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Public Bill Committee

DEFENCE REFORM BILL

Tenth Sitting

Tuesday 15 October 2013

(Afternoon)

CONTENTS

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Saturday 19 October 2013

STRICT ADHERENCE TO THIS ARRANGEMENT WILL GREATLY FACILITATE THE PROMPT PUBLICATION OF THE BOUND VOLUMES OF PROCEEDINGS IN GENERAL COMMITTEES

The Committee consisted of the following Members:

Chairs: Mr Graham Brady, †Albert Owen

† Brazier, Mr Julian *(Canterbury)* (Con)
† Brown, Mr Russell *(Dumfries and Galloway)* (Lab)
† Colvile, Oliver *(Plymouth, Sutton and Devonport)* (Con)
Docherty, Thomas *(Dunfermline and West Fife)* (Lab)
Donaldson, Mr Jeffrey M. *(Lagan Valley)* (DUP)
† Dunne, Mr Philip *(Parliamentary Under-Secretary of State for Defence)*
† Ellwood, Mr Tobias *(Bournemouth East)* (Con)
† Gilbert, Stephen *(St Austell and Newquay)* (LD)
† Hamilton, Mr David *(Midlothian)* (Lab)
† Harvey, Sir Nick *(North Devon)* (LD)
† Hinds, Damian *(East Hampshire)* (Con)
Jones, Mr Kevan *(North Durham)* (Lab)
† Lancaster, Mark *(Lord Commissioner of Her Majesty's Treasury)*
† Mordaunt, Penny *(Portsmouth North)* (Con)
† Pawsey, Mark *(Rugby)* (Con)
Phillipson, Bridget *(Houghton and Sunderland South)* (Lab)
† Seabeck, Alison *(Plymouth, Moor View)* (Lab)
† Wheeler, Heather *(South Derbyshire)* (Con)
Woodcock, John *(Barrow and Furness)* (Lab/Co-op)

John-Paul Flaherty, *Committee Clerk*

† attended the Committee

Public Bill Committee

Tuesday 15 October 2013

(Afternoon)

[Albert Owen *in the Chair*]

Defence Reform Bill

Clause 14

Regulations relating to qualifying defence contracts

Amendment proposed (this day): 31, in clause 14, page 9, line 30, at end insert—

'(1A) Before making any regulations under this Part, the Secretary of State must consult with the industry body and those persons as he thinks fit and must have regard to the results of the consultation.'.—*(Alison Seabeck.)*

2 pm

Question again proposed, That the amendment be made.

The Chair: I remind the Committee that with this we are discussing the following:

Amendment 32, in clause 14, page 10, line 2, leave out 'and' and insert—

(aa) the contract is not made under the terms of a framework agreement that was concluded before the relevant date, where that agreement determines the basis for pricing contracts placed under it, unless the Secretary of State and the primary contractor agree that the contract is to be a qualifying defence contract,

(ab) the invitation to tender for the contract work identifies the prospective contract as a contract to which this subsection applies, and'.

Amendment 33, in clause 14, page 10, line 21, at end insert

'so long as that direction does not place suppliers in one country at a disadvantage compared to those in other countries.'.

Amendment 41, in clause 27, page 19, line 43, at end add

'so long as that direction does not place suppliers in one country at a disadvantage compared to those in other countries.'.

Amendment 45, in clause 41, page 27, line 15, at end insert—

'"industry body" means any body which appears to the Secretary of State appropriate to represent manufacturers and suppliers;

"manufacture" includes assembly, install and service and "manufacturer" means any person who manufactures goods for defence purposes;

"supplier" means any person who supplies goods, works or services for defence purposes.'.

Clause stand part.

The Parliamentary Under-Secretary of State for Defence (Mr Philip Dunne): It is a pleasure to see you in your place, Mr Owen.

Before we were interrupted, I was explaining how the single-source regulations office would conduct itself when making recommendations, and saying that we believe the envisaged process will be rigorous. The SSRO will draw on its experience of monitoring and analysing single-source procurement over preceding years. It will talk to suppliers, the Ministry of Defence, the GoCo—if we go down that route—and other interested parties, such as trade bodies. It will draw up and publish its suggestions and conduct a full public consultation, and only once all that feedback is taken into account will it formulate its recommendations. That process will be set out in the framework document, to which I have already referred, between the Ministry of Defence and the SSRO. All executive non-departmental public bodies have a framework document that sets out detailed aspects of the relationship between the body and the sponsoring Department, including aspects such as payment provisions.

I hope that the Committee agrees that the consultation process is open and comprehensive. I am aware that it is not written into the Bill, but as it is a detailed procedural matter, that is not necessary. However, I assure the Committee that there is no intention to lay down regulations without consulting the industry beforehand, as I have already said. Ultimately, it is the Ministry of Defence as well as the industry that will lose out if we do not have a fair single-source framework. If we get this wrong, our suppliers will exit the market and our armed forces will be deprived of the equipment that they need, which is clearly not our intention. I hope that I have reassured the Committee that the industry will always be consulted appropriately, and that the hon. Member for Plymouth, Moor View will therefore withdraw amendment 31.

Alison Seabeck (Plymouth, Moor View) (Lab): Does the process have any specific time scale? The SSRO might need to take a little longer to come to decisions than is comfortable for the MOD. How relaxed will the MOD be about that?

Mr Dunne: I do not think that a timetable has been set in stone. We want to leave it to the SSRO to satisfy itself, on starting the process, that it has an appropriate level of engagement with the industry. We are seeking to give the SSRO as many freedoms as possible to enable it to be independent and to take the decisions that it wishes to take. I hope that that satisfies the hon. Lady.

Amendment 32 would exempt new single-source contracts from the provisions of part 2 in two circumstances: if an existing framework agreement is in place, and if the supplier is not notified before contract let, via an invitation to tender, that the contract will be a qualifying contract under part 2. I will consider each in turn. The expression "framework agreement" refers to contracts we have signed with a supplier that, in contract terms, allow for the possibility of future call-off contracts, and it sets out some standard terms that will apply to those contracts. A framework agreement might be about reporting obligations and pricing rules, as in part 2, but might equally contain clauses relating to the treatment of intellectual property rights, to how risks will be partitioned between the parties or to contract duration. We have a number of such agreements, and they can last for many years. I believe that the longest has lasted up to 25 years.

The term "framework agreement" might also cover the current terms of business agreements or TOBAs—for example, with BAE Systems for shipbuilding and Babcock for ship and submarine maintenance. The hon. Member for North Durham—uncharacteristically, he is not in his place—referred to an agreement with BAE Systems on munitions.

Alison Seabeck: May I explain that my hon. Friend the Member for North Durham is attending a memorial service?

Mr Dunne: I am grateful to the hon. Lady for informing the Committee about the reason for the hon. Gentleman's absence. I was not seeking to cast aspersions. *[Interruption.]*

The Chair: Order. A phone is going off. Will everyone check that it is not theirs? No, it is outside the room. I apologise, Minister, but I saw you checking your phone just in case.

Mr Dunne: Thank you, Mr Owen. I happen to have a temporary phone that I cannot personally turn off. I will have a go, but I was not guilty.

All our current single-source contracts, including framework contracts, were signed under the outdated and now discredited "Yellow Book" framework. That is not to say that they all represent poor value for money, but they will not generally include the level of transparency that we propose under part 2. The new framework ensures a fair and reasonable price and gives us the protections that we need to ensure value for money. We have not sought to apply it retrospectively, which was a concern of Opposition Members, although, as we discussed earlier this morning, it will be possible to apply it by agreement with the contractor when an existing contract is amended. We expect that to occur only rarely.

Were we to introduce the principle of retrospectivity, we would be required to reopen all our single-source contracts above £5 million, which number just over 1,000. Quite apart from that being an onerous task, it also carries with it some risk for us, as reopening a contract does not automatically result in a reduction in price. The consequence of not applying the measure retrospectively is that we will be left with the legacy of the old framework for many years to come. Some of our existing single-source contracts are long—often over 10 years—and some even extend beyond 20 years. We have no desire to make the transition longer than it must be.

The call-off contracts taken off the framework contracts are all genuinely new contracts relating to new requirements. We would like them to be covered by the new framework, as we would like them to have a fair and reasonable price and the protections we require. Suppliers would not be disadvantaged by that unless they believed that their current frameworks would give them a higher price or that they would need to provide less transparency. If that were the case, there would be all the more reason to apply the provisions of part 2 to the call-off contracts of framework contracts.

The second part of the proposed amendment exempts contracts if a supplier is not informed via an invitation to tender that the contract would be under the provisions of part 2. Purely as a drafting point, I must point out that we cannot link the application of part 2 to an invitation to tender. An invitation to tender is not commonly used in single-source procurement because we would, by definition, be tendering only with one party. It is part of our current process that is used for most competitive procurement, but not for single source. It is not therefore suitable to include it as a trigger for this legislation.

The intent of the amendment is to ensure that a supplier does not fall unknowingly under the provisions of part 2. For example, there could be a requirement for us to inform the supplier before contract let without linking it to a specific procurement step. We have done that for single-source subcontractors because we are not in control of the procurement process for single-source subcontracts. We need to ensure that a subcontractor is aware that they fall under part 2, so we have put a requirement on the prime contractor to make an assessment of whether a prospective subcontract will be a single-source subcontract and, if so, to inform both the subcontractor and the Ministry of Defence of that fact before letting the contract. If that is not done, the subcontract will be exempt from part 2. For prime contracts, however, we are in control of the procurement process, so we will always notify prospective suppliers of the fact that a contract will be under part 2.

It is extremely unlikely that a supplier would enter into a single-source contract above £5 million without knowing that it was a qualifying defence contract. As I said at the beginning of this morning's sitting, the vast majority of our single-source contracts are with our top suppliers, for whom the new framework will quickly become custom and practice. Furthermore, the new framework will be integrated into our acquisition processes and training. We must follow rigorous procurement processes to ensure that we comply with European Union procurement law, and any exemption from normal procurement requirements, such as under an article 346 exemption, will trigger an assessment of whether a contract can be placed on a single-source basis. We will also inform all our single-source suppliers of the new law, should we get Royal Assent.

