PARLIAMENTARY DEBATES

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OFFICIAL REPORT

Sixth Delegated Legislation Committee

DRAFT SINGLE SOURCE CONTRACT (AMENDMENT) REGULATIONS 2024

Wednesday 6 March 2024

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The Committee consisted of the following Members:

Chair: Mrs Sheryll Murray

† Abrahams, Debbie *(Oldham East and Saddleworth)* (Lab)
† Bruce, Fiona *(Congleton)* (Con)
† Byrne, Liam *(Birmingham, Hodge Hill)* (Lab)
† Cartlidge, James *(Minister for Defence Procurement)*
† Eagle, Maria *(Garston and Halewood)* (Lab)
† Eastwood, Mark *(Dewsbury)* (Con)
† Evans, Dr Luke *(Bosworth)* (Con)
Fletcher, Katherine *(South Ribble)* (Con)
Hamilton, Fabian *(Leeds North East)* (Lab)
† Henderson, Gordon *(Sittingbourne and Sheppey)* (Con)
Jenkyns, Dame Andrea *(Morley and Outwood)* (Con)
† Jones, Gerald *(Merthyr Tydfil and Rhymney)* (Lab)
McDonald, Stewart Malcolm *(Glasgow South)* (SNP)
† Morrissey, Joy *(Lord Commissioner of His Majesty's Treasury)*
Penning, Sir Mike *(Hemel Hempstead)* (Con)
† Ribeiro-Addy, Bell *(Streatham)* (Lab)
† Richardson, Angela *(Guildford)* (Con)

George James, *Committee Clerk*

† attended the Committee

Sixth Delegated Legislation Committee

Wednesday 6 March 2024

[MRS SHERYLL MURRAY *in the Chair*]

Draft Single Source Contract (Amendment) Regulations 2024

9.26 am

The Minister for Defence Procurement (James Cartlidge): I beg to move,

That the Committee has considered the draft Single Source Contract (Amendment) Regulations 2024.

It is a pleasure to see you in the Chair, Mrs Murray. There is a lot of tension in Westminster today—possibly not on this item, but it is very important none the less.

The Ministry of Defence's preferred approach to procurement remains through open competition in the domestic and global markets, but we are often limited to a single supplier to provide the capabilities that our armed forces need, particularly when we have to procure equipment quickly, in the face of rapidly evolving threats. We also need to preserve key industrial and technological capabilities within the UK, for strategic reasons. The combination of those factors means that single source procurement amounts to about 50% of defence procurement spend on equipment and services, or some £13 billion per year.

Where there is a lack of competitive pressure, the MOD needs alternative ways of assuring value for money for the taxpayer, while ensuring that our suppliers are paid the fair returns required to preserve their long-term viability. Like many countries, the UK Government use a statutory framework, introduced through the Defence Reform Act 2014 and the attendant Single Source Contract Regulations 2014. These set out clear rules on pricing single source defence contracts, which place the onus on suppliers to demonstrate that their costs are appropriate, attributable and reasonable, and they define the level of profit that can be applied. Where there is a dispute about the price, either party can make a referral on the matter to the impartial Single Source Regulations Office for a legally binding decision.

Since their introduction in 2014, the single source contract regulations have generally worked well and have helped to ensure that the prices paid for single source contracts are reasonable. Under the regime, there are now some 575 contracts, with a total value of more than £90 billion. However, any set of regulations needs to adapt as the environment changes. In this case, we have found that the rules continue to work well for traditional defence procurement—for ships, submarines, aircraft and other platforms—but that they work less well for sectors such as software and digital. Moreover, the imperative to procure things more quickly means that we sometimes need to buy off-the-shelf items, without running a competition, either because we need compatibility with existing systems or because we do not have the time. To address that, we completed a detailed statutory review of the regime in 2022. That proposed a series of reforms in a Command Paper entitled "Defence and Security Industrial Strategy: reform of the Single Source Contract Regulations", which was published for consultation in April 2022.

The changes made by these amendment regulations are the next stage in implementing the reforms. They will deliver improvements to the regime in three key ways. First, they will increase the flexibility on where the regime can be used, to ensure that more defence contracts can be single sourced without compromising assurance or value for money and fair prices. The amendment regulations introduce a number of alternative ways of pricing a single source defence contract, most significantly by allowing prices to be set with reference to market rates, rather than always having to use the bottom-up default pricing formula. Another example is where existing UK or overseas laws constrain the way in which prices are set, in a way that is inconsistent with the single source regime. In such circumstances, the amendments will allow the disapplication of the pricing formula, to the minimum extent necessary to comply with those other laws.

