brief description of the goods, works or services provided under the sub-contract;
- (vi) the date on which the sub-contract was entered into;
- (vii) the contract completion date (or, if that date is not known, the expected contract completion date);
- (viii) the (actual or estimated) price payable under the sub-contract; and
- (ix) if an assessment has been made under regulation 61(1) or (4), the outcome of that assessment.

### **Contract costs statement**

**29.**—(1) The primary contractor must provide a contract costs statement within 12 months after the contract completion date of the qualifying defence contract.

(2) The statement must contain the following information—

- (a) the start and end dates of the contractor’s accounting period;
- (b) if there has been any agreement between the contractor and the Secretary of State as to the cost allocation and apportionment methodology to be used in the contract cost statement, a description of that agreement and any deviations from the methodology;
- (c) an annual profile of the actual allowable costs, showing—
  - (i) all purchased items, services and expenses (including payments to sub-contractors) which are direct costs;
  - (ii) any other direct costs; and
  - (iii) all indirect costs, showing each cost recovery rate charged and the quantum of the corresponding cost recovery base;
  - (iv) the total actual costs which the contractor claims are allowable costs;
- (d) if there is any variance between the total actual costs (sub-paragraph (c)(iv)) and the costs described in sub-paragraph (c)(i) to (iii), an explanation of the reason for that variance;
- (e) if there is any variance between a cost recorded in the most recent information provided in response to a direction under regulation 30(1) or (3)(d) and the amount reported for the same cost in sub-paragraph (c)(i) to (iv), an explanation of the reason for that variance; and
- (f) the percentage of the allowable costs included in the statement which are still estimated rather than actual.

(3) Up to 2% of the actual allowable costs required by paragraph (2)(c) may, without explanation, be estimated costs.

(4) 2% or more of the actual allowable costs required by paragraph (2)(c) may be estimated costs, if an explanation is given of—

- (a) why it is not possible to provide actual costs at the time the statement is provided; and
- (b) when actual costs will be available.

(5) In this regulation—

- (a) “direct costs” means costs which—
  - (i) the contractor claims are allowable costs under the contract; and
  - (ii) have not been calculated using a cost recovery rate;
- (b) “indirect costs” means costs which—
  - (i) the contractor claims are allowable costs under the contract; and
  - (ii) have been calculated using a cost recovery rate.

### **On-demand contract report**

**30.**—(1) Within one month of the initial reporting date of the qualifying defence contract, the Secretary of State may by written direction require the primary contractor to provide the information described in regulation 29(2) (contract costs statement) for one or more specified periods, each such period ending on a date before the contract completion date.

(2) The contractor must provide the information required under paragraph (1) within 12 months after the last day of each period specified in the written direction.

(3) Before the contract completion date, the Secretary of State may by written direction require the primary contractor to provide the information described in any of—

- (a) regulation 23(2) (contract pricing statement);
- (b) regulation 24(2) (contract reporting plan);
- (c) regulation 27(4) and (5) (interim contract report);
- (d) regulation 29(2) (contract costs statement).

(4) The Secretary of State may make more than one written direction under paragraph (3) in relation to the contract.

(5) The contractor must provide the information required under paragraph (3)(a) or (b)—

- (a) if the contractor and the Secretary of State agree a date which is no more than three months after the date of receiving the written direction, by that date; or
- (b) if no such agreement is made, within one month of receiving the written direction.

(6) The contractor must provide the information required under paragraph (3)(c)—

- (a) if the contractor and the Secretary of State agree a date which is no more than six months after the date of receiving the written direction, by that date; or
- (b) if no such agreement is made, within two months after receiving the written direction.

(7) The contractor must provide the information required under paragraph (3)(d)—

- (a) if the contractor and the Secretary of State agree a date which is no more than 18 months after the date of receiving the written direction, by that date; or
- (b) if no such agreement is made, within six months after receiving the written direction.

## **PART 6**

### **Reports on overheads and forward planning etc**

#### **Application of this Part**

**31.**—(1) This Part applies where—

- (a) a person (“P”) is party to a qualifying defence contract; and

- (b) the ongoing contract condition is met in relation to a financial year (“the relevant financial year”).
- (2) Paragraph (1) is subject to section 25(4) (minimum value of qualifying defence contract for reporting requirement to be imposed), and the amount specified for the purposes of that subsection is—
  - (a) for the financial years ending on 31 March 2016 and 31 March 2017, £20,000,000;
  - (b) for subsequent financial years, £50,000,000.
- (3) The reference in paragraph (1) to the ongoing contract condition being met in relation to a financial year has the meaning given by section 25(5).
- (4) The reference in paragraph (1) to a financial year does not include the financial year ending on 31 March 2015.

### **Interpretation**

- 32.**—(1) In this Part, “QBU” (qualifying business unit) means—
- (a) a unit to which paragraph (3) applies in respect of a relevant period;
  - (b) an undertaking to which paragraph (4) applies in respect of a relevant period; or
  - (c) a group of undertakings to which paragraph (5) applies in respect of a relevant period.
- (2) A period is relevant if it ends on a day falling within the relevant financial year.
- (3) This paragraph applies to a unit in respect of any period if—
- (a) the unit carries on any activities for the purposes of an undertaking which is, or is associated with, the designated person;
  - (b) separate financial accounting statements are produced in respect of it for that period;
  - (c) in that period it provides anything for the purposes of any qualifying defence contract or qualifying sub-contract to which the designated person, or any person associated with the designated person, is party; and
  - (d) the total value of what it provides for those purposes in that period is at least £10,000,000.
- (4) This paragraph applies to an undertaking in respect of any period if—
- (a) no unit is a QBU in respect of that period by virtue of carrying on activities for the purposes of that undertaking;
  - (b) the undertaking is, or is associated with, the designated person;
  - (c) financial accounting statements are produced in respect of it for that period;
  - (d) in that period it provides anything for the purposes of any qualifying defence contract or qualifying sub-contract to which the designated person, or any person associated with the designated person, is party; and
  - (e) the total value of what it provides for those purposes in that period is at least £10,000,000.
- (5) This paragraph applies to a group of undertakings in respect of any period if—
- (a) no unit is a QBU in respect of that period by virtue of carrying on activities for the purposes of any of those undertakings;
  - (b) none of those undertakings is a QBU in respect of that period;
  - (c) each of those undertakings either is, or is associated with, the designated person;
  - (d) a single set of financial accounting statements is produced in respect of the group for that period, separate from those of the parent undertakings of any of those undertakings;

- (e) in that period the group provides anything for the purposes of any qualifying defence contract or qualifying sub-contract to which the designated person, or any person associated with the designated person, is party; and
  - (f) the total value of what the group provides for those purposes in that period is at least £10,000,000.
- (6) In this Part—
- (a) “defence contract” means—
    - (i) any contract to which the Secretary of State for Defence is party; or
    - (ii) any contract entered into for the purpose of enabling a contract within paragraph (i), or this paragraph, to be fulfilled;
  - (b) “the designated person” means—
    - (i) where the person mentioned in regulation 31(1) (“P”) is associated with one or more other persons, the ultimate parent undertaking in relation to P and those other persons,
    - (ii) otherwise, P,
 and section 25(9) (definition of “ultimate parent undertaking”) applies for the purposes of this sub-paragraph as it applies for the purposes of section 25(3);
  - (c) “direct costs” means costs which have not been calculated using a cost recovery rate;
  - (d) “pricing QBU” means a QBU in relation to which a cost recovery rate has been used for determining the price payable under any contract mentioned in paragraph (3)(c), (4)(d) or (5)(e), as the case may be;
  - (e) “the relevant accounting period”, in relation to a QBU, means the period in respect of which paragraph (3), (4) or (5) applies to the QBU.