Finally, qualifying contracts are required to be priced in accordance with part 2, so the situation will be apparent to any prime contractor before they enter into the contract. Taking all those considerations together, it is exceedingly unlikely that a qualifying single-source contract will be entered into inadvertently, without the supplier first being made aware that it would be a qualifying contract. In such a situation, if the impact was material we could conceivably exempt the contact from the framework using the power in clause 14(7), and review our processes or training if necessary.

There is also a problem with making proactive notification a requirement in statute. It would effectively put the decision of whether to apply the new framework in the hands of the officials running a procurement process. If, by omission or for any other reason, prior notification was not provided, the contract would effectively have been exempted from the framework. That would potentially undermine the broad application of the framework and the power of the Secretary of State to exempt contracts, which will be delegated only with appropriate controls. We want the framework to apply as widely as possible, with only the Secretary of State or those exercising power on his behalf being able to exempt contracts from the framework. That will ensure a level playing field. I hope that that explains why we are resisting amendment 32, and I urge the hon. Lady not to press it to a vote.

Amendment 33 concerns one of the key themes I outlined earlier—namely, the application of part 2 to overseas suppliers. The main function of clause 14 is to specify the conditions necessary for a single-source

[Mr Dunne]

primary contract to be considered as a qualifying defence contract and thereby fall within the ambit of part 2. For the most part, the clause applies to new single-source contracts above £5 million, which incidentally will exempt nearly all our suppliers that are small and medium-sized enterprises.

We considered it necessary, however, to give the Secretary of State the power to exempt specific contracts from part 2, even if they are single-source contracts above £5 million; that power is set out in subsection (7). Exceptional circumstances could arise that would make it beneficial, for commercial or other reasons, to agree a single-source contract using a pricing structure other than the one required by the Bill, in situations in which the transparency protections were not required. One example would be the purchase of additional commercial items that were readily available in the civil market, such as computer monitors. To ensure compatibility with our existing infrastructure, we might want to use a particular supplier, so the procurement would be a single-source procurement. However, the item might have a well-established market price, established in a competitive market. In such cases, we would not need standardised importing and open book rights to ensure value for money, because it would be self-evident from the marketplace, and we would not need to price using the rules set out in clauses 15 to 21. The power of exemption gives us the right to exempt such a contract from being a qualifying defence contract.

Another example is one that could arise when entering into single-source contracts with a foreign-owned supplier: specifically, a situation in which the terms of part 2 conflict with the legislative requirements of other Governments. For example, some of the standard reports would give us sight of a supplier's plans for the key industrial sites sustained by a single-source procurement. We need that information so that we can monitor planned investment or disinvestment activity and compare it with our forecast capability requirements. However, that could result in a foreign supplier having to reveal the forecast throughput assumptions of facilities that are predominantly used by a foreign Government, which could expose that country's defence planning assumptions to our gaze. That could well be treated with considerable reluctance by the other country.

Without the power to exempt particular contracts, which we intend to use only in exceptional cases, we could find ourselves in the uncomfortable position either of not being able to procure certain equipment or of having to force a supplier to provide information, thereby offending an ally or other nation. I assure the Committee that such occurrences will be rare. Most of our large foreign single suppliers have UK subsidiaries through which we purchase equipment. They also have UK-based sites, and we will be able to access information about those sites if we pay through single-source contracts.

Amendment 33 would prevent the Secretary of State from granting an exemption if it placed suppliers in one country at a disadvantage compared with those in other countries. The concern behind the amendment is that foreign-owned companies might gain an advantage over their British-owned counterparts because they would not be exposed to the reporting and transparency obligations.

2.15 pm

The Secretary of State's power of exemption is included only for practical reasons; it is not intended to benefit foreign-owned companies at the expense of British-owned companies. That would be an unusual policy for any UK Government to introduce. The amendment appears to assume that companies operating within the regulations will be at a disadvantage when compared with those that are not. The additional transparency overhead that we are introducing will be passed back to the MOD through single-source prices as long as they are fair and reasonable and suppliers can use a pricing framework that grants them a fair and reasonable price. We do not regard that to be an oppressive regime.

It is also somewhat hard to understand how suppliers will be put at a competitive disadvantage as a result of a framework that applies only to single-source procurement. We use single-source procurement when competition has been explicitly rejected and, if this involves a foreign company, there will by definition be no UK company able to produce the required capability. In fact, UK companies will be the principal beneficiaries of single-source procurement.

To sum up, we expect the Secretary of State to use his exemption power only in exceptional cases. The new framework will help us to get value for money, so we have no desire to limit its application, except where it is simply impractical. In any event, I disagree that companies will be disadvantaged by the framework, as they will still get a fair and reasonable price. I therefore urge the hon. Lady not to press her amendment—or amendment 41, which is essentially the same but applied to single-source subcontracts—to a vote.

I turn to amendment 45, which relates to clause 41 on interpretation.

Alison Seabeck: That amendment is contingent on the earlier amendments, in that it deals with their wording, so the Minister might not need to pursue that for too long.

Mr Dunne: I am grateful to the hon. Lady. I was not intending to speak to that amendment at any great length, because as she says it is consequential to three other amendments that we have discussed. The definition of an "industry body", introduced by the amendment, is not required for other purposes in the Bill, other than in relation to the three amendments that we have just been talking about. As we have not yet considered amendment 43 and have yet to vote on amendments 31 and 17, if those are withdrawn, the amendment will not be required. I therefore encourage the Committee to revert to consideration on amendment 31.

Alison Seabeck: I thank the Minister for his follow-up comments on our amendments. He has answered thoroughly the concerns that were raised with us from outside and that we wanted the Committee to discuss, particularly those on overseas suppliers. I know that the Minister was confident that UK companies would be protected in regard to the nature of the contract and the single-source arrangements, but the industry clearly was not. To have his comments on the record is enormously helpful.

On that basis, I beg to ask leave to withdraw the amendment. However, I seek your advice, Mr Owen,

about amendment 45, which, as the Minister pointed out, has some relevance to later clauses. Should we vote on that now?

The Chair: You are withdrawing amendment 31. Amendment 45 could be taken at a later stage, when we come to clause 41.

Alison Seabeck: That probably would be more sensible. That later amendment is a probing amendment, but if we were to move it, we would need to pursue this one as well.

The Chair: At a later stage.

Alison Seabeck: Yes.

The Chair: Thank you. Just for clarification, are you withdrawing amendment 31?

Alison Seabeck: Yes.

Amendment, by leave, withdrawn.

Clause 14 ordered to stand part of the Bill.

Clause 15

PRICING OF CONTRACTS

Alison Seabeck: I beg to move amendment 34, in clause 15, page 10, leave out lines 39 and 40.

The Minister has set out the way in which the formula has been worked out. His team of officials have either done a brilliant job or it is a bit like local government finance where only one person really understands it. Because the rest of us are none the wiser, the last thing we want is for them to go under a bus. I shall move on, however.

Amendment 34 is another probing amendment. Apparently, when a contract that has been a placed as a result of a competition is to be amended in a material way, the whole contract must be re-priced, rather than just the additional element. There might be a simple yes or no answer to this question but as I am not sure about this I will press on. Several different types of contracts fall within the qualifying defence contracts: firm-price contracts, which include the advanced medium range air-to-air missiles and Chinook helicopter contracts; fixed-price contracts such as the F400M; target cost incentive fee contracts, which include the Astute submarine contract and the future carrier programme; and the cost-plus contracts, which are rarely used by the MOD, but have been used in the JSF contracts.

Within the formula, there are two elements: the contract profit rate, which is described step by step in clause 17, and allowable costs, which are set out in clause 20. The ability to apply the new pricing regime retrospectively to contracts where its use was not envisaged at the time the contract was priced is giving the industry, the trade unions and the Opposition some concern. Perhaps the Minister could set out a practical example of what could happen in such circumstances. For example, a new radio system might be ordered as a result of a competitive process and an upgrade might become available after the contract was awarded which the MOD customer wanted to be included in the radios that were being supplied. Instead of just the price of the contract being renegotiated to allow for the additional cost of the upgrade, the amended contract could be designated a QDC and the whole contract, including parts of the original contract not affected by the upgrade, could be re-priced under the new regulations.

Generally, the industry does not have a problem with amendment to contracts let as a result of competition being priced under the new regime, but it has concerns about the retrospective application of the new rules to the original part of the contract. How would such a renegotiation on such a large-scale project which falls within one of the TOBAs affect companies such as Babcock or BAE? They could be undertaking QDCs as well as a range of other business that did not fall within the single-source regulatory regime.

The Bill sets out in addition three principles for determining if an element of cost is allowable in a price. Each element must be appropriate, attributable and reasonable, as the Minister explained. The SSRO will publish the guidance on how to determine which costs are appropriate as well as what is meant by attributable and appropriate. I think those fall within the single-source cost standards. When will the guidance be published? How can business plan with confidence if it is unclear how long this might take? Will there be any parliamentary oversight of those regulations? I inferred from the Minister's earlier comments that there will be significant openness so I assume that that is likely.

Can the Minister also tell us who will judge that a cost is reasonable when the quantum of costs specific to the pricing of contracts is assessed? Will that sit entirely with the board of the SSRO or will the Secretary of State be the ultimate arbiter? In a sense, it revisits our earlier debate on the independence of the SSRO. Does the MOD have, as part of the clause, responsibility to disclose to the supplier any information that could be relevant and material to the setting of the price, such as forecast demand? If so, how will that work? For example, is the MOD obliged to tell the supplier that it is contemplating reducing its capability in a relevant area and that this might be reflected in a lower demand for the items being purchased or reduce the expected level of through-life support in the longer term? That information may have a significant impact on how the supplier prices the work and their investment decisions.

How will the MOD be able to give a clear idea of the likely export potential, for example, of a particular item? Clearly, some items will not be exportable, because they are sovereign, but some might be. The unit cost of an item, such as a hypothetical jet fighter, could vary enormously from the optimistic prediction to the final outcome. Global recessions, cuts and various other outside influences could mean that the assumptions were way off beam. Can the Minister talk us through what happens if the forecast demand varies? If it is higher, who benefits? If it is lower, who pays? Some of that fits around some of his comments on earlier clauses about overpayment and underpayment, but if he could say a little more on that, it would be useful.

