Guidance note

Update to the Single Source Contract Regulations 2014: Changes to the categories of contracts that cannot be QDCs or QSCs

The Defence Reform Act 2014 and the Single Source Contract Regulations 2014 set out a regulatory framework governing the pricing and transparency of single source defence contracts. This article is the first in our series tracking amendments to the regulations, looking at the changes to the categories of contracts excluded from being QDCs or QSCs that came into effect on 1 August 2018.

Quick read

The Defence Reform Act 2014 (the "**Act**") and the Single Source Contract Regulations 2014 (the "SSCR") set out a regulatory framework for pricing, recordkeeping and reporting in contracts for goods, works and services above £5M in value that are placed by the Ministry of Defence without competition (known as "**Qualifying Defence Contracts**" or "**QDCs**"). They also apply to single-source sub-contracts to QDCs above £25M in value (known as "**Qualifying Sub-Contracts**" or "**QSCs**").

The Single Source Contract (Amendment) Regulations 2018 (the "**2018 Amendment Regulations**") came into effect on 1 August 2018, making four key changes to the categories of contracts that are excluded from being QDCs or QSCs[1]:

- Contracts made within an international cooperative defence programme can now be included if agreed by the parties to the contract
- Contracts for intelligence activities are no longer excluded
- There is a new exclusion on national security grounds
- Contracts which effectively transfer an existing contract to a new party on materially the same terms are now excluded

This article summarises the changes and offers some observations on what they mean in practice for MoD and contractors.

The key changes and what they mean for MoD and contractors

Section 14 of the Act sets out the criteria that determine whether a contract is a QDC and therefore subject to the rules on pricing, recordkeeping and reporting established by the Act and the SSCR. Generally speaking, any contract under which the Ministry of Defence procures goods, works or services for defence purposes will qualify if it has a value of £5M or more and is not the result of a competitive process.

Section 28 of the Act does the same for QSCs, providing that a contract will generally qualify if involves the provision of anything for the purposes of a QDC (or another QSC), has a value of £25M or more and is not the result of a competitive process.[2]

However, Regulation 7 of the SSCR specifies certain categories of contracts that cannot be QDCs and Regulation 58 specifies categories of contracts that cannot be QSCs (commonly referred to as "exclusions"). Contracts within these exclusions fall entirely outside the regulatory framework, even if they meet the other criteria to be a QDC or QSC.

There were previously five exclusions in respect of QDCs and four exclusions in respect of QSCs – the 2018 Amendment Regulations have amended the exclusions as follows:

[1]The 2018 Amendment Regulations also correct drafting deficiencies in Regulation 5 (calculating the value of a contract) and Regulation 13 (rates agreed on a group basis).

[2]Regulation 58 of the SSCR also sets out additional criteria that are relevant where a sub-contract is entered into only partly for the purpose of enabling performance under a QDC.

Exclusion	How has the exclusion been amended?	What does this mean?
Existing Exclusions		
Contracts to which a government of any other country than the UK is a party *(Regulation 7(a) – an exclusion in respect of QDCs only)*	No change	N/A
Contracts made within the framework of an international cooperative defence programme *(Regulation 7(b) and Regulation 58(2)(a))*	A narrowing of the exclusion such that the parties to the contract can now agree that it is a QDC or QSC (as applicable) and subject to the SSCR.	The rationale for this change is straightforward: there are some large single source contracts which may include a comparatively small component of requirements developed with one or more international allies. Previously, the entire contract would have been excluded from being a QDC or QSC, even the UK-specific parts that would otherwise have been subject to the SSCR. The amendment provides an opportunity for these contracts to fall within the regime, whilst recognising that it would not be practicable for them to qualify automatically. Whilst the need for agreement from both parties may limit the extent to which this caveat is used, and indeed where there is no agreement then such contracts will not be QDCs or QSCs as was the case before, the amendment to this exclusion has allowed the scope of the regime to be extended.
Contracts for the acquisition of land or rights over land *(Regulation 7(c)(i) and Regulation 58(2)(b)(i))*	No change	N/A
Contracts for the management or maintenance of any land, buildings or other structures *(Regulation 7(c)(ii) and Regulation 58(2)(b)(ii))*	No change	N/A
Contracts for intelligence activities *(Regulation 7(c)(iii) and Regulation 58(2)(b)(iii))*	Removal of this exclusion and replacement with a new exclusion where there is a risk to national security – see below.	The lack of a definition of "intelligence activities" in the Act resulted in confusion as to the meaning and application of this exclusion. In practice, it meant that a greater number of contracts were excluded from the regime than may have been intended. For example, MoD invests heavily in systems designed to gather intelligence, such as surveillance aircraft or sensors. These contracts have in some cases been excluded from the regime, despite their existence being widely known or there being no risk to national security of including them within the regime.

New Exclusions		
Contracts in relation to which compliance with the recordkeeping and reporting obligations in the SSCR and the Act would require disclosure of information which would create a risk to national security (new Regulation 7(d) and new Regulation 58(2)(c))	Addition of this new exclusion to replace the previous exclusion in respect of contracts for intelligence activities.	The exclusion now covers potential risk to national security rather than intelligence activities per se. Contracts will now be excluded if compliance with the recordkeeping and reporting requirements in the legislation would create a risk to national security, even if there is no connection to intelligence activities. Conversely, contracts for intelligence capabilities, where there is no risk to national security, will no longer be excluded. The aims of this amendment are to avoid excluding contracts from the regime unnecessarily, and to provide better protection for those contracts for which an exclusion is justified. Whether it achieves these aims, and whether it expands or narrows the application of the regime in practice, will depend largely on how it is interpreted by MoD and contractors. It has the potential to be interpreted broadly, but according to the Explanatory Memorandum it is intended to apply only where the information that would be disclosed is highly classified and security could not be met through ordinary security measures.
New contracts which replace an existing contract (new Regulations 7(e) and 7(f) and new Regulations 58(2)(d) and 58(2)(e))	A new exclusion in respect of new contracts which are, in substance, transfers of existing non-QDCs or non-QSCs from one legal entity to another on materially the same terms. The purpose of the new contract must be to ensure the performance of obligations that were to be performed under the original contract.	It is not uncommon for defence contracts to be transferred from one legal entity to another, for example due to a corporate restructuring or a consolidation of different contracts for sub-systems or components into a single, final deliverable with one prime contractor. Previously, a new contract which replaced an existing one would be subject to the legislation if it was not let competitively and met the other requirements to be a QDC or QSC (as applicable). This was the case even if the original contract was let competitively. This posed a risk of delaying or deterring a contract being transferred to another legal entity, even if the transfer was in the interests of all of the parties and the original competition had adequately assured value for money in the procurement.

New contracts which replace an existing contract (new Regulations 7(e) and 7(f) and new Regulations 58(2)(d) and 58(2)(e))	A new exclusion in respect of new contracts which are, in substance, transfers of existing non-QDCs or non-QSCs from one legal entity to another on materially the same terms. The purpose of the new contract must be to ensure the performance of obligations that were to be performed under the original contract.	Now, the new exclusion applies in respect of new contracts which replace existing contracts, provided that the new terms are in all material respects the same as the previous terms (save for the identity of the parties). This exclusion should provide a practical solution that prevents the regime from being unnecessarily applied to contracts that were originally excluded from it. However, parties will need to be careful with its application. The exclusion may not be available if as part of the transfer there are changes or additions to the original contractual requirement or any more than minor amendments to the contract terms,

Please get in touch if you would like to discuss any of these changes or what they mean for your contracts.

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