### **General requirements**

- 33.**—(1) Every report provided under this Part must contain the following information—
- (a) the name, position and contact details of—
    - (i) the individual submitting the report; and
    - (ii) an individual to be notified if any compliance notice or penalty notice is given in relation to the report;
  - (b) the date the report is due;
  - (c) the date the report is submitted; and
  - (d) the relevant financial year to which the report relates.
- (2) A report provided under any of regulations 34 to 39 must contain the following information—
- (a) the name of the QBU to which it relates;
  - (b) the relevant accounting period to which the report relates; and
  - (c) an address to which correspondence relating to the report may be sent.
- (3) Where a report requires an analysis of staffing costs, that must include—
- (a) the total number of employees;
  - (b) the proportion of the cost of employing those employees recovered through cost recovery rates, and the proportion recovered through direct costs;
  - (c) the total number of contractors; and

- (d) the proportion of the cost of engaging those contractors recovered through cost recovery rates, and the proportion recovered through direct costs.
- (4) In this regulation, “contractor” means any individual who provides services under contract for the purposes of activities undertaken by a QBU, but who is not employed by the designated person or any person associated with the designated person.
- (5) All reports provided under this Part must be provided to the Secretary of State and to the SSRO.
- (6) All reports under this Part, except a strategic industry capacity report (regulation 40), must be provided in electronic form.
- (7) A strategic industry capacity report must be provided either in electronic form or in hard copy.
- (8) In preparing reports, the designated person must have regard to any relevant guidance issued by the SSRO.

### **Actual rates claim report**

- 34.**—(1) The designated person must provide, for each relevant financial year, an actual rates claim report for each pricing QBU in that relevant financial year.
- (2) The actual rates claim report must be provided either—
    - (a) three months after either—
      - (i) the end of the relevant accounting period, or
      - (ii) the date on which the ongoing contract condition was first met in relation to the relevant financial year,whichever is the later; or
    - (b) if the designated person and the Secretary of State agree a date which is within three months after the end of the period described in paragraph (a), by that date.
  - (3) The report must contain the following information—
    - (a) a list of all cost recovery rates which have been calculated for that QBU and for which a claim relating to the relevant accounting period has been or will be made;
    - (b) a list of all the cost recovery bases that have been used to calculate the cost recovery rates described in sub-paragraph (a);
    - (c) a description of any deviation from the relevant statutory guidance in calculating those cost recovery rates;
    - (d) the QBU’s financial accounting statements and supporting accounting schedules for the relevant accounting period;
    - (e) a quantified analysis of the adjustments made between those financial accounting statements and costs claimed for recovery through cost recovery rates;
    - (f) a quantified analysis of any adjustments for costs—
      - (i) incurred in the relevant accounting period that have been or will be included in a claim relating to a period other than the relevant accounting period;
      - (ii) incurred in a period other than the relevant accounting period that have been or will be included in a claim relating to the relevant accounting period;
    - (g) a quantified analysis of QBU costs recovered as direct costs under any qualifying defence contract, qualifying sub-contract or other defence contract;
    - (h) a quantified analysis of QBU costs allocated to each cost recovery base listed under sub-paragraph (b);

- (i) a calculation of the amount of each such cost recovery base; and
- (j) a calculation of each cost recovery rate, including, for each such rate—
  - (i) the total cost claimed and the cost recovery base which has been used to calculate it; and
  - (ii) the amount of each such cost recovery base.

### **QBU actual cost analysis report**

**35.**—(1) The designated person must provide, for each relevant financial year, a QBU actual cost analysis report for each QBU in that relevant financial year.

(2) In the case of a pricing QBU, the report must be provided with the actual rates claim report for that pricing QBU for that relevant financial year.

(3) In any other case, the report must be provided either—

- (a) three months after either—
  - (i) the end of the relevant accounting period, or
  - (ii) the date on which the ongoing contract condition was first met in relation to the relevant financial year,

whichever is the later; or

- (b) if the designated person and the Secretary of State agree a date which is within three months after the end of the period described in paragraph (a), by that date.

(4) The Secretary of State may by written notice require the designated person to provide a further QBU actual cost analysis report for any one or more QBU for the relevant financial year.

(5) The designated person must provide a further QBU actual cost analysis report within a month of receiving a notice under paragraph (4).

(6) The Secretary of State may only require one further QBU actual cost analysis report for any one QBU in a relevant financial year.

(7) The report must contain the following information (“costs analysis information”) for the relevant accounting period —

- (a) a quantified analysis of the total actual operating costs incurred by the QBU, showing the amount of each type of cost (including activity costs) and, for each type of cost, the amount attributable to each business function;
- (b) an analysis of staffing costs relative to business function;
- (c) a quantified analysis of the total actual revenue for the QBU, presented in the following categories—
  - (i) revenue from any qualifying defence contract or qualifying sub-contract;
  - (ii) revenue from any other defence contract;
  - (iii) any other revenue;
- (d) actual values for all cost recovery bases that have been used to calculate the cost recovery rates which have been calculated for that QBU and for which a claim relating to the relevant accounting period has been or will be made; and
- (e) actual values for the cost recovery rates.

(8) If a QBU estimated cost analysis report (regulation 37) was required for the QBU in relation to the financial year immediately preceding the relevant financial year, the report must contain—

- (a) the costs analysis information as estimated in the previous report; and



- (b) an explanation of any difference between the costs analysis information as estimated in the previous report and the costs analysis information in this report.

### **Estimated rates claim report**

**36.**—(1) The designated person must provide, for each relevant financial year, an estimated rates claim report for each pricing QBU that was a pricing QBU of the designated person in relation to the financial year immediately preceding the relevant financial year.

(2) The estimated rates claim report must be provided either—

(a) three months after either—

(i) the end of the relevant accounting period, or

(ii) the date on which the ongoing contract condition was first met in relation to the relevant financial year,

whichever is the later; or

(b) if the designated person and the Secretary of State agree a date which is within three months after the end of the period described in paragraph (a), by that date.

(3) The report must contain the following information for the accounting period immediately following the relevant accounting period—

(a) a list of all cost recovery rates which will be calculated for that QBU and for which it is anticipated that a claim will be made during a future relevant accounting period;

(b) a list of all the cost recovery bases that have been used to calculate the cost recovery rates described in sub-paragraph (a);

(c) a description of any deviation from the relevant statutory guidance in calculating those cost recovery rates;

(d) the budget for the QBU, approved in accordance with the QBU's internal budgetary procedures, including a quantified analysis by the categories used in the QBU's financial statements and supporting accounting schedules;

(e) a quantified analysis of the adjustments made between the budget and costs claimed for recovery through cost recovery rates;

(f) a quantified analysis of any adjustments for costs incurred in or forecast for one relevant accounting period but recovered in other relevant accounting periods;

(g) a quantified analysis of QBU costs estimated to be recovered as direct costs under any qualifying defence contract, qualifying sub-contract, or other defence contract;

(h) a quantified analysis of QBU estimated costs allocated to each cost recovery base listed under sub-paragraph (b);

(i) a calculation of the estimated amount of each such cost recovery base; and

(j) a calculation of each estimated cost recovery rate, including, for each such rate—

(i) the total estimated cost claimed and the cost recovery base which has been used to calculate it; and

(ii) the estimated amount of each such cost recovery base.

### **QBU estimated cost analysis report**

**37.**—(1) The designated person must provide, for each relevant financial year, a QBU estimated cost analysis report for each QBU that was a QBU of the designated person in the relation to the financial year immediately preceding the relevant financial year.

- (2) In the case of a pricing QBU, the report must be provided with the estimated rates claim report for that pricing QBU for that relevant financial year.
- (3) In any other case, the report must be provided either—
- (a) three months after either—
    - (i) the end of the relevant accounting period, or
    - (ii) the date on which the ongoing contract condition was first met in relation to the relevant financial year,
 whichever is the later; or
  - (b) by agreement with the Secretary of State, a date within three months after the end of the period described in paragraph (a).
- (4) The Secretary of State may by written notice require the designated person to provide a further QBU estimated cost analysis report for any one or more QBU for the relevant financial year.
- (5) The designated person must provide a further QBU estimated cost analysis report within a month of receiving a notice under paragraph (4).
- (6) The Secretary of State may only require one further QBU estimated cost analysis report for any one QBU in a relevant financial year.
- (7) The report must contain the following information (“costs analysis information”) for the relevant accounting period—
- (a) a quantified analysis of the total estimated operating costs for the QBU, showing the amount of each type of cost (including activity costs) and, for each type of cost, the amount attributable to each business function;
  - (b) an analysis of estimated staffing costs relative to business function;
  - (c) a quantified analysis of the total estimated revenue for the QBU, presented in the following categories—
    - (i) revenue from any qualifying defence contract or qualifying sub-contract;
    - (ii) revenue from any other defence contract;
    - (iii) any other revenue;
  - (d) estimated values for all cost recovery bases that have been used to calculate the cost recovery rates which will be calculated for that QBU and for which it is anticipated that a claim will be made during a future relevant accounting period; and
  - (e) estimated values for the cost recovery rates.
- (8) The report must contain—
- (a) an explanation of any differences between the actual costs analysis information in relation to the financial year immediately preceding the relevant financial year and the estimated costs analysis information for the relevant financial year; and
  - (b) a description of material future initiatives that may be included in any future actual rates claim report or estimated rates claim report, and for each initiative an explanation of the estimated impact on the costs analysis information over the next five periods in respect of which financial accounting statements are expected to be produced for the QBU.

