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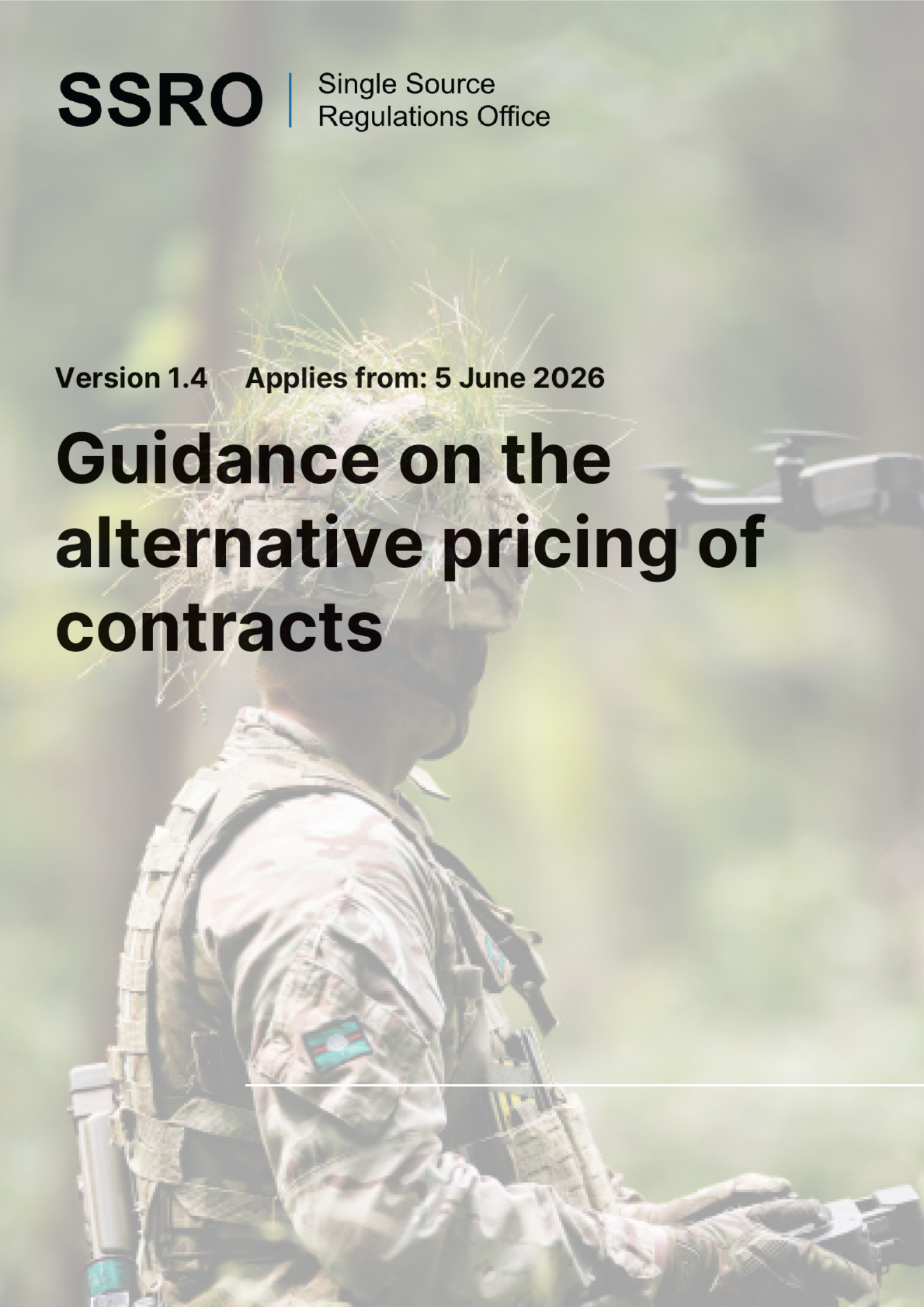


Version 1.4 Applies from: 5 June 2026

Guidance on the alternative pricing of contracts

Versions of this guidance

This is version 1.4 of the guidance on the alternative pricing of contracts which applies to contracts entered into or amended on or after 5 June 2026.

The table in Appendix A highlights changes that have been made from the previous version of the guidance.

The publication and application dates of this guidance are shown below.

Version number	Date published	Applies to contracts agreed on or after
1.4	**1 June 2026**	**5 June 2026**
1.3	16 March 2026	1 April 2026
1.2	14 March 2025	1 April 2025
1.1	10 October 2024	10 October 2024
1	24 January 2024	1 April 2024

Contents

1. Introduction

Guidance on Alternative Pricing

1.1 This document is guidance on the use of alternative pricing methods to price a qualifying contract or component of such a contract. It should be read in conjunction with other SSRO guidance referenced in this document.