Over time, I am sure that the MOD expects that its knowledge and data about pricing and the allowable costs elements under this new regime will improve. That will make it easier to forecast and the MOD will have a much more reliable benchmarking system. While this expertise is continuing to build, can the Minister say how he and his officials are factoring in any additional risks to allow for potential errors in that benchmarking process that might currently be more rather than less

[Alison Seabeck]

likely? Also, over what sort of period—optimistically—would he expect this element of pricing to be assessed, hand on heart, with confidence?

Mr Dunne: Before I deal with the amendment, Mr Owen, I hope that you will permit me to make a brief statement on behalf of the MOD. It is with extreme sadness that the Ministry must announce the death of a soldier from 14 Signals Regiment attached to Task Force Helmand Brigade Reconnaissance Force on 15 October. The serviceman was killed in action as a result of enemy fire while on patrol in the area of Kakaran. Media are being notified shortly, next of kin have been informed and we have been asked for the customary period of grace before further details, such as the name of the soldier, are announced. Our thoughts and prayers are with his family today.

Alison Seabeck: Before the Minister proceeds, may I associate Opposition Members with those comments, and ask him please to ensure that our condolences are passed to the family? Our thoughts are with them.

The Chair: I am grateful to the Minister for the announcement, and I am sure that what has been said by both Front-Bench spokespersons is echoed by everybody in this Committee.

We will proceed with amendment 34.

Mr Dunne: One of the primary aims of the framework is to ensure a fair and reasonable price for qualifying contracts. Clauses 15 to 21 provide for the pricing of the contracts, and central to that is the formula, to which the hon. Lady referred in her remarks. It will apply to all qualifying contracts, as defined in clause 15.

I have provided the Committee with a worked example, because I recognise that algebra may not be the strongest suit of every member of the Committee and I thought it would be helpful to try to set out a worked example. As the hon. Lady did not refer to it, I assume that it was very clear to her how the formula works, and I take her as a proxy for all members of the Committee and assume that they have also found that helpful.

The formula provides that the price will be determined by the allowable cost under the contract, plus a profit element based on a given profit rate, known as the contract profit rate. The Committee will be relieved to hear that I will not go through every single step of the implementation of the formula, having set out that written example.

There are several ways in which a contract can be priced in accordance with the formula, depending on how it becomes a qualifying contract. For new single-source contracts, which will be the majority, the price will be agreed in accordance with the pricing rules; in effect, when the contract is let. However contracts, particularly long contracts, are amended from time to time, and we need a way of pricing those contract amendments.

With the agreement of suppliers, a contract can also become a qualifying defence contract. For example, if we make a large non-competitive contract amendment, we can agree that a contract that was originally let competitively becomes a qualifying defence contract. Contract amendments are, after all, usually single source, so we also need to set out how those amendments are priced.

Not all contract amendments result in a change to the contract price, but where they do, there must be a consistent basis for price amendment. Without a consistent basis, the aims of a fair, reasonable price and value for money would not be met, and it would also undermine the benefits of subsequent standardised reporting on that contract. Clause 15(3) therefore requires that contract amendments affecting the price of the contract are also priced in accordance with the pricing formula. In doing so, it allows for two alternative, mutually exclusive, methods of application—either to determine the price of the amendment as a distinct item or to re-determine the price of the whole contract, including the amendment.

Amendment 34 would remove subsection (3)(a), which is the option to re-determine the price of the whole contract including the amendment, meaning that all contract amendments must be priced as discrete items. The hon. Lady's probing amendment allows us to explain why there is a distinction between two types of methodology. We considered this matter in depth when drafting the Bill and found that both means of determining the price of a contract amendment are essential to the proper operation of the framework, because there are many types of contract amendment—

2.31 pm

Sitting suspended for Divisions in the House.

2.56 pm

On resuming—

Mr Dunne: I know that Committee members will be upset that we have lost half an hour of our consideration as a result of those votes. I will try to make good the time by speeding up a bit.

I was in the midst of describing that there are many different types of contract amendment that may result in a change in the contract price. I was asked by the hon. Member for Plymouth, Moor View to give some examples and I will do so. Examples include an increase or decrease in the number of items being procured; a change in the item specifications, or a change in the timing of the contract outputs. In all cases, the contract amendment will be priced by estimating the changes in the allowable costs that result from that amendment.

However, the circumstances of the amendment matter. I will give the hon. Lady two examples. In both, let us say that we started with a contract for 50 identical items and then decided we needed an additional five. In the first example, the additional requirement is identified halfway through the manufacture of the original 50 items, and the additional five items are to be added to the end of the manufacturing run of the original 50, with a similar delivery profile. In that case, the additional costs can be easily estimated and the amendment can be priced on a discrete basis for the additional five items alone.

In the second case, if the additional requirement is identified early in the contract and the new total of 55 items is required in the same period as the original 50, the costs may be more complicated. That may require setting up an additional manufacturing line,

expediting orders for parts and so on. In that case, to estimate the costs of the additional five items, the contract has, in effect, to be re-costed as a whole for the full 55 items.

Another example where it is impractical to price an amendment as a separate item is a contract delay. That will impact on almost every single cost item in one way or another. Providing the mechanism to re-price the whole contract is a reflection of the practical reality of contract pricing. Contract amendments happen all the time and, when we can, we price the amendment. Otherwise, we re-price the whole contract.

Subsection (3) does not prescribe which of the two methods is to be used. That is a matter for agreement between the two parties when making the contract amendment, and removing one of those options would place an artificial restriction on pricing more complex and material contract amendments. I know the hon. Lady was not suggesting that; it was just the probing nature of her amendment.

I would like to address some of the specific questions raised by the hon. Lady on the clause and pricing as a whole. She asked when single-source cost standards would be published and whether they would be subject to parliamentary oversight. They will be published by the SSRO. Initially, they will reflect the current Government accounting convention. They will form statutory guidance and will not therefore be subject to specific parliamentary oversight.

It may be helpful if I explain to the hon. Lady that, as provided in the draft regulations, the single-source cost standards would take effect from 1 October 2014, so the regulations will apply to any new single-source contract after that date. The profit rate within the formula that will be used for the early contracts will be the rate determined at present by the review board, which reports an updated profit rate in April each year. The April 2014 update from the review board will be its final profit rate. That will be applied to the early contracts for the SSRO until it makes its first calculation in April 2015.

3 pm

Alison Seabeck: Am I correct in assuming that the Secretary of State will announce that figure in the *London Gazette* each March?

Mr Dunne: The hon. Lady is as diligent as ever and has spotted that that information is usually published in the *London Gazette* in March each year. That process can be expected to continue.

The hon. Lady asked who will judge whether the quantum of the cost is reasonable. That is part of the negotiation between the MOD and the supplier, which will focus on whether the cost is fair and reasonable. In making an assessment of reasonableness, both parties must have regard to the guidance issued by the SSRO. Alternative quotes have been sought for outsourced work and for forecast labour.

I can tell the hon. Lady that the MOD must disclose relevant information for pricing. All pricing assumptions should reflect the best understanding at the time of pricing. She asked for an example and I have given her a hypothetical example. Another example would be the just-placed Foxhound contract where we have added additional units in successive periods.

The hon. Lady asked whether a retrospective application to TOBA would be affected. That would be the case were a new contract placed as a result of a renegotiation of one of the TOBA contracts, but that would have to be agreed by the supplier.

Alison Seabeck: The regulations that apply to this part include some of the terminology we discussed under clause 14, including "defence purposes". I am not entirely sure—I am taking liberties here, Mr Owen—whether the Minister actually answered my question about the inclusion of "defence purposes" in part 1 and its interpretation in part 2.

The Chair: The Minister now has the opportunity.

Mr Dunne: The hon. Lady is again characteristically observant. I do not think that I responded to that question.

Alison Seabeck: It is relevant.

Mr Dunne: The hon. Lady is right that there is some relevance to part 2, although the definition is used in part 1. The definition will be in the regulations and I can point her to paragraph 2(2) of the draft single source contract regulations, which states:

"A contract is entered into for defence purposes if the Secretary of State for Defence is party to the contract."

Part 1 relates to defence procurement, so the definition there covers the wider scope of work that a GoCo might undertake. The definition in part 2 is used specifically to identify contracts that should be subject to part 2 and the regulations, which is quite a different purpose.

With those explanations, I encourage the hon. Lady to withdraw her amendment.

Alison Seabeck: I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Clause 15 ordered to stand part of the Bill.

Clause 16

PRICING OF CONTRACTS: SUPPLEMENTARY

Question proposed, That the clause stand part of the Bill.

Alison Seabeck: The Opposition have one quick question on this clause. We have heard concerns that the provision may undermine the incentive placed on the contractor to give accurate estimates of costs, in particular if the contractor expects the Government to take a soft line—I am not sure what the industry means by "soft line" with regard to the regulations—on the initial estimate. Similarly, that incentive could be undermined if the defence service providers find themselves in a position where they could conceivably hold the Government and the contractor—"to ransom" is not quite the right phrase—over a barrel for increased fees to complete half-finished projects.

Regulation 19(4), which applies to the final price adjustment, states that the contracting authority must, within three months of receiving the contract costs certificate, notify the contractor as to whether it intends to make a final price adjustment to the total price payable. That is a slightly different mechanism to the one in the "Yellow Book"—the Minister has explained why some of the changes to the "Yellow Book" are

[Alison Seabeck]

required—but could it explain the three-month period? I am sure that there was a good reason for that and am just interested to know what it was.