### **Estimated rates agreement pricing statement**

**38.**—(1) The designated person must, for each relevant financial year, provide an estimated rates agreement pricing statement for each pricing QBU that was a pricing QBU of the designated person in relation to the financial year immediately preceding the relevant financial year.

(2) The designated person must provide the estimated rates agreement pricing statement for each pricing QBU with the estimated rates claim report for that pricing QBU for the same relevant financial year.

(3) The Secretary of State may by written notice require the designated person to provide a further estimated rates agreement pricing statement for any one or more pricing QBU for the relevant financial year.

(4) The designated person must provide an estimated rates agreement pricing statement within three months of receiving a notice under paragraph (3).

(5) The Secretary of State may only require one further estimated rates agreement pricing statement for any one pricing QBU in a relevant financial year.

(6) The report must contain the following information—

- (a) a description of the facts and assumptions used in calculating each cost recovery base listed in the estimated rates claim report (regulation 36(3)(b));
- (b) whether the amount of each cost recovery base (regulation 36(3)(j)(ii)) has been estimated in a manner consistent with equivalent estimates in previous years and, if not, a description of any changes;
- (c) a description of the facts and assumptions used in calculating the matters described in regulation 36(3)(d) to (h);
- (d) a description of indices and rates used in calculating the estimated costs included in the estimated rates claim report, including for each—
  - (i) its source (including that source's version or date); and
  - (ii) an explanation of why its use was considered to be appropriate; and
- (e) a description of all material assumptions—
  - (i) regarding changes to costs relating to employment;
  - (ii) used to derive any estimated staff head count upon which estimated costs in the estimated rates claim report are based;
  - (iii) used in calculating any costs relating to decreasing over-capacity that have been included in the cost recovery rates (regulation 36(3)(a)); and
  - (iv) regarding significant costs that have been included in the cost recovery rates and that are novel or unusual.

### **Rates comparison report**

**39.**—(1) The Secretary of State may, for any relevant financial year, by written notice require the designated person to provide a rates comparison report for any one or more pricing QBU for that relevant financial year.

(2) The designated person must provide a rates comparison report within two months after receiving a notice under paragraph (1).

(3) The Secretary of State may only require one rates comparison report for any one QBU in a relevant financial year.

(4) The report must contain the following information—

- (a) a list of all qualifying defence contracts and qualifying sub-contracts—
  - (i) that have a contract completion date on or after the first day of the relevant accounting period;
  - (ii) to which the designated person or any person associated with it is party; and

- (iii) the price of which have been or will be calculated using a cost recovery rate which relates to the costs of the QBU;
- (b) for each of those contracts—
  - (i) any unique identifying number allocated to the contract by the contractor;
  - (ii) any unique identifying number allocated to the contract by the Secretary of State;
  - (iii) any title given in the contract;
  - (iv) the date on which the contract was entered into;
  - (v) the regulated pricing method or methods used in determining the price payable under the contract; and
  - (vi) whether the contract is a qualifying defence contract or a qualifying sub-contract;
- (c) a list of all the cost recovery rates used in any of those contracts, and the actual value of each of those rates as provided in the QBU actual cost analysis report; and
- (d) for each cost recovery rate used in determining the contract price under regulation 10 (or, if the price has been re-determined under regulation 14, used in the most recent determination)—
  - (i) the actual amount of the cost recovery base attributable to the contract;
  - (ii) the amount of the cost recovery base used in determining the contract price; and
  - (iii) the cost recovery rate used in determining the contract price.

#### **Strategic industry capacity report: general requirements**

**40.**—(1) The designated person must provide, for each relevant financial year, a strategic industry capacity report either—

- (a) 12 months after either—
  - (i) the end of the time period in relation to which financial accounting statements are prepared for the designated person and which ends on any day falling within the relevant financial year (“designated person’s accounting period”), or
  - (ii) the date on which the ongoing contract condition was first met in relation to the relevant financial year,
 whichever is the later; or
- (b) if the designated person and the Secretary of State agree a date which is within six months after the end of the period described in paragraph (a), by that date.

(2) The report must contain the information specified in regulations 41 to 44 and (unless otherwise specified) that information must relate to the designated person’s accounting period.

(3) For the purposes of regulations 41 and 42(1), a person is a qualifying supplier if—

- (a) it is associated with the designated person;
- (b) during the designated person’s accounting period to which the report relates, the person provides anything for the purposes of a qualifying defence contract or qualifying sub-contract—
  - (i) to which the designated person, or any person associated with it, is party; and
  - (ii) which has its contract completion date on or after the first day of the designated person’s accounting period.

### **Strategic industry capacity report: corporate structure**

- 41.** The strategic industry capacity report must contain—
- (a) a list of any undertakings associated with the designated person;
  - (b) for each such undertaking—
    - (i) if it is a registered company, its registered name and company number, and the address of its registered office;
    - (ii) any trading name (if that is different to its registered name);
    - (iii) its accounting period; and
    - (iv) whether it is a qualifying supplier of the designated person;
  - (c) a list of all the QBUs of the designated person;
  - (d) in the case of a QBU which is a QBU by virtue of regulation 32(1)(a) or (c)—
    - (i) the undertaking, or a list of the undertakings, that are listed in that QBU; and
    - (ii) for each of those undertakings, the approximate proportion of its costs that are included in the QBU's financial accounting statements;
  - (e) for each QBU and qualifying supplier of the designated person, a description of its revenue, showing the proportion derived from—
    - (i) any qualifying defence contract or qualifying sub-contract;
    - (ii) any other defence contract;
    - (iii) all other sources; and
  - (f) a description of any anticipated change to the corporate structure of the designated person and any undertakings associated with it, including mergers or acquisitions, that may affect the performance of any qualifying defence contract, any qualifying sub-contract or any other defence contract.

### **Strategic industry capacity report: activities, people and infrastructure**

- 42.—(1)** The strategic industry capacity report must contain—
- (a) a description of the activities undertaken by the designated person, and all QBUs and qualifying suppliers, which relate to any qualifying defence contract, any qualifying sub-contract or any other defence contract; and
  - (b) a description of any physical site in relation to which at least £1,000,000 of costs has been attributed to those activities in the financial accounting statements for the designated person's accounting period, including—
    - (i) the name and location of the site;
    - (ii) the registered names of any companies which are associated with the designated person and carry out any activity on the site;
    - (iii) a description of any QBU that carries out any activity on the site;
    - (iv) a description of any qualifying defence contract or qualifying sub-contract which has a value of or above £50,000,000 and in relation to which any activity was carried out on the site;
    - (v) the capabilities or activities provided on the site for defence contracts;
    - (vi) the capacity which is on the site to deliver those capabilities or activities;
    - (vii) a description of the key infrastructure on the site used in the delivery of defence contracts;

- (viii) the extent to which the capacity available on the site has been used;
- (ix) an estimate of the number of employees (on a full-time equivalent basis) engaged in work on the site which relates to any qualifying defence contract, qualifying sub-contract or other defence contract; and
- (x) a description of the key skills provided by those employees.

(2) The information required by sub-paragraphs (1)(b)(vii) and (viii) must be presented in the following categories—

- (a) qualifying defence contracts or qualifying sub-contracts;
- (b) other defence contracts;
- (c) all other contracts.

### **Strategic industry capacity report: forecast costs of maintaining industrial capacity**

**43.**—(1) The information described in each paragraph of this regulation may be expressed either—

- (a) for each of the sites described under regulation 42(1)(b), or
- (b) for each QBU,

and is only required for those sites or QBUs (as the case may be).