There are also cases in which it would be useful to disapply the pricing formula to part of a contract, particularly where a contract comes under the regulations significantly after it was signed. This will avoid the need to reopen the pricing of work that may have been completed and paid for years in the past and increase suppliers' willingness to bring long-running contracts under the regime. The amendments will allow the pricing formula to be applied only to new elements of the contract.

Secondly, the reforms will speed up and simplify the way the regulations work in practice. The legislation currently states that for contracts that fall under the regulations, a single profit rate needs to be applied to the entirety of the contract when it is signed. For some larger single source contracts, it makes commercial sense to use different pricing types for different elements of the contract, meaning a single profit rate might be too high or too low for some elements. These amendment regulations will explicitly allow contracts to be split into different components where it makes sense to do so. They will also simplify the determination of an appropriate profit rate for a contract by reducing the number of steps in the profit rate calculation from six to four. The SSRO funding adjustment will be abolished, and the adjustment made to ensure that profit is only earned on a contract once will be removed from the profit calculation, to be considered as part of the assessment of allowable costs for contracts.

The regime also applies to single source contracts under which the Secretary of State procures goods, works and services for defence purposes. While the meaning of "defence purposes" is usually clear, there are some cross-Government contracts that are used by both the MOD and other Departments. The amendments clearly set out the circumstances under which such contracts will fall under the regime, striking a careful balance between the need to ensure that prices are fair and avoiding unnecessarily extending the scope of the regime.

Finally, the amendments will clarify and generally tidy up the regulations based on the experience of those who use them, removing ambiguities that have come to light and making them generally easier to apply. We have consulted extensively with our suppliers on the

policy underpinning the amendments; I thank them for their contributions, which have led to some useful improvements.

Overall, the amendments are designed to make the regulations easier and quicker to apply in practice. To ease their initial implementation, we will be flexible in the application of the reforms, particularly with the first contracts that use them. For example, we will waive many of the reporting requirements on componentised contracts before the beginning of 2025. We will continue to work with industry to address its specific concerns.

Maria Eagle (Garston and Halewood) (Lab): It is my understanding that the necessary changes in reporting will not come into effect until October, a few months after the rest of the regime, so the Minister has to delay reporting to 2025 anyway, does he not? The law is not going to change until October anyway.

James Cartlidge: The right hon. Lady makes a fair point. We are trying to be flexible in introducing these reforms. The regulations cover some incredibly important defence contracts, from nuclear submarines to procurement for urgent operational requirements and so on, so it is good to have that bedding-in period. I think it makes sense to take this approach.

Finally, I draw the Committee's attention to the correction slip issued in relation to the draft regulations as they were originally laid. This corrects a minor error—no doubt spotted by all members of the Committee—to a cross-reference in regulation 31(d) in the first draft of the regulations. I hope that Members will join me in supporting the regulations, which I commend to the Committee.

9.33 am

Maria Eagle: It is a pleasure to serve under your chairmanship, Mrs Murray. I am sorry to have caused you a bit of fuss when you arrived in the Committee Room this morning.

I thank the Minister for putting forward the rationale behind what appear on paper to be fairly complicated changes to the single source regulations. The policy objectives set out by the Minister and referred to in the impact assessment seem sensible. The aim to increase the flexibility of the single source regime, making it simpler and quicker to use, seems like a good idea. The aim to increase assurance on value for money is certainly a good idea; as the Minister set out, we are talking about 575 contracts worth £90 billion, and parliamentarians need some assurance on value for money in respect of all that. Anything that seeks to improve and increase assurance on value for money by enabling contracts that currently have to be exempt to be brought under the scheme, and perhaps by introducing better reporting—although we are not dealing with the reporting aspects of the changes today—has to be a good thing. The compartmentalisation will mean that one can get assurance on individual parts of a contract in a way that perhaps is not possible under the current regime. It seems like good idea to aim for these improvements.

