EXPLANATORY MEMORANDUM TO

THE SINGLE SOURCE CONTRACT (AMENDMENT) (NO. 2) REGULATIONS 2018

2018 No. 1350

1. Introduction

1.1 This explanatory memorandum has been prepared by the Ministry of Defence and is laid before Parliament by Command of Her Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The regulations make changes to the Single Source Contract Regulations 2014 ("the SSCRs") and refer to Part 2 of the Defence Reform Act 2014 ("the Act"). They are not affected by EU Exit legislation.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is throughout the United Kingdom.

4.2 The territorial application of this instrument applies to England, Wales, Scotland and Northern Ireland.

5. European Convention on Human Rights

5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

6.1 The Act is intended to improve the procurement and support of defence equipment by the MOD and to strengthen the reserve forces. The Act contains four Parts and seven schedules. Part 2 creates a regulatory framework for "single source contracts" (that is, defence contracts which are not competed). MOD policy is to procure contracts via an open competitive process wherever possible but there are circumstances where only one contractor is able, or willing, to meet the MOD's requirements or where MOD decides to award a contract without competition for reasons of national security, which can be done in accordance with Article 346 of the Treaty of the Functioning of

the EU. Substantial parts of the new regulatory framework were set out in the SSCRs rather than in the Act.

6.2 Before the Act came into force, there was no legal framework regulating single source defence contracts but there were voluntary arrangements in place contained in a document called the Government Profit Formula and its Associated Arrangements (usually referred to as the "Yellow Book"). This voluntary framework was superseded by the legislation when the SSCRs came into effect on 18th December 2014.

6.3 The Act also created an executive Non-Departmental Public Body (NDPB) known as the Single Source Regulations Office (SSRO) to support the oversight of the new regulatory framework. The Act sets out the SSRO's functions, which include advising the Secretary of State on setting key rates used in the regulatory framework (including the baseline profit rate), monitoring the operation of the framework, undertaking analysis, and keeping the regulatory framework under review.

6.4 The SSCRs have been amended once, by a statutory instrument which came into force on 1st August 2018 and which clarified which contracts cannot be subject to the legislation (exclusions) as well as correcting drafting defects previously identified by JCSI.

7. Policy background

What is being done and why?

7.1 The Secretary of State for Defence is required by the Act to review single source legislation within three years of the legislation coming into force and must consider the recommendations made by the SSRO for changes. This review is to ensure that the legislation is operating as intended and to allow stakeholders to provide feedback. This review was completed in December 2017. It concluded that the legislation was functioning as intended and was effective, but it also identified several changes where improvements could be made. The Government's position on the review is set out in the Command Paper to be published shortly.

7.2 The first amendments to the SSCRs were made by statutory instrument which came into force on 1st August 2018. These covered changes which were required to be made as soon as possible and which were relatively straight-forward. The main change covered by this instrument is complex and required more time both to prepare and to clear with interested parties. The principle changes made in this instrument relate to pricing amendments within the Framework and amending the time limits for making determination referrals.

Pricing amendments within the Framework

7.3 Contracts which are subject to the legislation are called Qualifying Defence Contracts (QDCs). The Framework also applies to sub-contracts from QDCs (which are called qualifying sub-contracts or QSCs), and the same rules apply to them subject to some modifications (see regulations 64 and 65).

7.4 Regulation 14 of the SSCRs makes provision for repricing a QDC when it is amended in a way that affects the price. The primary legislation gives two alternatives to re-pricing a contract when it is amended: re-apply the pricing formula set out in section 15(4) to the whole contract or, use that formula to determine the price payable in

respect of the amendment and, by implication, add that to the original contract price. There are several factors which influence how these options are applied. However, experience has revealed that there is some confusion amongst suppliers about how the current provisions should be applied and that this is deterring suppliers from agreeing to amend contracts.

7.5 We have identified six different categories of situation where a contract amendment affects the price: three where, although there is a change to the contract price, there is no change to the requirement, and three where there is a change to the contractual requirements. The instrument replaces regulation 14 with a schedule which sets out the six categories and describes how the pricing for each category should be worked out. In each case the principle that either the price payable under the amended contract is re-determined in accordance with the pricing formula (i.e. the contract is repricing as a whole) or the price payable in respect of the amendment is determined in accordance with the pricing formula and added to the rest of the price that was previously determined is adhered to, but adhering to these principles requires a different approach to be applied to each of the six categories of contract amendment.

Time Limits for Determination Referrals

7.6 Regulation 52 specifies those matters which may be referred to the SSRO for a determination (the defined pricing structure and the output metrics which must be used in contract reports) but also provides that the referral "must be made no later than six months after the QDC is entered into". Consequently, this does not include the situation where the contract becomes a QDC by amendment (under s. 14(4) or (5)) or where it is amended more than six months after the contract was entered into and that amendment affects the specified matters. This was not the intention in drafting the original legislation and this amendment seeks to address this issue.