(2) The strategic industry capacity report must contain—

- (a) a description of forecast costs for the five years following the last day of the designated person's accounting period, and a description of any anticipated changes in accounting policies or business practices that could have a significant effect on those costs;
- (b) a description of forecast labour requirements for those five years;
- (c) if cost recovery rates are used for any QBUs, an estimate of what those rates are likely to be for each such QBU over those five years;
- (d) a description of any policy—
  - (i) to employ apprentices or recent graduates,
  - (ii) to provide staff bonuses,
  - (iii) for training and development of personnel,
 and the approximate cost of that policy;
- (e) an explanation of the reasons for any material changes in the cost of maintaining industrial capacity; and
- (f) a description of any likely event or change in circumstances relating to qualifying defence contracts, qualifying sub-contracts or other defence contracts which could have a material effect on the ability of the designated person to maintain its industrial capacity.

(3) The information required by paragraph (2) must be presented in the following categories—

- (a) qualifying defence contracts or qualifying sub-contracts;
- (b) other defence contracts;
- (c) all other contracts.

### **Strategic industry capacity report: capacity and supply chain**

**44.** The strategic industry capacity report must contain a description of—

- (a) the key delivery milestones for all work currently being undertaken by the designated person (or any person associated with the designated person) for qualifying defence contracts, qualifying sub-contracts or other defence contracts (“current committed work”);
- (b) the key planning assumptions for any possible future qualifying defence contract, qualifying sub-contract or other defence contract to which the designated person (or any person associated with the designated person) will be party and which is expected to have a value of or over £50,000,000 (“planned future contract”), including the date on which the designated person anticipates that any planned future contract will be entered into;
- (c) any current under-capacity or over-capacity of personnel or infrastructure relative to current committed work and planned future contracts, and any plans to rectify that;
- (d) any current or planned measures to improve efficiency or productivity relative to current committed work and planned future contracts;
- (e) any plans for material investment in people, skills or infrastructure in order to deliver current committed work and planned future contracts, including the approximate costs of those plans;
- (f) all persons that are party to a contract with the designated person, or any person associated with the designated person, which has a value of at least £25,000,000 and which—
  - (i) supports the delivery of current committed work; or
  - (ii) is expected to support the delivery of planned future contracts; and
- (g) any likely event or change in circumstances relating to the supply chain that could have a material effect on the performance of current committed work and planned future contracts.

#### **Small or medium enterprises (“SME”) report**

**45.**—(1) The designated person must provide an SME report for each relevant financial year.

- (2) The designated person must provide an SME report within 12 months after either—
  - (a) the end of the designated person’s accounting period, or
  - (b) the date on which the ongoing contract condition was first met in relation to the relevant financial year,

whichever is the later.

(3) The information in the SME report must relate to the designated person’s accounting period.

- (4) The report must contain the following information—
  - (a) a description of the designated person’s policies and procedures for engaging with SMEs, including—
    - (i) any standard contract or payment terms used in relation to SMEs;
    - (ii) any special assistance provided to SMEs;
  - (b) a description of any initiatives intended to—
    - (i) increase opportunities for SMEs to support the delivery of defence contracts; or
    - (ii) encourage technical innovation by SMEs relevant to such contracts;
  - (c) an estimate of—
    - (i) the total revenue which the designated person or any person associated with it received from defence contracts;

- (ii) the amount of that total revenue which related to purchasing goods and services for the purpose of defence contracts from persons which are not associated with the designated person; and
- (iii) the amount of that total revenue which related to purchasing goods and services from SMEs; and
- (d) a description of the extent to which the goods, works or services provided by SMEs have contributed to defence contracts to which the designated person or any person associated with the designated person is party.

## PART 7

### Records and reports: restrictions

#### **Disapplication of requirements to give information**

**46.**—(1) Any requirement imposed by—

- (a) regulation 21 (examination of relevant records),
- (b) Part 5 (reports on qualifying defence contracts),
- (c) Part 6 (reports on overheads and forward planning etc), or
- (d) section 26 (duty to report relevant events, circumstances and information),

shall not apply to the extent that compliance would require the person (“P”) which is subject to the requirement to contravene a relevant restriction.

(2) A “relevant restriction” is—

- (a) a prohibition or restriction imposed by an enactment; or
- (b) an obligation of confidentiality owed by P to another person, unless that other person—
  - (i) is associated with P; or
  - (ii) gives consent to P’s complying with the requirement in question.

#### **Reference to SSRO to investigate obligation of confidentiality**

**47.**—(1) Where P intends not to comply (either in whole or in part) with a requirement listed in regulation 46(1)(b) to (d) because to do so would contravene a relevant restriction, it must notify the Secretary of State.

(2) A notice under paragraph (1) must be in writing and state—

- (a) the requirement with which P intends not to comply; and
- (b) the grounds on which P intends not to comply with the requirement.

(3) If the Secretary of State reasonably suspects that an obligation of confidentiality has been entered into otherwise than for genuine commercial reasons, the Secretary of State may, within 40 working days of receiving the notice, refer the matter to the SSRO for investigation.

(4) Upon receipt of a reference under paragraph (3), the SSRO must investigate whether the obligation has been entered into for genuine commercial reasons.

(5) If the SSRO finds that the obligation was entered into otherwise than for genuine commercial reasons, the requirement specified in the notice continues to apply.



## PART 8

### Compliance

#### Contraventions of section 31

**48.**—(1) The requirements specified for the purposes of section 31(3)(a)(i) (failure to comply with duty to keep accounting and other records) are—

- (a) to keep relevant records in accordance with regulation 20;
- (b) to permit the Secretary of State to examine relevant records in accordance with regulation 21(1) to (3);
- (c) to make available a copy required under regulation 21(4);
- (d) to provide further information or explanation when requested to do so under regulation 21(5).

(2) The requirements specified for the purposes of section 31(3)(a)(ii) (failure to comply with reporting requirements) are those imposed by Part 5 (reports on qualifying defence contracts) and Part 6 (reports on overheads and forward planning etc).

(3) The reports specified for the purposes of section 31(3)(b) (misleading reports) are those required by Part 5 (reports on qualifying defence contracts).

#### Time limits for compliance notices and penalty notices

**49.**—(1) The periods specified for the purposes of—

- (a) section 31(5) (time limits for giving compliance notice), and
- (b) section 32(5) (time limits for giving penalty notice) in the case set out in section 32(3) (contravention which cannot be remedied),

are those set out in paragraph (2).

(2) The periods are—

- (a) in the case of a contravention within section 31(3)(a)(i) (failure to comply with duty to keep accounting and other records)—
  - (i) six months after the date on which the requirement to keep relevant records ends, or
  - (ii) two years after the contract completion date,whichever ends earlier;
- (b) in the case of a contravention within section 31(3)(a)(ii) (failure to comply with reporting requirements), six months after the date the report is due;
- (c) in the case of a contravention within section 31(3)(b) (misleading reports) or 31(3)(c) (duty to report relevant events, circumstances and information)—
  - (i) one year after the date the Secretary of State becomes aware of the contravention, or
  - (ii) two years after the contract completion date,whichever ends earlier;
- (d) subject to paragraph (e), in the case of a contravention within section 31(3)(d), (e) or (f) (assessment of a proposed sub-contract)—
  - (i) one year after the date the Secretary of State becomes aware of the contravention, or
  - (ii) two years after the contract completion date of the contract to which the proposed sub-contract relates,

whichever ends earlier;

- (e) in the case of a contravention within section 31(3)(d), (e) or (f) (assessment of a proposed sub-contract) where the proposed sub-contract is required to enable the performance of more than one contract (regulation 58(3)(b) or (4)(b))—

- (i) one year after the date the Secretary of State becomes aware of the contravention, or  
(ii) two years after the first contract completion date of any of those contracts,  
whichever ends earlier.

(3) The period specified for the purposes of section 32(5) (time limit for giving penalty notice) in the case set out in section 32(2) (failure to take steps specified in a compliance notice) is three months after the last day of the period within which the compliance notice specified that the specified steps must be taken.

