
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⁽¹⁾ 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

(1) <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.