

Allowability of costs

1. Referrals are a feature of the legislation; they are not a feature of the contract. Therefore, it is difficult to justify how these costs can be recovered or absorbed under the contract to which the referrals relate, since the costs are not incurred for the purposes of the contract nor to enable its performance.
2. Compliance with the legislation giving rise to referral-related costs do not appear to be recoverable under a qualifying contract. Indeed, many activities involved in making referrals fall to general administration which will act as a deterrent to small businesses in making referrals.
3. It is therefore inappropriate (under the current terms of the DRA) for the SSRO to require the costs to be AAR for the purposes of recovery. Indeed, the costs for claims related to the Secretary of State's conduct could not be AAR as they are not incurred for the purposes of the contract or to enable its performance.
4. Furthermore, if the MoD has caused the contractor additional effort by acting unreasonably, then that additional effort could not be considered to be consistent with the AAR principles. This cost of additional effort should be recoverable as if for a claim for damages and paid outside the pricing/payment framework of the contract, and accounted for as a credit.
5. Most referrals can be regarded as an adjunct to negotiation. There should be a general principle that costs of referral lie where they fall unless the SSRO determines that one party has acted unreasonably, in which case it will be for the other party to claim its additional costs. This should apply to both parties, although there will be some specific grounds on which a contractor can make a referral purely for the conduct of MoD itself [§23(6), §35(1)(a)].
6. Another example of MoD's actions that might give rise to a referral was illustrated by Mr Dunne, Parliamentary Under-Secretary of State for Defence, in the Public Bill Committee on 15 October 2013:

"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."

In these circumstances the contractor's costs of servicing the referral should be paid by MoD to the contractor outside the pricing/payment framework of the contract.
7. Rather than consider "the conduct of the parties and whether they have acted reasonably" it would be better to consider if a party has acted unreasonably. Regard will need to be had to the reality that a party accused of something should be able to defend itself vigorously, but not act in an arbitrary or vexatious manner or to deliberately extend the proceedings by lack of good faith or application, or by prevarication or equivocation.

8. Disagreements on costs or contract price are often about where in the spectrum of confidence is an estimate of cost or a rate each party assumes is their red line, and do not necessarily indicate unreasonable behaviour.
9. The recovery of referral-related costs should also include the cost of financing the servicing of the referral and any interest on the financing costs.

SSRO investigation of costs

10. The consultation document states "we consider that any investigation of a requirement to pay costs should cease if the SSRO terminates its investigation of the referral without giving an opinion or making a determination." [6.5 and 6.3 of Guidance] However, if the referral has been made by MoD on a vexatious basis (or *in terrorem*) and then MoD withdraws its referral having achieved its objective (or it concludes that it has no case), the contractor will have incurred costs unnecessarily, for which it should be compensated.
11. How does payment of referral-related costs support the achievement of "good value for money is obtained in government expenditure on qualifying defence contracts" or "qualifying defence contracts are paid a fair and reasonable price under those contracts"? [Guidance 1.7] Referrals are not made under the contract but under the legislation, so the criteria referenced do not necessarily apply, particularly where MoD has acted unreasonably.
12. How can the amount of any referral related costs be quantified until the referral is settled, as support to the referral (after the referral has been made) may be a continuing cost? [Guidance 5.4]

Payment of costs

13. No statement has been made about the payment of costs. A principle of payment within say 60 days of the SSRO notice needs to be established, with interest payable consistent with section 34(2) of the DRA.

Babcock International Group
Comments on SSRO Guidance on Requiring the Payment of Referral Related Costs

Executive Summary

The general principle that costs may be awarded where a party has acted unreasonably appears fair, however clarity is required as to whether costs are for the purposes of the contract or to enable performance. It seems inequitable that costs could be disallowed in cost and target derived contracts for a dispute under the contract related to the Act and/or Regulations, and strange that a party could claim those costs if it acted unreasonably. Clarity is therefore required on how apportionment of costs applies to the circumstances of reasonable and unreasonable behaviour on each method of price determination.

Response to SSRO consultation questions

a. Is the draft guidance clear?

Yes – subject to clarification of the specific points, below.

b. Is the draft guidance helpful?

Yes – subject to clarification of the specific points, below.

c. How, if at all, might the draft guidance be made clearer or more helpful?

Provision of responses to the clarifications/queries below.

d. Are there any matters relevant to the SSRO's power under section 35(4) which have not been adequately addressed in the draft guidance?