### Maximum penalties

**50.**—(1) In the following Table, each entry in the second column shows the amount specified for the purposes of section 33(1) (maximum penalty) for the following contraventions, where the relevant amount falls within the range shown in the corresponding entry in the first column—

- (a) a contravention within section 31(3)(a)(i) (failure to comply with duty to keep accounting and other records); or  
(b) a contravention within section 31(3)(a)(ii) (failure to comply with reporting requirements), other than the ones mentioned in paragraph (2)(a);

but this is subject to paragraph (3).

(2) In the following Table, each entry in the third column shows the amount specified for the purposes of section 33(1) (maximum penalty) for the following contraventions, where the relevant amount falls within the range shown in the corresponding entry in the first column, for—

- (a) failing to comply with the requirements in—  
(i) regulation 23 (contract pricing statement); or  
(ii) regulation 38 (estimated rates agreement pricing statement); or  
(b) a contravention within section 31(3)(d), (e) or (f) (assessment of proposed sub-contracts);

but this is subject to paragraph (3).

(3) In a case where—

- (a) the Secretary of State gives a person a penalty notice in respect of a contravention within section 31(3)(a)(ii) (failure to comply with reporting requirements), and  
(b) within the 12 months immediately preceding the date on which the Secretary of State gives the person that penalty notice, at least five other penalty notices for contraventions within section 31(3)(a)(ii) have been given to the person (or any person or persons associated with that person),

the amount specified for the purposes of section 33(1) (maximum penalty) is the amount prescribed by paragraph (1) or (2) (as the case may be) for that contravention, plus 20% of that amount.

(4) Any penalty notice which has been cancelled by the SSRO shall be disregarded for the purposes of paragraph (3).

(5) In this regulation, “the relevant amount” means—

- (a) in the case of either—  
(i) a contravention within section 31(3)(a)(i) by a person which is the designated person for the purpose of Part 6, or

- (ii) a contravention within section 31(3)(a)(ii) which consists in a failure to comply with a requirement imposed by Part 6,  
the total value of all qualifying defence contracts and qualifying sub-contracts to which the person who has been given the penalty notice, or any person associated with that person, is party;
- (b) in all other cases, the value of the qualifying defence contract.

<b>Relevant amount</b>	
Less than or equal to £20,000 £50,000,000	£50,000
More than £50,000,000 but less than or equal to £200,000,000	£250,000
More than £200,000,000 but less than or equal to £500,000,000	£500,000
More than £500,000,000 but less than or equal to £1,000,000,000	£750,000
More than £1,000,000,000	£1,000,000

## PART 9

### SSRO: opinions and determinations

#### **Matters on which the SSRO must give an opinion**

**51.**—(1) The matters relating to a proposed qualifying defence contract which are specified for the purposes of section 35(1)(a) (matters on which the SSRO must give an opinion) are—

- (a) the appropriate amount of adjustment that should be made under step 2, 3 or 6 in regulation 11;
- (b) the appropriate amount of a group cost risk adjustment (regulation 13(2)), group POCO adjustment (regulation 13(4)) or group capital servicing adjustment (regulation 13(5));
- (c) any question relevant to the cost recovery rates that should be used to estimate likely allowable costs;
- (d) the extent to which a particular cost would be an allowable cost.

(2) The matters relating to a qualifying defence contract which are specified for the purposes of section 35(1)(a) are—

- (a) if the contract price were to be re-determined (regulation 14)—
  - (i) the appropriate amount of adjustment that should be made under step 2, 3 or 6 in regulation 11;
  - (ii) the appropriate amount of a group cost risk adjustment (regulation 13(2)), group POCO adjustment (regulation 13(4)) or group capital servicing adjustment (regulation 13(5));
  - (iii) any question relevant to the cost recovery rates that should be used to estimate likely allowable costs;

- (iv) the extent to which a particular cost would be an allowable cost;
- (b) whether the Secretary of State has acted unreasonably in exercising a power to require the contractor to provide information under regulation 30 (on-demand contract report).

#### **Matters in relation to which the SSRO must make a determination**

**52.**—(1) The matters relating to a qualifying defence contract which are specified for the purposes of section 35(1)(b) (matters in relation to which the SSRO must make a determination) are the defined pricing structure and output metrics that the contractor must use in all reports provided under Part 5 for that contract.

(2) A reference to the SSRO for a determination in relation to any of those matters must be made no later than 6 months after the qualifying defence contract is entered into.

#### **Time limits for applications for opinions**

**53.**—(1) An application for an opinion on whether the Secretary of State has acted unreasonably in exercising a power to require a contractor to provide information under regulation 30 (on-demand contract report) must be made within three months of the contractor receiving a written direction under paragraph (1) or (3) of that regulation.

(2) A reference under section 35(3)(a) (reference by Secretary of State and primary contractor for SSRO's opinion) must be made no later than two years after the contract completion date of the contract to which the reference relates.

#### **Matters to which the SSRO must have regard in making determinations**

**54.** In making any determination under the Act or these Regulations, the SSRO must have regard (in addition to any other matter to which these Regulations require it to have regard) to—

- (a) any regulations or statutory guidance made under Part 2 of the Act which were in force at any time material to the matters under consideration;
- (b) the extent to which any relevant statutory guidance has been followed (and any justification advanced for not following it);
- (c) the extent to which any person has fulfilled its responsibilities under Part 2 of the Act and these Regulations;
- (d) any relevant previous decisions of the SSRO; and
- (e) representations made by the parties to the contract (or the persons who would be parties to the proposed contract), and (where not such a party or person) by the Secretary of State.

#### **References in relation to contracts entered into before the relevant date**

**55.**—(1) A reference under section 35(7) (contracts entered into before the relevant date) may be made no later than two years after—

- (a) the date described in the contract as the contract completion date;
- (b) if no such date is described in the contract, the date on which the contractor completes all obligations which entitle it to final payment under the contract; or
- (c) if the contract is terminated before either of the dates described in (a) or (b), the date that the contract is terminated.

(2) In making a determination or giving an opinion under section 35(7), the SSRO must have regard to—

- (a) any relevant published decisions of the Review Board for Government Contracts;

- (b) the Government Profit Formula and Associated Arrangements in force at the date the contract was entered into;
- (c) the terms of the contract; and
- (d) representations made by the parties to the contract and, where not a party to the contract, the Secretary of State.

## PART 10

### Restrictions on disclosing information

#### Information specified for the purposes of paragraph 1(1)(c) of Schedule 5

**56.**—(1) Information is specified for the purposes of paragraph 1(1)(c) of Schedule 5 (information to which that Schedule applies) if it falls within any of paragraphs (2) to (5) below.

(2) Information falls within this paragraph if—

- (a) it has been obtained by the Secretary of State under Part 4 of these Regulations (records); and
- (b) its disclosure would be likely to substantially prejudice the commercial interests of any person.

(3) Information falls within this paragraph if it has been provided to the Secretary of State or the SSRO in accordance with any of the following provisions—

- (a) regulation 23(2)(a), (d) or (e)(i) (contract pricing statement), including information described in any of those provisions and required under regulation 30(3);
- (b) regulation 23(2)(f), if the information relates to any information within sub-paragraph (a) above;
- (c) regulation 25(2)(b) to (f) and (l) (contract notification report);
- (d) regulation 26(6)(a) to (h) and (k) (quarterly contract report);
- (e) regulation 27(4)(b) to (i) and (5)(a), (b) and (e) (interim contract report), including information described in any of those provisions and required under regulation 30(3);
- (f) regulation 28(2)(b) to (k) and (p) (contract completion report);
- (g) regulation 29(2)(c) to (e) (contract costs statement), including information described in that provision and required under regulation 30(1) or (3);
- (h) regulation 34(3)(d) to (j) (actual rates claim report);
- (i) regulation 35(7) and (8) (QBU actual cost analysis report);
- (j) regulation 36(3)(d) to (j) (estimated rates claim report);
- (k) regulation 37(7) and (8) (QBU estimated cost analysis report);
- (l) regulation 38(6) (estimated rates agreement pricing statement);
- (m) regulation 39(4)(c) and (d) (rates comparison report); or
- (n) regulations 41 to 44 (strategic industry capacity report).