However, on reading through the regulations, there seems to be increasing complexity, in addition to their having taken quite a long time to get to this stage. The Minister is the fifth Minister for Defence Procurement in this Parliament and the original consultations on the regulations began in 2019 with his predecessor minus four, as it were, so the Department has been working on this for some time. Does he have anything to say about what appears to be increasing complexity when one of the aims is to try to increase simplicity? Notwithstanding the positive things that might come out of that increased complexity, it seems to me that the regime is more complex. Sometimes, increasing flexibility does mean increasing complexity; those are perhaps two sides of the same coin. I would be interested to hear the Minister say something about how the new regime will tackle the increasing complexity.

Certainly there were concerns expressed by those who responded to the Government's consultation on the regulations. Although there were only 10 responses, two of them were from industry bodies and so might be thought to represent a broad range of the industry that has to deal with this regime. One was from the Single Source Regulations Office, which—whatever one might say about it—knows its stuff in this regard. Only seven were from supplier companies directly.

On looking at the Government's response to the consultation, there are a lot of concerns about complexity and lack of clarity, particularly in respect of the new ways of dealing with pricing. The Minister is moving from one pricing mechanism to seven different pricing mechanisms, so that is by definition increasing complexity. If flexibility means one can get better value for money, that is all well and good, but I am slightly concerned about the increasing complexity.

Stakeholders who responded to the consultation asked for greater clarity. They seemed to be asking, "How are these things going to work in practice?" In the Government's response to the consultation, they rely a lot on the statutory guidance. The response states:

> "It is likely that the Statutory Guidance will develop further,"

and that "additional clarity" will be in statutory guidance. It states the same in respect of a number of the concerns raised by consultees. For instance,

> "Additional clarity will be provided in the SSRO's statutory guidance"

and

> "any necessary additional clarity on its practical application"

will be

> "provided through Statutory Guidance."

But we do not have the statutory guidance in front of us. Those of us in Parliament who are looking at the regulations and trying to scrutinise them cannot see the statutory guidance or even draft statutory guidance.

It is now 6 March and the Minister has set out that the regulations are going to come into force from April—a mere three weeks from now. I commend him for his ambition. Given that the consultations have been going on since 2019 and there have been three Prime Ministers and five Ministers for Defence Procurement in that time, at least he has got there and produced the regulations, but we cannot see the statutory guidance. Can he tell us when we will see it? I do not blame the Minister personally for this, but there has been a trend during this Parliament, which I think started with some of the Brexit and covid statutory instruments, of parliamentarians being expected to scrutinise things without having all the relevant documentation—in this case, the statutory guidance, which will be a big part of how well this regime works—to hand, or without its having even been written.

[Maria Eagle]

Certainly, given the Government's response to the consultation, it seems likely that the statutory guidance will be heavily relied upon by those trying to use these regulations on both sides, in the Department and in industry, to understand how these concepts are to be applied. I would be interested to know when we will see the statutory guidance. I see references in the explanatory memorandum and the impact assessment to the SSRO hoping to produce it in parallel with these regulations going through Parliament, but that really is not satisfactory for those parliamentarians seeking to scrutinise the regulations to see whether they will work or whether, to begin with, there will be a big problem in implementing these proposals and the rules within them. I do not blame the Minister personally for that, but it is undesirable that we do not have sight of the statutory guidance, at least in draft form.

I accept that the impact assessment suggests that on average there were only around 60 qualifying defence contracts between 2016-17 and 2022-23, and that 10 qualifying subcontracts a year made use of the regulations. However, as the Minister said in his opening remarks, we are talking about £90 billion, 575 contracts and 50% of the Department's spend, so it is important from a value for money point of view that the Department and the Minister get this right. Can he say any more about how much of the Department's spend and how many contracts he now expects to come under these regulations, given that they are being made more flexible? The impact assessment suggests that the number will be very small—it kind of assumes that there will be only 10 extra—but is that realistic, given that the aims of the regulations are to increase flexibility and make things easier to use, to get rid of some exemptions and to increase compartmentalisation in a way that ought to bring more potential contracts under these regulations? I would like to hear a little more about what the Minister expects the impact of these changes will be.

The SSRO has a statutory obligation to review these things over time. It has done so since it was established, and there have been previous changes to the regulations as a consequence of those reviews. I think this is the third review, and I know that the implementation is to be reviewed through to 2027, so whoever might form the next Government will have to deal with the consequences and the outcome of all this. However, I would say that the changes to the regulations that the Minister has put forward are the most extensive since they were introduced. Does he agree with that?