Those, below, upon which clarification is sought.

e. Do you have any comments regarding the proposed publication and application dates of the guidance?

- Is July to August 2021 considered sufficient time to consider consultation responses and finalise guidance - noting it is the summer holiday period?
- Will there be responses to individual requests, or will the SSRO Regulatory Committee simply make any changes it considers appropriate?
- Will any changes to the Guidance be submitted for further consultation prior to publication?

Specific queries/clarification sought on the Guidance:

1.7 As with its other statutory functions, in exercising its power under section 35(4) of the Act, the SSRO aims to ensure that good value for money is obtained for the UK taxpayer in MOD expenditure on QDCs and that single source suppliers are paid a fair and reasonable price under those contracts. The policy and procedures for requiring the payment of referral-related costs support the achievement of these aims.

1.8 ...The SSRO may depart from the policy and procedures as it considers necessary or appropriate.

If the SSRO depart from the policy and procedures how can it still be asserted that in doing so they are supporting the achievements of the aims of section 35(4) of the Act?

2.6 If a party to a referral feels that the SSRO is acting unfairly in determining a requirement to pay costs or has not complied with a legal requirement or this guidance, they should raise their concerns with the Case Team at the earliest opportunity. Such concerns must be raised prior to the SSRO concluding its decision on the referral. The SSRO will deal promptly with any such concerns raised.

See Section 5.5, below.

3.9 The SSRO will consider the following factors when deciding, upon a request to do so, whether the circumstances require the payment of an amount of referral-related costs from one party to another

3.9 b. the extent of the costs under consideration and whether it would be proportionate to investigate them

Proportionate to whom, the SSRO or the parties? And, proportionate to what - the costs of the referral to both parties, the costs of the referral as a percentage of the total contract value under determination, or the costs of the referral as a percentage of the requesting party's annual profit?

3.9 d. the extent to which the costs have been incurred as a consequence of the conduct of the parties;

The majority of costs will be incurred as a consequence of the conduct of the parties. This should refer to the "unreasonable" conduct of a party.

3.9 f. what it was reasonable to expect in the circumstances;

Reasonable to expect by whom? What expectation is this based on – the expectation of the payment of costs, or the expectation of the outcome of the determination/opinion?

3.9 h. the impact on the paying and receiving parties of a requirement to pay costs.

The MoD will invariably claim that it is impecunious and has no additional funds.

4.3 Before requiring the payment of any referral-related cost, the SSRO will look for evidence as to the following matters:

d. the part of the cost attributable to the unreasonable behaviour of the party who would be required to pay.

Why is this the only aspect of Section 3.9 that the SSRO will take in evidence?

4.4 The SSRO will take a proportionate approach when determining what type and standard of information is required regarding referral-related costs. Our expectations for evidence will be tailored depending on:

It is not clear what a "proportionate approach" is in this context, should it refer to a "reasonable approach"?

5.1 ...The process should be viewed as indicative and may need to be adapted for the circumstances of the referral in which any requirement to pay costs is considered.

At what stage will the parties be informed whether the process needs to be adapted?

5.2 ... As part of this engagement, where relevant to the case, the party or parties are encouraged to discuss with the SSRO any matters related to the recovery of referral-related costs.

At this stage a party may not be aware that it wants to recover costs – e.g. the other party may not have exhibited unreasonable behaviour at that point.

5.3 The parties to the referral are encouraged to raise any request for the SSRO to require the payment of referral-related costs at the earliest opportunity in the referral process.

See response to Section 5.2 – a party may not know that it wants to seek costs until very late in the process, for example until the SSRO has indicated that it may require one party to pay costs.

5.5 The SSRO will notify affected parties if it plans to consider a requirement to pay costs as part of the referral.

At what point will this occur, noting that the parties will have already incurred costs, and the requirement of Section 2.6, above?

Also, will the SSRO indicate which party it will require to pay costs? If it does not, the other party will not be able to raise a concern until the determination or opinion is given.

5.7 ...The extent of the SSRO's investigation of costs will depend on the type and amount of referral-related costs under consideration.

Is it possible to provide an indication of what type of costs would be more likely to lead to an extensive investigation and will there be limits in terms of amount of costs or proportionality that determine whether or not an investigation will be made?

5.11 The Referral Committee's decision on any requirement to pay costs will normally be communicated with the opinion or determination to which the requirement relates...

If a contractor has had to continue to incur costs, will those be taken into account in the Referral Committee's decision?

5.13 ... the SSRO will publish such information about any requirement to pay costs as it considers is helpful to aid wider understanding about the operation of the regulatory framework.