(4) Information falls within this paragraph if—

- (a) it—
  - (i) has been provided to the Secretary of State under section 26 (duty to report relevant events etc); or

- (ii) has been provided to the Secretary of State in a notice given under regulation 47(2);  
and
  - (b) it is of a kind that could have fallen within any provision listed in paragraph (3).
- (5) Information falls within this paragraph if—
- (a) it has been provided—
    - (i) to the SSRO for the purposes of any application, reference or appeal to the SSRO; or
    - (ii) by the SSRO under section 36(3)(b) or arrangements made by virtue of section 37(2)(a); and
  - (b) its disclosure would be likely to substantially prejudice the commercial interests of any person.

## PART 11

### Qualifying sub-contracts

#### Interpretation

**57.** In this Part, “contracting authority” means the party which is, or would be, liable to pay the contract price under a qualifying sub-contract.

#### Requirements for qualifying sub-contracts

**58.**—(1) The amount specified for the purposes of section 28(3)(c) and (4)(c) (minimum value of a qualifying sub-contract) is £25,000,000.

- (2) A contract may be a contract to which section 28(3) or (4) applies only if it is neither—
  - (a) made within the framework of an international cooperative defence programme; nor
  - (b) made wholly for the purposes of one or more of the following—
    - (i) the acquisition of land (including existing buildings or other structures, and land covered with water), and any estate, interest, easement, servitude or right in or over such land;
    - (ii) the management or maintenance of any land or buildings or other structures; or
    - (iii) intelligence activities.
- (3) A contract may be a contract to which section 28(3) applies only if the performance of at least 50% by value of the obligations under the contract is required either—
  - (a) to enable the primary contractor to perform the qualifying defence contract mentioned in section 28(3)(a); or
  - (b) to enable the combined performance of the qualifying defence contract mentioned in section 28(3)(a) and any other qualifying defence contracts or qualifying sub-contracts, or prospective qualifying defence contracts or qualifying sub-contracts, to which the primary contractor (or any person associated with the primary contractor) is or might become party.
- (4) A contract may be a contract to which section 28(4) applies only if the performance of at least 50% by value of the obligations under the contract is required either—
  - (a) to enable the performance of contract A (within the meaning of section 28(4)(a)); or
  - (b) to enable the combined performance of contract A and any other qualifying defence contracts or qualifying sub-contracts, or prospective qualifying defence contracts or

qualifying sub-contracts, to which the person for whom anything is to be provided under contract A (or any person associated with that person) is or might become party.

(5) For the purposes of paragraphs (3) and (4), one or more obligations under a contract (“the actual contract”) form 50% by value of the obligations under that contract if, were they to constitute all the obligations under a contract, the value of that contract would be at least 50% of the value of the actual contract.

(6) Part 2 of the Act, and these Regulations, shall not apply to a qualifying sub-contract in respect of which no notice has been given under section 29(2)(b) or (4)(b).

### **Competitive process for single sub-contracts**

**59.** For the purposes of section 28, the award of a contract is the result of a competitive process if—

- (a) the contracting authority either—
  - (i) published a notice of intention to seek offers in relation to the provision of goods, works or services; or
  - (ii) invited one or more persons other than the sub-contractor, and not associated with the sub-contractor, to negotiate or provide offers in relation to the provision of goods, works or services;
- (b) the contracting authority conducted a transparent and arms-length procurement process;
- (c) the contracting authority used appropriate evaluation criteria to identify the offer made by the sub-contractor as the best offer;
- (d) the material terms of the contract are wholly or substantially the same as that best offer; and
- (e) at the time of making that offer, the sub-contractor did not consider it likely, or could not reasonably have considered it likely, that its offer would be the only offer reasonably capable of acceptance by the contracting authority.

### **Competitive process for sub-contracts made under a framework agreement**

**60.—(1)** This regulation applies where the contracting authority—

- (a) has either—
  - (i) published a notice of intention to seek offers in relation to a proposed agreement or other arrangement (“framework agreement”) which establishes terms under which a person (a “framework contractor”) would enter into one or more contracts with the contracting authority in the period during which the framework agreement applies; or
  - (ii) invited two or more persons to negotiate or provide offers in relation to the terms of a proposed framework agreement;
- (b) has entered into a framework agreement with one or more framework contractors; and
- (c) enters into a contract with a framework contractor.

(2) For the purposes of section 28, the award of a contract is the result of a competitive process if—

- (a) the terms governing the price payable under the contract are determined by a framework agreement and the conditions in paragraph (3) are met; or
- (b) the terms governing the price payable under the contract are determined by a competition between two or more framework contractors and the conditions in paragraph (4) are met.

(3) The conditions mentioned in paragraph (2)(a) are—

- (a) the procurement process by which the contracting authority entered into the framework agreement with the sub-contractor—
    - (i) was transparent and arms-length; and
    - (ii) used appropriate evaluation criteria to determine which sub-contractor or sub-contractors should be awarded a framework agreement;
  - (b) the material terms of the framework agreement are wholly or substantially the same as were offered by the sub-contractor—
    - (i) in a tender submitted in response to the notice mentioned in sub-paragraph (1)(a)(i); or
    - (ii) in negotiations following the invitation mentioned in sub-paragraph (1)(a)(ii);
  - (c) at the time of making that offer, the sub-contractor did not consider it likely, or could not have reasonably considered it likely, that its offer would be the only offer reasonably capable of acceptance by the contracting authority; and
  - (d) where this regulation applies by virtue of paragraph (1)(a)(ii), the persons mentioned in that paragraph included at least one person who was not the sub-contractor (or a person associated with the sub-contractor).
- (4) The conditions mentioned in paragraph (2)(b) are—
- (a) at least one of those framework contractors was not the sub-contractor (or a person associated with the sub-contractor);
  - (b) the competition—
    - (i) was transparent and arms-length; and
    - (ii) used appropriate evaluation criteria to identify the offer made by the sub-contractor as the best offer;
  - (c) the terms governing the price payable under the contract are wholly or substantially the same as were offered by the sub-contractor in that best offer; and
  - (d) at the time of making that offer, the sub-contractor did not consider it likely, or could not have reasonably considered it likely, that its offer in respect of the contract would be the only offer reasonably capable of acceptance by the contracting authority.

### **Assessing whether a contract would be a qualifying sub-contract**

**61.**—(1) Where either—

- (a) a primary contractor (“A”) proposes to enter into a contract with another person (“B”), and the proposed contract involves the provision by B of anything for the purposes of a qualifying defence contract to which A is a party, or
- (b) a person (“C”) proposes to enter into a contract with another person (“D”), and the proposed contract involves the provision by D of anything for the purposes of a qualifying sub-contract to which C is a party,

A or C (as the case may be) must assess whether the proposed contract would be a qualifying sub-contract if it were entered into.

(2) A or C (as the case may be) must keep a record of the assessment for the purpose of its inclusion in the records which A or C (as the case may be) would be required by regulation 20 to keep if the contract were entered into.

(3) Where the assessment is that the proposed contract would be a qualifying sub-contract if it were entered into, A or C (as the case may be) must give notice in writing of that fact to the Secretary of State and to B or D (as the case may be).



(4) Where—

- (a) a person (“E”) proposes to enter into a qualifying defence contract or a qualifying sub-contract (“the proposed contract”),
- (b) E also proposes to enter into a contract (“the proposed sub-contract”) with another person (“F”), and
- (c) the proposed sub-contract involves the provision by F of anything for the purposes of the proposed contract,

E must assess whether the proposed sub-contract would be a qualifying sub-contract if it and the proposed contract were entered into.

(5) E must keep a record of the assessment for the purpose of its inclusion in the records which E would be required by regulation 20 to keep if the proposed contracts were entered into.

(6) Where the assessment is that the proposed sub-contract would be a qualifying sub-contract if it were entered into, E must give notice in writing of that fact to the Secretary of State and to F.

### **Appeal against assessment**

**62.**—(1) Where an assessment is made under regulation 61(1) that a proposed contract would be a qualifying sub-contract if it were entered into, B or D (as the case may be) may appeal to the SSRO against the assessment.

(2) Where an assessment is made under regulation 61(4) that a proposed sub-contract would be a qualifying sub-contract if it and the proposed contract were entered into, F may appeal to the SSRO against the assessment.