Does the Minister think that everything will be ready by 1 April? Does he anticipate any confusion, which might cause its own problems, when the new regime is introduced but people do not have statutory guidance and do not really know how to operate it, and are concerned about which pricing arrangement to use? Does he expect a blockage to start with? Changes to the reporting obligations will not even be legislated for until October, so will sufficient reporting mechanisms be available to parliamentarians and the general public, as taxpayers whose money is being used in these contracts, to assure themselves of the value for money of any contracts that might be signed between April and October?

Having read all this, I think the SSRO will have a bigger job to do than it does currently. There are more references to it arbitrating disputes as a consequence of these regulations, and obviously it has to continue doing the job it has been doing. Does the Minister anticipate any extra pressure on the SSRO as a result of the changes in these regulations? Will it be able to cope with the extra burdens that they will put on it? Is it to have extra resource, either monetary or in the form of personnel, to enable it to do so?

I wonder why, having taken two years to consult—that is a positive interpretation; it is two years since publication of the consultation document, but perhaps four years since some of the consultation started—the Minister is rushing to implement the regulations by 1 April, without the statutory guidance having appeared. He is a man in a rush. I noticed that in the House last week, when he set out his integrated procurement model in respect of the other procurement that the Department does. He is introducing that in April, too. Is he sure that his Department and the officials who have to implement all this will be capable of making these big changes to single source procurement and introducing his new integrated procurement model at the same time?

The last thing that I want to raise with the Minister is the idea of sharing inflation risk, which has not been in the regulations previously. It is interesting that he has acknowledged that it can sometimes make commercial sense for the MOD to share inflation risk, whereas in the past it has generally sought to pass it all on to its suppliers and contractors. Under the current regime, have any contracts been delayed or, indeed, not placed because they have become unaffordable in the 18 months or so since the right hon. Member for South West Norfolk (Elizabeth Truss) crashed the economy and sent inflation through the roof? I wonder whether the situation changed as a result of our suddenly getting a lot of inflation and the Minister was therefore encountering problems under the current regime, or whether it just led him intellectually to think, "In these circumstances, perhaps we ought to have such arrangements." I would be interested to hear what prompted the change.

Having made all those points, I do not intend to divide the Committee. The underlying aims of the regulations are good, but I hope the Minister understands that there are some questions about them. I hope he will be able to reassure us about the practical implications of implementing them in the way and at the speed that he has set out—starting from April, in the absence of the statutory guidance—and that he has satisfied himself fully that it will go smoothly.

9.48 am

James Cartlidge: Thank you, Mrs Murray. My apologies—I have not done one of these Committees for quite a while, because there do not tend to be too many relating to the MOD, so I had forgotten the form.

I am grateful to the right hon. Member for Garston and Halewood, who asked some very good questions. I am more than happy to provide clarification. First, she asked a perfectly valid question about the balance between complexity and flexibility. In such cases I think one should always use a metaphor or a happy comparison. My first ever Adjournment debate as an MP was on part-time season tickets. That was before the pandemic, and I would argue personally that they have now become quite popular. One could argue that we should have a single rail ticket all around the country, but I do not

think it would work in practice. The flexibility is a choice, and I think it is welcome to many people, with off-peak tickets and so on. I think that applies here, too. We could try to have a completely uniform regime, but it is a complex business; these contracts cover areas of procurement that are mind-bogglingly complicated, such as nuclear submarines and all the ancillary items that come with them through the supply chain. However, the right hon. Lady makes a fair point.

On the statutory guidance, let me placate the right hon. Lady. Again, she asked a very fair question; we are talking about parliamentary accountability, after all. Draft statutory guidance has been shared extensively with industry, and the formal statutory guidance will be published in four weeks' time.

Maria Eagle: Given that the Minister has shared it with industry, might it not have been an idea to share it with the Committee, so that we could determine whether we are relatively happy with it?

James Cartlidge: That is a fair point, which I will reflect on. I shall ensure that the right hon. Lady and all colleagues on the Committee receive copies of the draft guidance as soon as possible, but to be clear, we think that this approach to statutory guidance is a fair one. On a subject of such complexity, if we did not do this, the legislation itself would have to be far more complicated in terms of definitions to ensure clarity for industry, which after all has to implement these relatively complex contracts.