Mr Dunne: The clause is designed to ensure that pricing arrangements work for qualifying defence contracts, which include a target price with sharing arrangements in the event of cost overruns or underruns. Wherever possible, we try to use a firm or fixed-price contract to ensure best value for money, but in some cases there is insufficient pricing certainty to be able to make a firm or fixed-price contract a sensible option for either party. For the supplier, the risk is simply too great to take on a fixed-price contract, and pricing as adequate risk contingency would not result in value for money for the taxpayer. In such circumstances, a target cost contract solution is generally used, which may well have pain share/gain share mechanisms in it around an assumed target price, so that both parties can benefit from savings and both parties suffer from cost overrun. That is the purpose of the clause.

On the hon. Lady's specific question as to why a three-month period has been used, the best answer is that that seems to us like a reasonable period of time. If there is any more scientific reason behind that period, I will revert to her, but if I do not reply to her, she can assume that we think it is a reasonable period in which to get agreement.

Question put and agreed to.

Clause 16 accordingly ordered to stand part of the Bill.

Clause 17

CONTRACT PROFIT RATE

Question proposed, That the clause stand part of the Bill.

Alison Seabeck: We are back to where we were with clause 15, but I would like some clarification on a couple of areas specific to this clause.

On clause 17(1), the contract profit rate is the key determinant in the final price of defence contracts. The process for determining it is left entirely to secondary legislation. Will the Minister tell the Committee why he felt it was not necessary to specify in the Bill any permissible range or general guiding principles?

Clause 17(2), specifically step 2, which is similar to clause 16(1), permits adjustments to the profit rate where the contractor's estimate of allowable costs differs from the actual allowable costs. Again, that perhaps provides limited incentives for the contractor to provide an accurate estimate at the outset. The Minister dealt with that issue in part in his response to my concerns about the previous clause.

In step 4, industry funding is top-sliced. We are told that that will be fair and equitable and spread across contractors based on the value of their QDCs. If their QDCs are subject to renegotiation at some point, will the proportion they pay to the SSRO also have to be retrospectively backdated and adjusted to reflect any change in the sums apportioned?

Will the Minister shed some light on the SSRO funding and the level that industry pays? It would appear that the funding from QDCs is open-ended; is there any cut-off point beyond which it will not be reasonable for the SSRO to come back to industry and say, "We might need to adjust this because of the changing circumstances"? There is a degree of confusion about the way in which some of the steps are set out. I would be grateful for some clarification.

Finally, to come back to the language being used, under step 6 in clause 17(2), we find the phrase

"an appropriate and reasonable return".

That is very general. Why has the decision been taken not to be more specific, perhaps by referring to a range of percentages of the contract value, a percentage above cost price or some other appropriate benchmark that could be clearly quantified and compared across the sector?

Mr Dunne: The clause gets to the heart of how the formula will be applied. In that respect, the worked example is quite instructive in trying to show how the different steps relate to one another.

The hon. Lady asked some very specific questions about how the steps are applied and why we have sought not to prescribe in the Bill how each step should work. The overriding point to make is that it is really for the SSRO to determine what it deems to be a fair and appropriate return, so that it is seen to be an independent arbiter. If the Ministry were to be too prescriptive in setting out how the formula should work, that would introduce inflexibility to the formula. Over future decades, circumstances might change and lead to the independent arbiter forming a different view. In addition, being too prescriptive would affect the arbiter's independence. We therefore think it is appropriate to draft the guidance on calculating the profit rate in the way that we have.

The hon. Lady asked how the incentive arrangements work, specifically in relation to step 2, and why we have settled on a maximum of 2%. We need to view this matter in the context of how the profit rate has been determined in the past. At present, the review board takes a basket of comparable manufacturing company margins that UK manufacturers are achieving in the UK, looks back over three years, does an average and comes up with a number, which varies but is around 10%. In some years, it is 9%, in others it is just over 10%. To take a topical example, let us compare that with energy sector profit margins, which are around 5%. It is a not unreasonable level of profit based on what the average manufacturing company across the country is currently getting. If we say that an incentive should be up to 2%, that means that roughly 20% of the profit rate is eligible for incentive either way, which seems to us to be about the right maximum. That is how we arrived at that figure.

The hon. Lady asked whether the contribution payment that the contractors would pay to the funding of the SSRO would be adjusted in the event that the profit rate was itself adjusted as the result of a contract negotiation. She is right that if the pricing of a contract was challenged and that led to a reduction in the supplier's profit there would be a corresponding reduction in its contribution to the funding of the SSRO, because that is formulaic and would come off the profit in the same proportion as it had been added to the profit.

Alison Seabeck: If there is an assumption that that would happen, would it not be sensible to put it in the Bill somewhere, so that suppliers could understand that they would have that recourse if things changed?

Mr Dunne: As I explained in an earlier sitting, the intent of the Ministry is to pick up the funding costs for the first three years, so the formula contribution will apply only from March 2017. We are seeking to divide the costs incurred by the SSRO evenly between the MOD and industry as a whole. The precise percentages that will apply to contracts will be based on the spend in any one year divided by the number of contracts that are entered into. It is very complicated and fast-moving. Both the amount and how it will be apportioned across contracts moves from year to year. Given that the amount of money involved will be relatively small, it is best not to tie the SSRO or MOD personnel up in knots by trying to anticipate in a formulaic sense exactly how that would work.

3.15 pm

The hon. Lady also asked whether the SSRO funding adjustment would be backdated. No, it will not. She asked, in relation to step 6, why we have not used a benchmark for capital rates. As I think I indicated earlier, the rates will be benchmarked against prevailing profit rates in industry, and against rates of return available from gilts and other benchmarking measures that are out there, in much the same way as the regulators of the regulated utility industries are benchmarked against their most relevant comparators. It will be up to the SSRO, if it decides that it wishes to change the calculation or the identification of the benchmarks, to do so in discussion with industry and the Ministry. I hope that I have answered the hon. Lady's questions on the profit rate.

Mr Tobias Ellwood (Bournemouth East) (Con): Forgive me, Mr Owen, if I am wandering into a debate that is perhaps more appropriate for clauses 30 and 31, but could I ask the Minister to say something about contracts that are not met—where the industry fails to provide the goods on time—and there is the converse of profit? In past procurements, many of the problems that we have faced have led to changes in circumstances, which have led to costs going up and overruns. What penalties would be in place under the new system to ensure that companies meet their contract? Perhaps the Minister could tell us now or when we come to clauses 30 and 31.

Mr Dunne: I am happy to address that now. My hon. Friend raises an important point that is part of the whole objective of our reform proposals for defence acquisitions: how do we ensure that the vital equipment that our armed forces need is delivered on time and on budget, and performs as it should? That is the underlying objective behind these entire reforms and the Bill. Much will be handled through the relationships that we were discussing in part 1 and will result from the nature of the negotiations that take place when new contracts are entered into. We hope to introduce new world-class standards, through a Government-owned, contractor-operated organisation if that is the route that we go down, to ensure that we make our contracts as efficient for the MOD as possible.

On single-source contracts, most of the penalties and incentives relating to an individual contract will be set in the contract. The single-source regulations that we are talking about, fixing the profit, in essence aim to determine that the costs that are allowable expenses of the Department and the profit that the contractor is able to earn are decided on a rigorous and independently assessable basis. There is within the profit formula a modest incentive element—I say modest; it is up to 20% of the profit—which we have talked about. That would clearly be forfeit in the event of non-compliance with the terms of the contract, but that is really the only direct element that achieves pain share/gain share through this part of the Bill.

Question put and agreed to.

Clause 17 accordingly ordered to stand part of the Bill.

Clause 18

CONTRACT PROFIT RATE: SUPPLEMENTARY

Alison Seabeck: I beg to move amendment 35, in clause 18, page 13, line 19, after 'that', insert—

', if the achievement of a fair and reasonable contract profit rate for a qualifying defence contract at the time of pricing was frustrated because the information supplied or made accessible by one party to the other at the time of pricing, and on which that contract profit rate was based in whole or in part, was materially inaccurate or incomplete.'.

The Chair: With this it will be convenient to discuss the following:

Government amendments 18 and 19 and Government new clause 5—*Single source contract regulations: time limits and determinations.*

Alison Seabeck: We again seek specific reassurance from the Minister on the industry's concerns about the degree of uncertainty it sees in parts of the Bill and this contract. Clause 18 follows on from the SSRO being allowed to determine, in line with clause 15, that the amount paid should be adjusted. Will changes to prices throughout contracts create uncertainty? Will contractors be able to appeal the decisions? If they will, could that not lead to expensive and lengthy legal processes for the MOD?

Clause 17 does not apply to contracts of de minimis value, as the Minister made clear today and earlier. Amendment 35 seeks to alter clause 18(3) so that while the SSRO may be able determine whether the price payable under the contract is to be adjusted at any time, as is currently the case to give industry some certainty, that re-determination of the contract price could be adjusted only if the original price was frustrated because of inaccurate information. I suspect that the Minister will say that the proposal is way too prescriptive and is therefore unnecessary, but I will wait for him to tell that to the Committee.

The measure would mean that industry would not be penalised when it had provided accurate, substantive information at the original point of pricing, and would offer the same protections for the MOD, therefore giving certainty all round. That is how we view the nature of the amendment. It is only a probing amendment, but I would like to hear the Minister's thoughts on the necessity of providing certainty, so that industry can continue to invest in people and technology.

The Minister's amendment is fairly self-explanatory, and his new clause 5 might be a response to some of the concerns over retrospectivity that we have flagged up. In

[Alison Seabeck]

which case, I am pleased that the Minister has listened to the voices being raised both inside and outside the House. I would welcome clarification of the reasons for removing clause 20(5)(a). What is the relationship between the clause and the change and is that a further response to industrial pressure?

Mr Dunne: This group of amendments relates to another of the key themes that I referred to in my opening remarks—namely, the ability to challenge the price of a contract throughout its duration and up to two years thereafter. I agree that, put that way, it seems a bit strange. It is the nature of the challenge that is the key issue here. The price can challenged only if it comes to light that the initial price was based on assumptions that were wrong or not fit for purpose.