(3) No appeal may be brought—

- (a) under paragraph (1) after the proposed contract is entered into;
- (b) under paragraph (2) after the proposed sub-contract is entered into.

(4) An appeal must be commenced by a written notice (“notice of appeal”) containing the following information—

- (a) the name and contact details of the person bringing the appeal;
- (b) if the person bringing the appeal is a company, its registered name and company number, and the address of its registered office;
- (c) the name and contact details of the person which made the assessment;
- (d) if the person which made the assessment is a company, its registered name and company number, and the address of its registered office; and
- (e) the grounds for the appeal.

(5) A notice of appeal must be—

- (a) accompanied by a copy of the notice of assessment given under regulation 61(3) or (6);
- (b) received by the SSRO no later than six months after the person bringing the appeal received the notice of assessment; and
- (c) copied to the person which made the assessment and to the Secretary of State at the same time that it is sent to the SSRO.

(6) The Secretary of State or the person which made the assessment may, within 20 working days of receipt of the copy of the notice of appeal, make a written submission to the SSRO on any matters to which they wish the SSRO to have regard in determining the appeal.

(7) Within 40 working days of receiving the notice of appeal, the SSRO must—

- (a) determine the appeal; and

- (b) notify in writing its determination to—
  - (i) the person bringing the appeal;
  - (ii) the person which made the assessment; and
  - (iii) the Secretary of State.

### **Cessation of application to qualifying sub-contracts**

**63.**—(1) If a sub-contractor is of the opinion—

- (a) that neither the condition in regulation 58(3) nor the condition in regulation 58(4) is now met in relation to the qualifying sub-contract, and
- (b) that Part 2 of the Act, and these Regulations, should therefore cease to apply to that qualifying sub-contract,

it may give the SSRO notice to that effect.

(2) A notice under paragraph (1) must—

- (a) be received by the SSRO no later than the contract completion date of the qualifying sub-contract;
- (b) be in writing;
- (c) state the date at which the sub-contractor believes that neither the condition in regulation 58(3) nor the condition in regulation 58(4) were met in relation to the qualifying sub-contract;
- (d) explain the sub-contractor’s reasons for that view; and
- (e) be copied to the other party to the qualifying sub-contract and the Secretary of State at the same time that it is sent to the SSRO.

(3) The other party to the qualifying sub-contract or the Secretary of State may, within ten working days of receiving a copy of the notice, advise the SSRO in writing of any matters to which they consider the SSRO should have regard in deciding whether to overrule the notice.

(4) The SSRO must consider the notice and any matters to which the other party to the qualifying sub-contract or the Secretary of State have advised that it should have regard.

(5) If the SSRO does not agree that neither the condition in regulation 58(3) nor the condition in regulation 58(4) is met, it must overrule the notice.

(6) If the SSRO agrees that neither the condition in regulation 58(3) nor the condition in regulation 58(4) is met, it must—

- (a) confirm the date on which neither the condition in regulation 58(3) nor the condition in regulation 58(4) were met in relation to the qualifying sub-contract; and
- (b) confirm that Part 2 of the Act, and these Regulations, no longer apply to that qualifying sub-contract.

(7) The SSRO must—

- (a) notify the sub-contractor, the other party to the qualifying sub-contract and the Secretary of State in writing of its decision;
- (b) if the effect of the fact that Part 2 of the Act and these Regulations have ceased to apply to the qualifying sub-contract is that any other contract may also cease to be a qualifying sub-contract, notify the parties to that other qualifying sub-contract in writing of its decision.

## **Modifications of Part 2 of the Act**

**64.**—(1) In their application to qualifying sub-contracts (and to sub-contractors) by virtue of section 30(1), the following provisions of Part 2 of the Act are modified as described in this regulation.

(2) Section 16(2)(a) has effect as if for “between the Secretary of State, or an authorised person, and the primary contractor” there were substituted “between the contracting authority and the sub-contractor”.

(3) Section 16(2)(b) has effect as if for “or the primary contractor” there were substituted “,the contracting authority or the sub-contractor”.

(4) Section 17(4)(a) has effect as if for “by the Secretary of State, or an authorised person, and the primary contractor” there were substituted “by the contracting authority and the sub-contractor”.

(5) Section 18(1) has effect as if for “The Secretary of State or an authorised person, and the primary contractor” there were substituted “The contracting authority and the sub-contractor”.

(6) Section 21(5) (direction excluding final price adjustment) does not apply.

(7) Section 35(1) has effect as if—

- (a) the contracting authority (in the case of a qualifying sub-contract), and
- (b) the person who proposes to enter into the qualifying sub-contract,

were persons mentioned in section 35(2).

(8) Section 35(3)(b) has effect as if for “other proposed party to the contract” there were substituted “proposed sub-contractor”;

(9) Section 35(4)(a) has effect as if for “by one party to the contract to the other” there were substituted “by the sub-contractor to the Secretary of State, or by the Secretary of State to the sub-contractor”;

(10) Section 35(4)(b) has effect as if for that subsection there were substituted—

- “(b) in the case of a proposed qualifying sub-contract—
  - (i) by the proposed sub-contractor to the Secretary of State; or
  - (ii) by the Secretary of State to the proposed sub-contractor.”

(11) Section 43(1) has effect as if after the definition of “authorised person” there were inserted—  
“contracting authority” means the party which is, or would be, liable to pay the contract price under a qualifying sub-contract.”

## **Modifications of these Regulations**

**65.**—(1) In their application to qualifying sub-contracts (and to sub-contractors) by virtue of section 30(1), these Regulations are modified as described in this regulation.

(2) Regulation 2(1) has effect as if after the definition of “contract completion date” there were inserted—

“contracting authority” means the party which is, or would be, liable to pay the contract price under a qualifying sub-contract.”

(3) Part 2 (qualifying defence contracts) does not apply.

(4) Regulation 11 (steps in determining profit rate) has effect as if—

- (a) in paragraph (6), for each “Secretary of State” there were substituted “contracting authority”;
- (b) in paragraph (8), for “Secretary of State” there were substituted “contracting authority”.

- (5) Regulation 12 (calculation of POCO) has effect as if in paragraphs (2) and (3) for “Secretary of State” there were substituted “contracting authority”.
- (6) Regulation 13 (rates agreed on a group basis) does not apply.
- (7) Regulation 14(1) (re-determination of contract price) has effect as if for “Secretary of State” there were substituted “contracting authority”.
- (8) Regulation 16 (final price adjustment) has effect as if—
- (a) in paragraph (1)—
    - (i) for “£5,000,000” there were substituted “£50,000,000”;
    - (ii) for “Secretary of State” there were substituted “contracting authority”;
  - (b) paragraphs (2) and (3) were omitted.
- (9) Regulation 18 (determination of contract profit rate adjustments) has effect as if—
- (a) in paragraph (1), the words “(including an adjustment agreed on a group basis under regulation 13)” were omitted;
  - (b) in paragraph (5), for the words “the contract price is to be adjusted by a specified amount” there were substituted “a payment of a specified amount must be made to or by the Secretary of State”.
- (10) In regulation 22 (general requirements and interpretation), sub-paragraphs (2)(a)(iii) and (2)(e) do not apply.
- (11) Regulation 23 (contract pricing statement) has effect as if in sub-paragraph (2)(e)(ii) for “by the Secretary of State” there were substituted “by either the contracting authority or the Secretary of State”.
- (12) In regulation 25 (contract notification report), sub-paragraphs (2)(g) to (i) do not apply.
- (13) In regulation 27 (interim contract report), sub-paragraphs (4)(j) to (l) do not apply.
- (14) In regulation 28 (contract completion report), sub-paragraphs (2)(l) to (n) do not apply.

*Philip Dunne*  
Minister for Defence Equipment, Support and  
Technology  
Ministry of Defence

Date

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## EXPLANATORY NOTE

*(This note is not part of these Regulations)*

Part 2 of the Defence Reform Act 2014 (c. 20) (“the Act”) creates a regulatory framework for “single source contracts” (that is, contracts which are not subject to a legal obligation to be advertised and competed) in the defence area. The framework is intended to apply to those contracts which are not subject to regulation under EU law. EU law requires most government contracts to be procured via an open process that involves publicly advertising the fact that the contract is available for tender, and then a competitive process to select the successful contractor. There is an exemption in Article 346 of the Treaty of the Functioning of the EU for measures which a Member State considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions or war materiel.