There were some good questions about the SSRO. I have had lots of engagement with the office, which is a highly competent and focused, very professional, relatively small organisation compared with some of those we have in the MOD. It does excellent work and we are always engaging with it on what more we can do together, because this is such an important area. As the right hon. Lady rightly said, arguably it covers 50% of equipment spend and contracts. There is a good reason for that, given the monetary value of some of the big submarine or ship builds. As for resources, the SSRO has made some efficiency savings and has an efficiency target, which I have discussed with it. Those have enabled the office to absorb some extra pressure, which is the best way to deal with it without having to have recourse to further injections of funding. Obviously, we always keep that under review.

The right hon. Lady asked about value for money. Frankly, we could spend all day talking about that, but as we have the Budget later and that will be the theme today, I will not detain colleagues long. I just make the point that the single source procurement regime exists to protect sovereign capability, but that is not its only role. For example, we may be purchasing something at very short notice and there is only one supplier. If we were to competitively let contracts in very sensitive areas, such as nuclear or some of our key naval contracts, there is of course a risk that they would be won by a company that we did not want to win them, so there is no point starting the process in the first place. I think there is a broad consensus on that point. That is why the regime exists and why it has become much more relevant.

The right hon. Lady made some interesting comments about speed, implying that I am a man in a hurry, but I seem to recall that when responding to my statement on acquisition reform she said that we were not going fast enough. We appear to be seeing one of those Leader of the Opposition-style flip-flopping processes under way, which is rather confusing to behold. She did ask a fair question, though: how does this reform fit in with wider reform of procurement? As I announced the other day, our new integrated procurement model is all about the threat we face as a country. We need to procure more quickly, because our competitors in military terms are moving at a frightening pace on some quite extraordinary capabilities that will pose a threat to the United Kingdom.

The purpose of our reforms is to ensure that we have the most effective procurement model, but this will never be completely straightforward, simple or swift; it is a highly complex area of procurement. Were we to undermine the single source regime and make it unfit for purpose, fewer companies would come forward and we would reduce the potentially available supply even further, not only from the big primes but right through the supply chain.

I engage constantly with industry. I had a small and medium-sized enterprise forum in Rosyth last week with Scottish SMEs. The week before I had one of our first engagements with industry at "Secret" in MOD Main Building. For me, that is a critical example of the new system. What it means is that industry is in the room, hearing military secrets of the most sensitive kind—obviously subject to the usual security, which we follow as closely as possible on this side of Europe—ensuring that firms understand what is coming down the track, what our plans are and what the likely security requirements are. That is moving much more quickly than before.

We talk about a three-week implementation time. At the moment, we have got companies in Ukraine that are spiralling capability within days. In that sort of context and with the need for speed because of the military scenario, we should not be afraid of acting swiftly. It is in the national interest.

I take on board the points that the right hon. Lady made. We want to make the regulations effective because they cover arguably the most critical procurements this country makes, in relation particularly to the deterrent, so I am grateful for her support.

Debbie Abrahams (Oldham East and Saddleworth) (Lab): This is not an area that I am that familiar with, but I would like to understand how equivalent this approach is to that of our allies in Europe and the US.

James Cartlidge: That is an excellent question, and it is something I have looked into in considerable detail. We want to be confident that our regime is comparable or stands up to scrutiny at least, compared to peers. We are talking about the awarding of enormous amounts of public money without competition, so it is important to get it right. I would say it is arguably more common in Europe than in the UK to have the dominance of one or two nationalised or semi-nationalised defence companies in each country. The area of comparison I looked at was the profit rates. What we would not want is a sense that the profit rate we allowed on a contract was significantly higher. It is very difficult to compare, and the initial information I have seen is difficult to track. As the Committee can imagine, getting data on this sort of

[James Cartlidge]

sensitive information is difficult, but we are looking at it. It shows, I think, that we are in the same ballpark, broadly, as our European peers.

We are talking about value for money and speed, and those important issues come together. Single source procurement can be an important instrument that is available at the moment in other contexts, and will become increasingly necessary, for example, for very fast procurement into Ukraine or situations in which we feel a supply chain needs to become more resilient because the military threat has heightened. From the MOD's point of view, this is a really important tool to have available. It covers an enormous amount of very sensitive procurement. I am confident that the regulations will improve the system, but we will constantly engage with industry and colleagues. I will ensure that the right hon. Member for Garston and Halewood receives a copy of the draft statutory guidance and that we issue the full biftas as soon as possible. I am grateful for colleagues' support.

Question put and agreed to.

Resolved,

That the Committee has considered the draft Single Source Contract (Amendment) Regulations 2024.

9.57 am

Committee rose.