To understand why we need to ability to challenge the price, I need to provide a bit of context. The new single-source framework is essentially a deal between suppliers and the Government. Suppliers get a fair and reasonable price and the Government get the protections they need to ensure value for money. That is a good deal for both parties. We have a duty to ensure taxpayer value for money, and an efficient and thriving defence sector that gets a fair price is good for defence as a whole. Determining a fair and reasonable price is therefore a key component of part 2, and clauses 15 to 21 set out how that is to be done. For example, they set out that the price must be determined on the basis of allowable costs—costs that are reasonable, appropriate and relate to the contract. On top of those costs, the supplier is entitled to a fair and reasonable profit rate based on a generic rate, with adjustments for risk and other matters.

Following those pricing rules will result in a price that is fair and reasonable. The rules on profit ensure that suppliers are adequately compensated for their expertise. The rules on cost ensure that the taxpayer does not pay more than he should. There would be no point in having such rules were they not enforceable. Indeed, that would undermine the deal central to the framework. That is the situation that we have at the moment. Even though the current review board for Government contracts annually recommends a profit rate, as we discussed earlier, there is no obligation to use it, and it is being used less and less on our larger contracts.

People might ask why we need price-enforcement provisions and why anyone would sign a contract with a price that was not fair and reasonable. The answer stems from the market failures inherent in single-source procurement. Single-source procurement is most commonly used when there is no alternative supplier. That means that we cannot walk away from the supplier without also walking away from the essential military capability that it provides. That is not a strong negotiating position, as our suppliers are only too aware. We are also sometimes under time pressures that mean that any delay to signing the contract puts lives at risk. That compounds the problem, which partly explains why we might not always get the best deal.

Another reason why we might sign a contract with a price that is not fair and reasonable stems from the fact that single-source procurement means that only one supplier is pricing the work. The knowledge that no one can put forward a cheaper, more competitive price puts a supplier in a highly unusual and privileged position. Instead of a healthy market incentive to price keenly, our single-source suppliers are under a direct financial incentive to do just the opposite, and the current framework regrettably encourages that. That is not to say that our suppliers always, or even routinely, do this. It cannot be denied, however, that an environment in which suppliers are rewarded for inflating their price is hardly conducive to getting value for money.

The changes under part 1, if taken forward, will help to address that capability imbalance. It is not enough for a supplier to show us its assumptions and to put all the duty on to the MOD to check that each and every one is reasonable, as with the current approach. That encourages a supplier to add many extras into its price in the hope that the MOD does not find them all. That is a terrible pricing incentive, far removed from a healthy market, and we must address it if we want to get value for money. Again, I am not saying that that always happens, but it is not conducive to getting value for money. We want to encourage suppliers to use good-quality pricing assumptions that are fit for purpose. If the cost is worth hundreds of millions of pounds, they should do a certain amount of due diligence to support that estimate. If they do not, they should be at risk of a future price change if it transpires that outturn costs bear little resemblance to the original estimates. Equally, and just as importantly, I accept that the MOD must have a duty to check such estimates. If we fail in our duty, any price change should take that into account. The proposals will replace the current misaligned pricing incentives with incentives that act as a proxy for the missing competitive pressures.

There are several reasons why we need rules setting out how to price single-source contracts and why we need an enforcement mechanism that encourages all parties to apply them. This is the only way that something akin to market pricing incentives can be put into the system. We have chosen to give the SSRO, in its role as an independent expert on single-source procurement, the function of acting as an independent adjudicator in the event that the pricing rules are not followed. One alternative might have been the courts, but the technical and specialist nature of single-source procurement means that that route would be more risky to both parties and almost certainly more expensive.

Under clauses 18 and 20, the SSRO can make a determination that the price of the single-source contract needs to be adjusted. It will make that assessment if it considers, for example, that a supplier's assumptions were misleading or not fit for purpose at the time of pricing—in other words, that they were not fair and reasonable. If the SSRO thinks that the MOD should have asked more questions, it will also take that into account and any price reduction will be lessened. The industry has raised concerns, reflected in the hon. Lady's amendment, that that adds risk into single-source procurement. Our challenge back to industry is that such risk can easily be mitigated. If the pricing rules are followed and an audit trail of assumptions is kept, any risk should be minimal. We are also introducing amendments to mitigate this risk further, which I will come to later and which address one of the concerns raised in the evidence presented in the CBI's letter last week.

I return to amendment 35, which would reduce the grounds for referral to the SSRO. A referral could be made only if inaccurate or incomplete information had been provided by a supplier to the MOD. If the information provided was misleading, the amendment would prevent the SSRO from reviewing, and potentially adjusting, the price of a contract. If there was an error in calculation, there would similarly be no ability to refer the matter. I accept that hon. Lady's assertion that this is a probing amendment, but if it were accepted it would put the duty back on to the MOD to ensure that all the details of a price were fair and reasonable, which is precisely the situation that we are in at the moment and trying to avoid. I therefore urge her not to press her amendment.

3.30 pm

I turn to the group of Government amendments—amendments 18 and 19 and new clause 5—which also relate to the SSRO's adjudication role. I mentioned that we had responded to the concern raised by the CBI, and I will briefly quote from its recent letter to the Committee. It said that

"the legislation permits the MOD to challenge a contract price at any time up to two years after contract award, which would cause uncertainty for suppliers and potentially undermine shareholder value and willingness to invest in the UK. To alleviate industry's concerns, the legislation should clearly define the grounds on which a challenge can be made, and limit the number of times and overall time frame within which the MOD can appeal to the SSRO to challenge a contract price."

I am pleased to say that the amendments we are proposing will address those issues.

The SSRO referrals were never designed to add risk into single-source procurement. We understand that there might be occasions when a supplier and the MOD are simply uncertain as to whether a cost is allowable. In that case, either party can refer the matter to the SSRO for an opinion. If that is used as the basis for pricing, the parties can be confident that they have followed a reasonable interpretation of the pricing rules.

The purpose of these opinions and determinations is to ensure value for money for the Government and a fair and reasonable price for contractors under qualifying defence contracts, and to provide an appropriate appeal mechanism for the compliance regime. However, the time period in which referrals may be made to the SSRO is not, as currently drafted, clearly specified. For example, subsection (3) currently provides for referrals related to the termination of a contract profit rate to be made "at any time". It is therefore possible that one party could refer the matter to the SSRO many years—or, conceivably, even decades—after the contract had ended. That is clearly unreasonable and was not our intent.

To specify time periods for each referral in the Bill would, however, require many amendments; it would also introduce inflexibility into the framework. We would therefore like to be able to specify time limits in the single-source contract regulations, allowing them to be changed if necessary, particularly in response to a recommendation by the SSRO under its duty to review the framework. New clause 5(1) gives us that power.

The time period that we specify in the regulations may be less than the current two years after the end of the contract. However, we need to ensure that it is long enough for us to look at the final outturned contract cost, to understand the variance with initial assumptions and to investigate whether that is a case for a referral. We will not limit the number of referrals, because new information can always come to light. However, we have neither the resources nor the inclination to bombard the SSRO with referrals. Furthermore, if we act unreasonably, the SSRO has the power to charge industry's costs back to us.

Before I consider the second part of new clause 5, I will touch on amendments 18 and 19, which are consequential to setting out the time periods for referrals to the SSRO in regulations. Amendment 18, which relates to clause 18, removes the reference to "at any time", to which I referred earlier. It also removes the reference to the price having to be first determined in accordance with clause 15. The price of all single-source contracts must be determined in accordance with clause 15, so that adds nothing. Amendment 19 is similar, but applies to clause 20(5). That also removes the reference to the price having to be first determined in accordance with clause 15. Amendments 18 and 19 both clear the way for the periods relating to referrals to the SSRO to be specified in the regulations.

The second part of new clause 5 will provide greater certainty to both parties of what the outcome of the binding financial determinations is likely to be. In discussions with the industry, it raised the concern that these SSRO determinations would add risk, given that the contract price might be changed. Determinations made by the SSRO are final, subject only to judicial review, and as currently drafted neither the Bill nor the regulations specifies the matters the SSRO should consider in arriving at a determination. Although the SSRO, as an independent and expert body, can be trusted to make determinations on a proper basis, we feel it would be helpful to have these matters set out with clarity, on a non-exhaustive basis, in the regulations.

Industry has also expressed a concern that without additional clarity there is an increased financial risk due to uncertainty. We agree that if a binding financial determination is not based on clearly identified matters, both parties to a qualifying contract could face increased uncertainty. It is certainly our intent that the price should change if the SSRO were to find that a supplier had deliberately withheld information or used pricing assumptions that were not fit for purpose. That risk to the supplier can be mitigated by the supplier following the pricing rules, and, if there is doubt, by asking the SSRO's opinion prior to pricing.

The industry accepts those points, but there is still concern. It is felt that the matters to which the SSRO should have regard need to be made clear. Subsection (2) of the new clause addresses that concern by allowing the SSRO to specify the matters to which the single-source regulations office must have regard in making a determination. That does not impose a restriction on the matters that the SSRO may take into account in reaching a determination; it will continue to be able to consider any matters that it believes relevant to the determination in question. However, the provision allows the specification of matters to which it must have regard, which will provide greater certainty for both parties to a qualifying contract.

Taken together, we believe that the three provisions will provide improved clarity for the SSRO referrals process, a clarity that should be welcomed both by Government and by industry.

Alison Seabeck: The interrelationship between clauses 15 to 21 means that we will inevitably keep skipping backwards and forwards a little. The Minister and his officials have done a pretty good job of setting out this part of the Bill. A balance needs to be struck, with due diligence on the side of both the MOD and industry. The Minister made that point well.

I am pleased to see that the Minister has taken on board the concerns of industry, and in particular the CBI, about the need for flexibility on the time frame for reviews and referrals. I was interested to hear him say that there will be no limitations on referrals. He is probably not able to answer this question now, but is there scope for more than one referral concerning the same contract if further evidence comes to light at a later stage? Perhaps he could send me a note when he has a moment.

Mr Dunne: I am happy to address that issue now. There are no limits on the number of referrals. We considered having one, but we thought that the importance for the taxpayer of ensuring that the contract was fair and reasonable overrode any industry concerns. We can succeed in an application to the SSRO for a determination only if the allowable costs were not fair and reasonable or if the pricing itself was regarded as not being fair and reasonable. We think we have right and justice on our side in championing the taxpayers' cause here, and we do not think that right should be fettered by a limitation on the number of referrals.