This framework will apply to primary contracts to which the Secretary of State for Defence is party and which meet the criteria in section 14(2) to (5) of the Act and Part 2 of these Regulations (these are called qualifying defence contracts). For those primary contracts which are entered into on or after the date on which these Regulations come into force (“the relevant date”, see section 14(9)(a)), and which are not the result of a competitive process (defined in regulations 8 and 9), these Regulations will apply from the date the contract is entered into (see section 14(3)). For a primary contract which becomes a qualifying defence contract because of an agreement made in amending the contract, these Regulations will apply from the date of that amendment (see section 14(4) and (5)).

The framework will also apply to sub-contracts of qualifying defence contracts which meet the criteria in section 28(2) to (4) of the Act and regulations 57 to 59 (these are called qualifying sub-contracts).

Part 2 of the Act creates a new Non-Departmental Public Body called the Single Source Regulations Office (“SSRO”) to oversee the regulatory framework (see section 13 of, and Schedule 4 to, the Act). The powers and duties of the SSRO are set out in Part 2 of the Act, and include providing (advisory, non-binding) opinions and binding determinations, reviewing penalties imposed under the civil compliance regime created by Part 2 of the Act, and publishing statutory guidance (this will be published on the SSRO’s website).

These Regulations implement the detail of the regulatory framework using powers provided in Part 2 of the Act. The Act also provides for a number of matters to be dealt with by statutory guidance issued by the SSRO. The Act, the Regulations and the statutory guidance together comprise the regulatory framework. Guidance on the framework has been prepared by the Department. This is published on the Department’s Acquisition Operating Framework website<sup>(6)</sup> and will be updated periodically.

Part 1 of the Regulations provides definitions of terms used in the Regulations, and gives the meaning for the term “defence purposes”. It also sets out how to calculate the value of a contract, which is necessary to determine whether a contract is of sufficient value to meet the threshold to be a qualifying defence contract (regulation 6) or qualifying sub-contract (regulation 57(1)), but also for other purposes in the regulations, for example calculating the value of sub-contract for the purposes of the quarterly contract report (regulation 26(6)(k)), the interim contract report (regulation 27(5)(e)) and the contract completion report (regulation 28(2)(p)).

Part 2 of the Regulations makes provision for a number of matters necessary for determining whether a contract is a qualifying defence contract. These are the threshold values, the types of contract that

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(6) <https://www.aof.mod.uk/aofcontent/tactical/toolkit/content/topics/sspr.htm> - note this requires access to the MOD’s Defence Gateway service at <https://www.defencegateway.mod.uk/>

may not be a qualifying defence contract (although they meet the other criteria), and the definition of a “competitive process”.

Part 3 makes provision for determining the price payable under a qualifying defence contract. Qualifying defence contracts must be priced according to a formula set out in section 15(4) of the Act. There are many different types of commercial arrangement used for qualifying defence contracts, and regulations 10 and 11 accommodate them by allowing the costs which are an element in the formula to be estimated at different times, and in various combinations of actual and estimated costs, leading to six “regulated pricing methods”. Parties to a contract may agree which of the regulated pricing methods is to be used for that contract (regulation 10(2)). An essential element in the formula is the contract profit rate, which must be calculated for each contract. Regulations 12 and 13 prescribe how to calculate the contract profit rate. The Act allows for the price determined in accordance with the formula to be adjusted in order to prevent excessive profits or losses being made, by means of a final price adjustment (section 21 and regulations 16 and 17). A final price adjustment can only be made for contracts which have been priced by the firm pricing method, the fixed pricing method or the volume-driven pricing method (regulation 16(1)(a)). Part 3 also prescribes the procedure for the SSRO to make determinations about contract profit rate adjustments (regulation 18) and allowable costs (regulation 19).

Part 4 requires primary contractors and persons which are required to make reports under Part 6 (supplier reports) to keep relevant records (“relevant records” is defined in section 23(2)). It prescribes the period for which records must be kept (regulation 20), and a procedure for the Secretary of State to examine the records and require copies to be made available or further explanation given (regulation 21). Section 23(3) sets out the purposes for which the Secretary of State may examine relevant records. This includes auditing records provided under section 24 (which are the reports on qualifying defence contracts, see Part 5) and section 25 (which are the reports on overheads and forward planning etc, see Part 6). Section 23(6) and (7) enable the SSRO to review the exercise of this power of examination, and make a declaration if it has been exercised unreasonably.

Primary contractors are obliged to report on certain matters relating to their contracts. Part 5 prescribes the matters that must be covered in the reports, the form the reports must take, and the times at which they must be made.

Most single source contractors are companies which are part of a larger corporate group. Section 25 of the Act enables certain reports to be required where one company in the group is party to a qualifying defence contract the value of which is above a prescribed threshold (see section 25(4) and (5)). The reports that may be required may relate to the overhead costs and forward planning of those corporate groups, or other specified matters (section 25(2)). The obligation to provide the reports falls on the ultimate parent undertaking of the primary contractor (section 25(3)). Part 6 prescribes the minimum value that a qualifying defence contract must have for the requirement for Part 6 reports to be imposed (regulation 31(2)), the information which must be provided in the reports, the form the reports must take, and the times at which they must be made.

Section 27(1) of the Act enables the Regulations to disapply a requirement imposed by virtue of section 23(5) (records, Part 4 of these Regulations), section 24 (reports on qualifying defence contracts, Part 5 of these Regulations), section 25 (reports on overheads and forward planning etc, Part 6 of these Regulations) or section 26 (duty to report relevant events, circumstances and information) to the extent that compliance with the requirement would require a person to contravene a relevant restriction (which is defined at section 27(2)). Part 7 prescribes those requirements which are disapplied to the extent that compliance with the requirement would require a person to contravene a relevant restriction. One of the relevant restrictions is an obligation of confidentiality, and Part 7 makes provision for the SSRO to investigate whether such an obligation has been entered into for genuine commercial reasons, and, if the SSRO finds that it has not been entered into for genuine commercial reasons, for the requirement to continue to apply.

The Act creates (at sections 31 to 34) a civil penalty regime to enforce compliance with the Act and the Regulations. Part 8 of the Regulations specifies the provisions breach of which will be a

contravention to which the civil compliance regime applies. It sets out the time limits within which any compliance notice or penalty notice must be issued, and the maximum penalties which can be imposed.

Part 9 makes provision in relation to opinions and determinations by the SSRO. It prescribes the matters on which the SSRO must give an opinion (regulation 51) or make a determination (regulation 52). It sets the time limits for applications for opinions (regulation 53). Regulation 54 prescribes matters to which the SSRO must have regard in making its determinations. The SSRO may make a determination or give an opinion in relation to a contract entered into before these Regulations come into force, if the contract requires the Review Board for Government Contracts (the SSRO's predecessor body) to make a determination or give an opinion (see section 35(6) and (7)). Regulation 55 prescribes the time limit for such references, and sets out the matters to which the SSRO must have regard in making any determination or giving any opinion under section 35(7).

The Act creates (at paragraph 2 of Schedule 5) a criminal offence of disclosing information obtained under or by virtue of Part 2 of the Act, if the information is of a kind specified in the Regulations. Part 10 of the Regulations specifies the information that will be subject to this offence.

Part 11 makes provision for qualifying sub-contracts. Section 30 provides that Part 2 of the Act, and these Regulations, apply to qualifying sub-contracts (and to sub-contractors) as they apply to qualifying defence contracts (and to primary contractors), subject to modification. Those modifications are set out in regulations 64 (modifications of Part 2) and 65 (modification of these Regulations). Regulation 58 prescribes the threshold value for a qualifying sub-contract, and the other requirements it must meet. The award of a qualifying sub-contract must not be the result of a competitive process (section 28(3)(b) and (4)(b)); regulations 59 and 60 prescribe what a competitive process is for a sub-contract. Contractors must assess whether a proposed sub-contract would be a qualifying sub-contract (regulation 61), and a prospective sub-contractor may appeal to the SSRO against that assessment (regulation 62). Regulation 63 provides a process for Part 2 of the Act, and the Regulations, to cease to apply to a qualifying sub-contract.