7.7 The instrument amends regulation 52(2) to allow for a referral for a determination to be made no later than six months after the QDC (or QSC) is entered into or, if a contract becomes a QDC by amendment, within six months of the amendment being made. It will also allow for a reference to be made if the QDC is amended in a way which affects the specified matters, again with a six-month time limit. This amendment will bring legislation into line with the original intent and allow for appropriate referrals to be made for amended contracts.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union or trigger the statement requirements under the European Union (Withdrawal) Act 2018.

9. Consolidation

9.1 There are no plans to consolidate the legislation.

10. Consultation outcome

10.1 The Act requires the SSRO to keep the legislation under review and it may make recommendations to the Secretary of State on any proposed changes which it considers appropriate. In addition, the Act requires the Secretary of State to carry out a review of the legislation within three years of the SSCRs coming into force, and

thereafter every five years. As part of this review, the Secretary of State must have regard to any recommendations made by the SSRO.

10.2 The SSRO undertook the following public consultation as part of the review:

1st Call-for-Input	May 2016 – July 2016
2nd Call-for-Input	Sept 2016 – Nov 2016
Public Consultation	Jan 2017 – to Mar 2017.

10.3 Details of this consultation and inputs from stakeholders can be found on the SSRO website along with its published recommendations to MOD.

10.4 In June 2017, the SSRO submitted its recommendations to the Secretary of State for Defence. This was followed by a series of further engagements by MOD with industry and the SSRO lasting from December 2017 to July 2018. The 1st SI, which came into force on 1st August 2018, was made as a result of this review. Further changes to legislation are planned for 2019.

10.5 The main stakeholders affected by the amendments to regulation 14 (pricing amendments) are suppliers in the defence industry. The Department has been engaging with these suppliers (and through the defence industry trade body ADS which has been acting to co-ordinate the views of the defence sector) through a series of workshops during 2018. Industry have been supportive of the proposed changes which will clarify how this operates within the legislation. The amendment to regulation 52 (time limits for referrals) is in response to feedback from the SSRO which included this change in the recommendations they submitted to the Secretary of State in June 2017. Industry have not expressed opposition to this amendment.

11. Guidance

11.1 Guidance on all aspects of the SSCRs, included all implemented changes, can be found on the MOD Commercial Toolkit (which is accessible, on request, by defence suppliers).

11.2 As the SSRO's sponsoring Department, the MOD will work with the SSRO to provide stakeholders with guidance on how the amendments contained in this instrument will operate. This guidance is available to the public on the SSRO website.

12. Impact

12.1 There is no impact on charities or voluntary bodies and there is assessed to be no significant additional impact on the public sector as the amendment to regulation 14 is intended to clarify how this measure operates in practice and the amendment to regulation 52 is unlikely to lead to a significant increase in the number of referrals submitted to the SSRO. Clarifying the repricing requirement will reduce the administrative burden on suppliers and is the result of feedback from industry in favour of the change.

12.2 An Impact Assessment has not been prepared for this instrument for the following reasons. The Better Regulations Executive (BRE) at the then Department for Business, Innovation, and Skills, was consulted in 2013-2014 concerning the new legislation. It advised MOD that as suppliers would be reimbursed for costs incurred in complying with the new requirements, and as all single source procurement was "an explicit rejection of the market", the new framework would not be regarded as "regulations" from the point of view of the Regulatory Policy Committee.

12.3 As suppliers will be subject to the same reporting burden as at present, we assess that the *additional* costs to industry arising from these amendments will be marginal and any costs of compliance can be reclaimed from MOD as allowable costs of a QDC or QSC, providing suppliers can demonstrate that these costs are appropriate, attributable, and reasonable (see s. 20(2)).

13. Regulating small business

13.1 The legislation applies to activities undertaken by small businesses but, as it only applies for QDCs with an individual value greater than £5m and QSCs with an individual value greater than £25m, the impact on small businesses from the current legislation is small. We assess that the *additional* impact on small businesses arising from the amendments will therefore be negligible.

14. Monitoring & review

14.1 The Act requires Secretary of State to undertake a review of the legislation within three years of it coming into force and, thereafter. every five years. The Secretary of State for Defence, however, has decided that, given the complexity of the framework and the need to keep it current, the next review should be completed within three years (i.e. by December 2020). This review will include significant engagement with the SSRO and the defence industry as it develops. The Act also requires the SSRO to keep the legislation under review and it may make recommendations to the Secretary of State on any changes which it considers appropriate.

15. Contact

15.1 Neil Hamilton at the Ministry of Defence (telephone: 0207 2188255 or email: neil.hamilton747@mod.gov.uk) can answer any queries regarding the instrument.

15.2 Charles Wason SCS1 at the Ministry of Defence can confirm that this Explanatory Memorandum meets the required standard.

15.3 Stuart Andrew MP at the Ministry of Defence can confirm that this Explanatory Memorandum meets the required standard.