Alison Seabeck: I thank the Minister for answering my question. The wording of new clause 5 is slightly clunky. It uses the phrase

"under this Part or the regulations"

on two occasions, which is a little unwieldy. Nevertheless, having made that point, I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Amendment made: 18, in clause 18, page 13, line 20, leave out from 'subsection (4)' to ', determine' in line 22.—*(Mr Dunne.)*

Clause 18, as amended, ordered to stand part of the Bill.

Clause 19

Rates etc relevant to determining contract profit rate

Alison Seabeck: I beg to move amendment 36, in clause 19, page 14, line 5, after 'adjustment for that year', insert

'and the reasons for any changes,'.

Clause 19 dictates that some of the standard rates that are relevant to determining the contract profit rate, as outlined in clause 17, are to be established by the Secretary of State using advice from the SSRO. Can the Minister confirm that the rates listed in subsection (1) will be key to determining the price the Government pay for defence services? The Secretary of State appears to have absolute discretion in this and need only publish reasons for rate changes when he disagrees with the SSRO's assessment of the appropriate rate under subsections (5) and (6). I can well understand the argument for this power to rest with the Secretary of State, but in the interests of transparency and perhaps the public interest, could he not publish the reasons for any changes to the rates, or at least any changes that would result in a significantly higher cost to the taxpayer, and could this not be placed in the House?

I should be grateful if the Minister set out why such a move would not be acceptable or necessary. There are, I am sure, good reasons but we should have them on the record, because there was no mention in Lord Currie's recommendations—as far as I could see; it is a large document—of the Secretary of State's powers in this regard. Have all of Lord Currie's recommendations regarding the methodologies applied to setting the contract profit rate been taken forward? He suggested that the SSRO might wish to establish a number of key principles for the negotiation of a fair and reasonable profit allowance, but he did not set out a specific rate, or rates.

There are a number of other areas in respect of which the Minister could usefully explain to the Committee why a power that Lord Currie did not recommend has been placed with the Secretary of State. Those include the approach now being taken to the calculation of a baseline profit rate on the basis of comparability, and how that can be varied to take account of factors specific to each contractor pricing unit— the capital requirements—and contract factors which would ultimately, I assume, then be adjusted in negotiation between the MOD and its contractor for each specific contract, commensurate with the risk being taken by the contractor.

Lord Currie did not leave all power in this regard with the Secretary of State. Can the Minister offer an explanation? I would not necessarily disagree with his putting this power with the Secretary of State, but I would like to understand the logic behind it. Is there a specific part of the Bill in which the protection against excessive profit and loss sits? What percentage of any excessive profit is likely to be recouped, and will a percentage be set?

Mr Dunne: This is one of the few amendments from the hon. Lady that has caused me a little difficulty, which is perhaps a difficulty in comprehending what she is driving at. It may stem from a possible misunderstanding of the current duties on the Secretary of State, and if I can explain those it might help her. Clause 19 places a statutory duty on the Secretary of State to publish, prior to the financial year to which they will apply, each of the four items set out in subsection (1). So the onus is on the Secretary of State to make public what the rates are. In determining those rates, the SSRO must provide the Secretary of State with an assessment of what it believes to be the appropriate rates, including the rate of its own funding adjustment. Following this assessment the Secretary of State must then publish the rates and the SSRO's funding adjustment in the *London Gazette*.

Already built into this process is the requirement for the Secretary of State to publish the reasons for any difference between what was published and what the SSRO recommended to him. This process applies to the items in subsection (1) and to the funding adjustment for the SSRO's own costs. The hon. Lady's amendment would require the Secretary of State to publish reasons for annual changes in the SSRO's funding adjustment, which would therefore add another step to what is an already comprehensive approach, without, in our view, enlightening the public materially any further.

As to the funding adjustment itself, we do not expect that to change significantly year on year. As we discussed earlier, the SSRO's costs relate to the people it will employ. We assume that there will be 35, although the number could go up or down a bit each year, and that might lead to a variation in the funding adjustment. However, we do not anticipate that the organisation will mushroom, or change materially, in size from one year to the next. Therefore, changes to the funding adjustment mechanism for the SSRO itself are likely to be modest in scale from one year to the next.

For that reason I hope the hon. Lady will recognise that the amendment would complicate things, rather than clarifying as she intended.

3.45 pm

Alison Seabeck: I accept the Minister's explanation of why the amendment is not necessary. I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Clause 19 ordered to stand part of the Bill.

Clause 20

ALLOWABLE COSTS

Alison Seabeck: I beg to move amendment 37, in clause 20, page 14, line 14, leave out subsection (1) and insert—

'(1) Single source regulations must contain measures for determining whether costs and provisions are allowable costs and provisions under qualifying defence contracts. The SSRO may issue guidance on the determination of allowable costs and provisions, including adjustments to implement profit at only one level within a number of group undertaking of which the contractor is one in relation to allowable costs and provisions under the contract (see step 3 at section 17(2)).'.

The Bill requires the SSRO to issue guidance about determining whether costs are allowable costs, and that guidance must be visible for the Secretary of State, the GoCo contractor—should it become reality—and the primary contractor. All those parties may also request the SSRO to determine whether a cost is allowable or not. That is all achieved in the clause, and subsection (4) in particular dictates that the Secretary of State can at any time require a primary contractor to prove that the allowable costs are appropriate, attributable to the contract and reasonable, as we have heard in relation to other clauses.

Will the Minister explain why that does not create a burden on primary contractors, by constantly requiring them to justify certain costs? How long will contractors be given to prove those costs, and will changing the price of the contracts create uncertainty? I am asking the Minister to revisit and reaffirm the line he has taken; because we are covering the Bill clause by clause, that would be helpful.

There appears to be an acknowledgement of the issue in subsection (2), which refers to parties being "satisfied". That suggests a non-objective standard, and I should therefore welcome the Minister's pointing out where that word has previously been used in legislation. It suggests ambiguity, and the aim in legislation is usually to avoid that.

There is a further concern which other members of the Committee may have had raised with them: on determining what is an allowable cost under subsection (5), is the Minister wholly satisfied that the Bill should not offer additional criteria for that determination? Industry's interpretation is that the provision means that the parties will have to start with SSRO guidance, but that ultimately the SSRO will tell them the absolute position on application. That seems to be putting the cart before the horse.

Amendment 37 would ensure that the regulations included definitions of allowable costs or non-allowable costs, or both, so that the basis of costing qualifying defence contracts would be more certain and transparent, and would be subject to public scrutiny. Will the Minister explain why he decided not to allow the regulations to define the absolute position, and that the SSRO should issue guidance on that and make a determination against regulations, and not against its own guidance? We need some clarification of what is intended.

Mr Dunne: Amendment 37 deals with the allowable costs under the new framework. The hon. Lady is quite right to focus on that element of the Bill, because of course, allowable costs typically account for 90% of the total cost of single-source procurement. I have indicated that we are spending £6 billion, which means that roughly £5.5 billion per annum of Government expenditure is defined in the clause. The rules about determining allowable costs are important.

There are three principles in the Bill for determining whether a cost is allowable, and each must be met for a cost to be allowable. First, a cost must be appropriate, as in clause 20(2)(a). That relates to the type of cost, such as whether it is for labour or materials, insurance or pension costs, rationalisation or redundancy costs. Some types of cost are always appropriate, such as direct labour, and some never, such as charitable donations, as I mentioned earlier. I applaud defence suppliers for making charitable donations, but they should not be seeking to charge them to the taxpayer, as they are not making them themselves.

Secondly, a cost must be reasonable. That relates to the quantum of the cost, and a cost may be reasonable if it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. That point is addressed in subsection (2)(c). Finally, a cost must be attributable to the contract. That might sound obvious, but as I illustrated earlier, that is not always the case at present. Without that principle, the cost incurred by a supplier could be both appropriate and reasonable, yet be either wholly or partially related to work other than that under the qualifying contract.

The hon. Lady asked why we have used the term "satisfied" in subsection (2). I will write to her to explain why. It does not seem to me an unreasonable word to use in the context, because it concerns being to the satisfaction of both the Secretary of State or his agent, and the primary contractor, so both parties have to be satisfied. We could have used the word "agreed", but I think "satisfied" is a level of agreement that is not quite as formal as a formal agreement in legislation. I hope that answers the hon. Lady and avoids the need for me to write. *[Interruption.]* She has indicated that is the case, and I am grateful to her.

The hon. Lady's amendment would ensure that the single-source contract regulations outline in more detail the three principles I have just referred to, and would further require the SSRO to issue additional statutory

[Mr Dunne]

guidance. As the Committee is aware, the single-source contract regulations made by the Secretary of State will contain the further detail essential to the operation of the new framework.

The Bill also provides for a range of statutory guidance, some to be issued by the Secretary of State, but most by the SSRO. Like the regulations, the statutory guidance has legal power. However, unlike the regulations, parties subject to part 2 can deviate from statutory guidance if they have reasonable grounds to do so. Parties must "have regard to" the statutory guidance. For matters where it is difficult to set out rules that cater for every possible set of circumstances, statutory guidance provides a means of setting rules that provide for the majority of cases but allow some flexibility to deal with unforeseen circumstances or grey areas as they arise over—in this case we hope—many years.

The first part of the amendment deals with the role and purpose of the single-source contract regulations and the second requires the Single Source Regulations Office to issue statutory guidance. The second part is not required, as the Bill already gives the SSRO that power, as I will briefly explain in a moment. Clause 20(1) requires the SSRO to issue statutory guidance on determining whether costs are allowable; it is its statutory responsibility to do so.

Clause 18(1) also provides that the SSRO may issue guidance on any of the six profit rate-setting steps set out in clause 17, which we have already discussed. Step 3 addresses an accounting issue that, due to complex supply chains, can result in profit being charged on some costs more than once. That is not a new issue, and the current regime has a mechanism that attempts to address it. The mechanism has not worked as well in practice as we would like, and this adjustment replaces it.