How are the factors to be considered when deciding on whether costs should be paid from one party to another (i.e. Section 3.9) relevant to a wider understanding of the regulatory framework?

End.

[REDACTED]
[REDACTED]
[REDACTED]

Ref: LMH/HSGF/2021/002
Date: 2nd July 2021

[REDACTED]
Senior Regulatory Investigations & Policy Manager
Single Source Regulations Office
Finlaison House
15-17 Furnival Street
London EC4A 1AB

Dear [REDACTED],

Requiring payment for referral-related costs consultation

Please see below the input from Leonardo UK Ltd on the above consultation. If you would like to discuss any of these matters further, please feel free to contact us.

a. Is the draft guidance clear?

Yes and no

- (i) Para 3.7 states *“Referral-related costs that are incurred by contractors in QDCs or sub-contractors in QSCs that satisfy the requirements specified in section 20(2) of the Act may be allowable costs under those contracts, subject to the requirements of the regulated pricing method used to determine the contract price.”*

Does this mean if the contract is a cost-plus contract that any referral-related contractor costs could be paid for via the contract? If so, we would recommend guidance makes this clear.

- (ii) Our assumption is any referral-related costs incurred by the contractor, but payable by the MoD, would be via a separate settlement.

- (iii) Para 3.6 states *“The general principle that guides the apportionment of referral-related costs is that the parties should bear their own costs, subject to any agreement between the parties for one party to recover some, or all, of their costs from the other.”*

We assume *“parties to bear their own costs”* would still leave the costs as AAR under the SSCR and believe this needs to be made clear in the guidance.

b. Is the draft guidance helpful?

Yes

[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED] 6AF



c. How, if at all, might the draft guidance be made clearer or more helpful?

In addition to that provided in (a) above, the following needs consideration in guidance.

(i) Which persons may have to pay such costs

Para 3.4 in relation to a QSC or proposed QSC only talks of the payment between the Secretary of State and the sub-contractor. However, Para 3.1 (g) refers to an appeal against assessment as a qualifying sub-contract (section 29(6)), which is carried out by the contractor (be that a prime or higher level sub-contractor). We recommend review of these two paragraphs to ensure alignment and clarity for the user.

d. Are there any matters relevant to the SSRO's power under section 35(4) which have not been adequately addressed in the draft guidance?

No

e. Do you have any comments regarding the proposed publication and application dates of the guidance?

No

We hope our comments are helpful to your review and are happy to discuss them further.

Yours sincerely

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[Redacted text]

[Redacted text]

Metasums Ltd response to consultation on requiring the payment of referral-related costs

I am in full agreement with the guidance as drafted and found the consultation paper itself excellently structured, well-argued and a full and frank analysis of the factors that needed to be considered. I have no points of disagreement nor suggestions for improvement.

From: [REDACTED] (SSAT-PolReg) <[REDACTED]@mod.gov.uk>
Sent on: Thursday, July 1, 2021 3:02:11 PM
To: [REDACTED]@ssro.gov.uk>
CC: Consultation Responses <Consultations@ssro.gov.uk>; [REDACTED] (SSAT-DepHd PolReg) <[REDACTED]@mod.gov.uk>
Subject: RE: SSRO consultation on requiring the payment of referral-related costs - ending 2 July 2021

CAUTION: External Email

Good afternoon [REDACTED],

We have discussed this consultation and we are happy that the guidance is clear and helpful. Clearly we have had a very small number of referrals to date and we think that this is fine for now, but we would like to keep it under review as things progress and revisit it should we need to.

Kind regards,

[REDACTED]

[REDACTED] | Policy & Regulations | Single Source Advisory Team | MOD Main Building | Floor 5 | Zone N | London | Whitehall | SW1A 2HB | Phone Number (Skype): +[REDACTED] |
Email: [REDACTED]@mod.gov.uk | *Please note I am currently working from home due to Covid-19.*

Please note my working days are Monday – Thursday.

For the SSAT Intranet page, please click [here](#) | For the SSAT Notifications and Enquiry Form, please click [here](#) | The Single Source Contract Regulations Base Line Profit for 2020 came into effect on 1st April 2020. Full details can be found [here](#) | The latest version of the Single Source Contract Regulations 2014 is available [here](#) | Allowable Costs guidance Version 5 Issued was published by the SSRO on 16 March 2020. Full details can be found [here](#) | SSAT Forum with FAQs is available [here](#)



Consider the environment – Think before you print!