Clauses 17 and 20 already allow the SSRO to issue statutory guidance on both allowable costs and the profit steps, and require that regard must be paid to that guidance. To go back, the first part of the amendment would require the regulations to contain measures for determining allowable costs. As we developed the framework we considered whether it would be better to put rules into legally binding regulations or to use statutory guidance, with the greater flexibility that provides. If statutory guidance is used, a second question arises, namely, who should issue that guidance: the Secretary of State or the SSRO? For allowable costs, we judged that the best approach would be to use statutory guidance and that that guidance should be issued by the SSRO. Using statutory guidance rather than regulations is a matter of practicality; requiring the SSRO to issue that guidance rather than the Secretary of State is a matter of principle.

If we were to specify binding rules for determining allowable costs in regulations, those regulations would need to be very detailed and extensive, catering for every possible scenario that might occur. Such regulations would probably run to many hundreds, perhaps thousands, of pages and it would require a veritable army of people to monitor, police and review them. That, frankly, is the situation that prevails in the US, where the Defence Federal Acquisition Regulations are over 3,000 pages long and the Government employ some 1,000 accountants to ensure that they are complied with. I am sure the hon. Lady will agree that we should not seek to emulate that situation through the Bill. It may be a suitable approach when over $1 billion is being spent each day on military equipment, as is the case in the United States, but we consider it overly bureaucratic for our much more limited defence budget, especially given that, as I indicated earlier, the rules apply to only a few hundred contracts.

The alternative is to use statutory guidance. As it is possible for a person subject to that guidance to deviate from it if they have sound reason to do so, the guidance can focus on principles and rules appropriate for the vast majority of cases. Where there are specific circumstances that reasonably justify an alternative approach, that approach may be taken while still being compliant with the law, although a person doing so must be prepared to justify the approach they have adopted.

I hope the hon. Lady recognises that the approach we have taken is pragmatic, designed to ensure that the rules are clear and that there is sufficient flexibility to allow for unfolding circumstances over the years. Given that, I hope she will withdraw the amendment.

Alison Seabeck: I thank the Minister for that explanation. He does not need to write to me about the issue relating to the word "satisfied". Although I understand the need to use "satisfied" as opposed to "agreed", given that we are working with a situation in which 90% of total cost will be going through as allowable costs, we might have avoided some prevarication if a word stronger than "satisfied" had been used. However, we will accept his reasoning on that matter.

I understand the Minister's point in his comments about the US situation. Size matters, and so it is a case of horses for courses. The solution that the Government have put forward is probably the most sensible given the demands that statutory regulation would put in place. I therefore beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Amendment made: 19, in clause 20, page 14, line 33, leave out paragraph (a).—*(Mr Dunne.)*

Clause 20, as amended, ordered to stand part of the Bill.

Clause 21

FINAL PRICE ADJUSTMENT

4 pm

Question proposed, That the clause stand part of the Bill.

The Chair: With this it will be convenient to discuss Government new clause 4—*Recovery of unpaid amounts*.

Mr Dunne: New clause 4 provides an enforcement mechanism for the SSRO determinations that result in a change to the contract price. I have already discussed in some detail why we need the ability to refer a contract to the SSRO in the event that we believe that the price rules set out in clauses 15 to 21 were not followed. The Bill, as drafted, already provides for the right to refer such matters to the SSRO. New clause 4 ensures that price adjustments made by the SSRO are always enforceable. The amendment is necessary as a doubt has arisen as to whether price changes made by the SSRO would be enforceable in all situations.

Under the new framework, the price of a contract will still be set out in a contract, although now that price must follow the pricing requirements set out in the Bill and regulations. The contract will also include provisions for how payment will be made, which is usually a schedule of payments at key dates. We also intend that contracts under the new framework will include terms and conditions setting out what happens in the event of an SSRO determination that changes the price. As the Bill is currently drafted, however, it is not clear what happens were a supplier not to agree to the inclusion of an appropriate provision in the contract, which may be particularly problematic if the SSRO price adjustment occurs after a contract has ended. That is, perhaps, an unlikely scenario, as we will seek to include contractual terms and conditions, but we have designed the framework to sit alongside the contract and want to ensure that no aspects of the framework are dependent upon having to agree specific contractual provisions.

Subsection (1) specifies that new clause 4 applies to SSRO determinations resulting in a price adjustment only, which include, under clause 18(3)(b), an SSRO determination for a contract profit rate, a determination, under clause 20(6), for allowable costs and, under clause 21(3)(b), a determination where there is a dispute as to what a supplier's actual costs were when determining a final price adjustment.

Subsections (2) and (3) of new clause 4 allow interest to be charged at a standard Government rate—currently 8%—if the price adjustment is not paid by the due date, which is determined by the SSRO. Subsection (4) ensures that the amount to be paid, including any interest, may be recoverable as a debt due. The new clause is therefore essential to ensure that the SSRO's decisions are always enforceable, and I commend it to the Committee.

Alison Seabeck: The Minister's explanation of the reasons behind new clause 4 is quite surprising. Not being able to enforce the price changes from the SSRO would have been disastrous. I am sure he is relieved that somebody on his team spotted that quite serious gap in the Bill's drafting. The Opposition have every reason to support the measure, because it is clearly important.

Question put and agreed to.

Clause 21 accordingly ordered to stand part of the Bill.

Clause 22

Records

Mr Dunne: I beg to move amendment 20, in clause 22, page 15, line 25, after the second 'records' insert

'(whether in hard or electronic form)'.

The Chair: With this it will be convenient to discuss the following:

Amendment 38, in clause 22, page 16, line 21, leave out 'may' and insert 'must'.

Clause stand part.

Mr Dunne: We are now moving on in our consideration of the Bill from pricing provisions to transparency provisions. Pricing and transparency are the key elements of the new rules. Without transparency, we will have no means of verifying that the pricing provisions have been followed. The transparency provisions have three elements. The first is "open book", requiring suppliers to keep relevant records and to provide access to them. The second is "standardised reporting", requiring suppliers to provide cost reports related to both qualifying contracts and the suppliers of those contracts. Third is a "proactive duty to notify", requiring suppliers to notify us if they are aware of material risks or issues to the performance of the contracts, which will ensure that there are no surprises. These three elements of transparency will provide the MOD with the information necessary to monitor and manage our qualifying single-source contracts in a timely manner, and verify whether the pricing elements of the framework are being appropriately applied.

Government amendment 20 is to clause 22, which obliges suppliers to keep accounting and other records, and allows us access to those records. The records we want to access are already routinely collected by suppliers for their own management purposes. However, because the clause requires suppliers to keep records, we must be clear about which records they must keep. Any ambiguity on this could result in suppliers being forced to keep unnecessary records, which is not our intention. The scope of these records is set out in subsection (2). It currently extends—this is the subject of the proposed amendment—to those "accounting and other records" which a supplier may reasonably be expected to keep and which are sufficiently up to date and accurate to allow the Secretary of State to carry out any of the purposes listed in subsection (3).

Those purposes include auditing the reports provided by the supplier, verifying supplier costs and exploring differences between estimated and actual supplier costs. Most of this information will be held by contractors electronically, for example, information held in cost accounting databases, so-called enterprise management systems, such as SAP or Oracle. The content of these databases may be analysed and interrogated in various ways but they are not intended to be printed out to give a hard copy that would be thousands of pages long.

Industry, in discussions with my officials, has expressed a legitimate concern that "records" could be interpreted in a way that would exclude such electronically held data, so a contractor might be expected to keep these records in hard copy form. That is what has prompted amendment 20, which inserts the phrase

"(whether in hard or electronic form)"

into subsection (2). Without the amendment, there are risks that we will not have access to the records we require or that such records may be undecipherable, and that unintended costs will be imposed upon industry to convert records. The amendment is necessary to mitigate both these risks, so I urge the Committee to accept it.

Amendment 38 relates to the reasonable use of the open book rights for which the clause provides. Under the new framework, the Secretary of State, or an authorised person, will be granted open book rights. Industry has expressed concerns that it might be beleaguered by constant requests for information, so we have included provisions requiring us to act reasonably when exercising those rights. For example, the right to examine the information is subject to that examination being "reasonably required" for a purpose listed in subsection (3). Where the Secretary of State, or authorised person, requires further information or explanation in relation to the information, any such request must also be reasonable.

The SSRO will have the ability, on application by a supplier, to review the Secretary of State's, or authorised person's, exercise of their open book rights. Where the SSRO considers that the rights have been exercised unreasonably, it may make a declaration to that effect. It may also, under clause 34(4), require us to pay industry's costs in relation to the referral. The effect of this declaration by the SSRO will give suppliers confidence that, if we continue pestering them with requests, they may refuse to grant them. If we then issue a penalty notice, the supplier will be able to appeal to the SSRO in the knowledge that it is very likely to side with the supplier.

As drafted, subsection (6), to which this amendment relates, allows the SSRO to look at how the Secretary of State or authorised person has exercised their open book rights. It does not compel the SSRO to do so in all cases, or impose a duty on the SSRO to do so, and this amendment proposes that it should. The SSRO will perform a variety of roles once established, some of which the Bill provides that it "may" carry out and others that it "must" carry out. Where it is provided that the SSRO must carry out a function, it will obviously have a duty to do so. Where it is provided that the SSRO may carry out a function, the intention and expectation is that it will carry it out where it can and it is appropriate for it to do so.

The SSRO will have finite resources at its disposal and its work load will fluctuate. The tasks or roles which it is bound to perform—that is, the statutory duties that it must perform—are of such a nature that there is full confidence that the SSRO will have sufficient resources at its disposal to be able to carry them out. For instance, clause 35(3) provides that the SSRO must, when requested to do so by the Secretary of State, analyse reports provided to it under the new framework and provide the results of that analysis to the Secretary of State or an authorised person. The number of reports that will be sent to the SSRO can be confidently estimated and so, therefore, can the resource required to perform that task in any given year.

With the clause in question, however, there is no such natural clarity. On any given contract in respect of which the Secretary of State, or authorised person, has open book rights under the new framework, those rights could, and indeed are likely to be exercised numerous times during the course of the contract. A contractor could, in theory, make an application to the SSRO in respect of each exercise of such a right, or indeed make multiple applications in respect of each exercise of such a right.

While that is, of course, highly unlikely, it is possible. It is therefore not appropriate to make it a duty on the SSRO to review every such application. In practice, I envisage that the number of applications will be perfectly manageable for the SSRO, and that repeated or frivolous applications will not be made. It will simply not be in anyone's interest to do so, hence the SSRO will be able to deal with all of them.

However, for the reasons I have already given, it is not appropriate for the SSRO to have a statutory duty to undertake a review irrespective of the circumstances of the application, and I consider this a proportionate power. I therefore ask the hon. Lady not to press the amendment.

Alison Seabeck: I thank the Minister for his explanation of Government amendment 20. That was extremely clear, and we do not have a problem with that change. Perhaps I am being rather pedantic, but would it be generally clearer in this day and age to refer to data rather than records? By definition, that would include electronic as well as hard records. That might help, particularly when looking at the way that modern enterprise planning—ERP—systems collect and supply data. They describe the material as data. Records could subsequently be compiled from those data. That is just a thought about the use of terminology.

The Minister spoke about the specific types of data, records and accounting information that he felt businesses would be required to produce in relation to the clause. He was specific; he said it had been clearly set out. However, if we look at regulation 20(3), it dictates that "relevant records" means

"accounting and other records which contractors and designated persons may reasonably be expected to keep".

The word "reasonably" seems a bit vague in how it could be interpreted, far more vague than the Minister's comments, which were clear and specific.

Regulation 21(2) outlines the period of time over which a contractor must keep relevant records. We have no issues with the periods set out in the regulations; indeed, they are quite sensible. I simply seek assurances from the Minister that every effort will be made to inform potential bidders, contractors and businesses of the new requirements. How does the Minister intend to do that? When I travelled around the north of England during the summer, there was a scary lack of awareness among some businesses about some of the requirements that might be coming down the line. I suspect that the Minister will rely on some of the trade organisations to ensure that businesses understand what is to be required of them, but I welcome his thoughts on that.

Mr Dunne: The hon. Lady raises an interesting point about how we will move from the current regime to the new one, in terms of informing our suppliers of what obligations on them will change. It is incumbent on the Ministry of Defence to ensure that there is adequate information available to our suppliers.

4.15 pm

It is fair to say that the large suppliers are fully engaged. As I have said, we are in regular dialogue with them. It is also fair to suggest that perhaps some of the second-tier suppliers, who might still be caught in some instances under the regulations, might not be as close to that state of affairs as the larger ones. The Ministry will need to find mechanisms to encourage suppliers to look at the information that will be available, and we must try to make sure that that information is readily comprehensible and digestible. I would be happy for the Department to make a communication plan with industry to ensure that the regulations, once passed, are made available to our suppliers in a comprehensive way.

I want to pick up on one comment that the hon. Lady made. She suggested that we should perhaps refer to records as "data". One of my hon. Friends, who is an expert on ferreting out data from my Ministry, has pointed out that "records" is a wider, embracing term,

which also includes analysis and reporting around pure data, and that therefore "records" is a better term to use than data.

Amendment 20 agreed to.

Clause 22, as amended, ordered to stand part of the Bill.

Clause 23

REPORTS ON QUALIFYING DEFENCE CONTRACTS

Mr Dunne: I beg to move amendment 21, in clause 23, page 16, line 42, at end insert—

'( ) The regulations may provide for a requirement to provide a specified kind of report to apply, in the case of contracts of a specified kind, only at the request of the Secretary of State or an authorised person.

"Specified" means specified in the regulations.'.

The Chair: With this it will be convenient to discuss amendment 39, in clause 23, page 16, line 42, at end insert—

'(e) may make provision for advance agreements between a primary contractor and the Secretary of State on the methodologies and processes used to generate those reports.'.

Mr Dunne: These two amendments relate to the standardised reports that suppliers have to provide for qualifying defence contracts under clause 23. Subsection (2) gives the Secretary of State the power to set out in the single-source contract regulations what will be in the reports, and when they will be required. In most cases, the dates when reports will be required will be relative to key points in the contract life-cycle. For example, contractors will be required to complete a contract notification report within one month of the new contract being let, and a contract completion report six months after the last day of the contract. There will also be a quarterly contract report, which will be required at the end of each calendar quarter.

Currently, clause 23 allows the regulations to specify when the reports are to be provided. However, we will also want the ability to request suppliers to provide some of the reports on an "as required" basis, primarily in response to unforeseen events during the course of the contract. Those events could include signing a material contract amendment, or the supplier notifying us that the financial health of a project is rapidly deteriorating. We have been advised that, under the current drafting, we could not make regulations requiring suppliers to provide reports in response to individual requirements triggered by such events. Amendment 21 makes it explicit that we can. Without the power to request reports "on demand", the only way to ensure an up-to-date view of the performance of each contract would be to increase the frequency of required reporting. For the majority of healthy, well-performing projects, this would be unnecessary and inefficient. In contrast, the right to request certain reports in response to emerging events means a more flexible and responsive standard reporting solution can be implemented, so the amendment will allow a more efficient reporting framework to be specified in the regulations. I therefore urge the Committee to accept Government amendment 21.

The second amendment relating to clause 23 is Government amendment 39. I have already mentioned that clause 23 requires the regulations to specify the matters to be covered in the reports. They may also require a contractor, in preparing their reports, to have regard to statutory guidance issued by the SSRO.

The regulations will clearly identify each report required, and the matters to be covered in each of those reports. It is important that they are specified in the regulations, as civil penalties will attach to this, so the requirements must be sufficiently clear. The detail that sits beneath those requirements—for example, detailed templates for each report—will be issued by the SSRO as statutory guidance. The amendment is to allow the regulations to provide for the Secretary of State to agree on the approach taken by a supplier in meeting the requirements set out in both the regulations and the SSRO's statutory guidance.

Alison Seabeck: Perhaps I misheard the Minister. He is speaking to Government amendment 21; our amendment is 39.

The Chair: Order. Just for clarification, amendment 39 is in the name of Alison Seabeck, not the Government.

Mr Dunne: I stand corrected, and I will be happy to listen to the hon. Member for Plymouth, Moor View, speaking to her amendment.

The Chair: Just for clarification, once Alison Seabeck has moved the amendment, you may respond, but you may make your observations now.

Mr Dunne: I am grateful for your guidance, Mr Owen. I will complete my observations, because there is not much more to them, and then I will respond to what the hon. Lady has to say as appropriate.

I recognise that a supplier will need to determine the most appropriate approach to allow them to process their information so that it meets the reporting requirements under clauses 23 and 24. For example, they will need to consider what information they already have—that will be the vast majority of it, since they also need that information to meet their own management purposes—what new information they might need to generate, and how most cost-effectively to put their information into a compliant report. The processes and methodologies used to do that will necessarily vary for each supplier, as it will depend on their internal systems and management processes. It will also vary according to the number and frequency of qualifying contracts that they expect to have. For example, for many qualifying contracts, our largest suppliers are likely to have enterprise management systems and will develop standard processes to comply with the reporting requirements of part 2 of the Bill. On the other hand, some suppliers will have just one or two qualifying contracts, and they may prepare reports more manually.

In preparing those reports, there will be technical, accounting and forecasting issues that suppliers will have to consider. It is expected that the SSRO will address many of the issues in its statutory guidance, and will add to that as the framework matures and common issues and solutions arise. The MOD will,

[Mr Dunne]

naturally, work with suppliers to resolve specific issues where appropriate. With our larger suppliers, we are likely to discuss with them their overall approach to preparing the reports and any individual issues that they have in doing so.

Nothing in the Bill will prevent the Secretary of State and a supplier from agreeing an appropriate approach to reporting; indeed, it is to be expected that they will. I anticipate that contractual terms and conditions will be included in contracts to clarify, for example, to whom the reports must be provided. If such an agreement is made, and a penalty notice was subsequently issued based on the non-compliance of a report that had been prepared using that approach, then that agreement would be taken into account by the SSRO in reaching any associated determination. That does not require additional legislation and is expected to form part of the practical operation of the reporting requirements under part 2.

Mark Pawsey (Rugby) (Con): I am listening carefully to what is being said about the amount of work that the SSRO will have to do with lots of reports. Is the Minister satisfied, given what he has told us about the size of the SSRO, that it will be adequately resourced to handle such a massive amount of information going into it?

Mr Dunne: Our estimate is that 35 people is about the right number, but it will clearly be up to the SSRO to determine, once it is up and running, whether that is sufficient. I want to take my hon. Friend back to my earlier remarks about the number of contracts to which the provision will apply. We are counting in the hundreds rather than the thousands, and there will be very few in the early years, because it will apply only to new contracts as they are put in place.

Alison Seabeck: I thank the Minister for setting out the logic behind his amendment. Our amendment 39 was purely probing. It was to ask the Minister whether he will make explicit what contractors are expected to include in the reports and the methods that they are expected to use to generate them. It has also allowed debate about whether the reports are necessary, and the Minister has explained the logic behind them.

Cutting to the chase, because I think that we have tidied up this matter, there appears to be no mention of how comparisons can be made in impact assessments. The more standardised the reporting process, the easier it generally is to make comparisons. Simply adding requirements, without their fulfilling their purpose because of the difficulty of pulling together evidence from a range of different reporting processes, may just add a burden on businesses without achieving the desired benefit. We have not tabled amendments in relation to that, but perhaps the Minister could comment on whether we are right to be concerned.

Mr Dunne: The standardised reporting requirements will not be overly onerous for contractors. The Government amendment will allow additional information to be given if the Ministry of Defence agrees with a contractor that it is appropriate to provide it. Standardised reports will be readily available from our major contractors, and will essentially be based on the kind of management information that contractors would in any event be expected to have at their disposal.

Amendment 21 agreed to.

Clause 23, as amended, ordered to stand part of the Bill.

Ordered, That further consideration be now adjourned.– *(Mark Lancaster.)*

4.26 pm

Adjourned till Thursday 17 October at half-past Eleven o'clock.