Pricing of contracts

1.2 The Defence Reform Act 2014 (the Act) and the Single Source Contract Regulations 2014 (the Regulations) require the price payable under a qualifying defence contract (QDC) or qualifying sub-contract (QSC), or component of a QDC or QSC, to be determined in accordance with a default pricing method (by applying the pricing formula) or an alternative pricing method. This guidance aims to help contractors and the Ministry of Defence (MOD) to agree the price of QDCs or QSCs in a way that is consistent with the Act and the Regulations. Where relevant contract-pricing matters are referred to the SSRO for an opinion or determination, the SSRO will have regard to its guidance and the extent to which this has been considered and applied by the contracting parties when reaching its conclusion. The SSRO may also take referrals on other matters discussed in this guidance.[1]

1.3 Section 15 of the Act, and part 3 of the Regulations set out how the contract pricing methods must be applied to determine the price payable under a QDC or QSC (or a component of such a contract). The methods to price a contract, whether applied individually or in combination, provide for flexibility to accommodate a range of contracting circumstances. It is important that the contracting parties familiarise themselves with the approaches to pricing set out in this and other SSRO pricing guidance and apply these pricing methods in a way that supports a commercial arrangement consistent with value for money for taxpayers and fair and reasonable prices for contractors.

The default pricing methods

1.4 The price payable under a QDC or QSC or a component of such a contract, which uses a default pricing method, must be determined in accordance with the following formula:

(Contract profit rate x Allowable Costs) + Allowable Costs

1.5 The contract profit rate must be determined using the four-step process and the allowable costs must be determined in accordance with one of the six default pricing methods. The contract profit rate applies at the agreed rate for the life of the contract or component and is not affected by future changes in the baseline profit rates or capital servicing rates, unless an amendment is made in respect of which these rates differ. The default pricing methods are:

1 https://www.ssro.gov.uk/ssro-referrals/guidance-on-the-ssros-procedures-under-the-defence-reform-act-2014-and-single-source-contract-regulations-2014/

a. Firm pricing;

b. Fixed pricing;

c. Cost-plus pricing;

d. Estimate-based fee pricing;

e. Volume-driven pricing; and

f. Target pricing.

1.6 The Schedule to the Regulations sets out how the price of contracts or components must be redetermined if the parties propose to make an amendment which affects the original contract price.

1.7 The SSRO has provided separate guidance to assist the contracting parties to determine the contract profit rate and allowable costs.[2]

About allowable costs

1.8 Section 20 of the Act specifies when costs are allowable and sets out related provisions as follows:

a. Section 20(1) of the Act requires the SSRO to issue guidance about determining whether costs are allowable costs under QDCs and QSCs.

b. Section 20(2) of the Act states that both parties need to be satisfied that costs are appropriate, attributable to the contract (or component) and reasonable in the circumstances (AAR).

c. Section 20(3) of the Act states that the Secretary of State and the contractor must have regard to the SSRO's guidance in determining whether a cost satisfies the AAR test.[3]

d. Section 20(4) of the Act states that a contractor (prime contractor or sub-contractor) may at any time be required to show that a particular cost is allowable.

Alternative pricing methods

1.9 There are a range of alternative pricing methods available and these are intended to be used in circumstances where application of the pricing formula may not be possible or because a fair price can be satisfactorily established by other means. This includes, for example, where prices are already regulated or where there is a market price which can act as a reference.

2 https://ssro.gov.uk/price-costs-and-profit/contract-profit-rate/ and https://ssro.gov.uk/pricing-guidance/ssro-allowable-costs/

3 For practical purposes the agreement of allowable costs will generally be with a MOD officer with suitable delegated authority from the Secretary of State. To reflect this, and where appropriate, this guidance refers to the Ministry of Defence (MOD) rather than the Secretary of State directly.

1.10 The price payable under a QDC or QSC, or a component of such a contract, which does not apply a default pricing method, must be determined in accordance with one or more of the alternative pricing methods specified in the Regulations. This guidance document describes the approach contractors and the MOD should take when they choose to use any of these pricing methods. The alternative pricing methods specified in the Regulations are:

a. Commercial pricing;

b. Prices determined in accordance with law;

c. Previously agreed price;

d. Novated contract price;

e. Competed rates applied to uncompeted volumes (CRUV);

f. Agreed changes to the contract profit rate; and

g. Aggregation of components.

1.11 The Schedule to the Regulations describes how the price of a contract or component must be redetermined if the parties propose to make an amendment which affects the original contract price.

Components

1.12 Prior to 1 April 2024 there were limited opportunities for contracts to have more than one contract profit rate. With the introduction of alternative pricing methods, the legislation now provides a definition of a component. A component of a contract means a part of a contract that is to be treated distinctly from other such parts in determining the price payable under a contract. A part of a contract is to be treated distinctly where either the Regulations contain provision to that effect (i.e. the effect of applying the Regulations is that part of the contract is treated distinctly in determining the price payable), or where the parties agree that it should. Regulation 9A specifies three circumstances in which a component must be formed:

a. Where a part of the contract uses a different contract pricing method to the contract pricing method used in any other part of the contract. A contract pricing method means an alternative pricing method or a default pricing method.

b. Where a part of the contract has a different contract profit rate to the contract profit rate used in any other part of the contract.

c. Where it is mandated in the context of certain alternative pricing methods by regulation 19C(6), and paragraphs 14(7)(c) and 16(2)(b) of the Schedule (to the Regulations).[4]

4 For more detail on this, contracting parties should review the Schedule to the Regulations. The SSRO is planning to issue specific guidance on contract pricing amendments in April 2026.

1.13 It is ultimately for the parties to decide whether they wish to price a QDC or QSC in a way that results in components being formed. A component is only formed when both parties to the contract elect to price it in a manner which meets the requirements for a component to have been formed. The parties should ensure that they have identified components formed as the result of having made one or more pricing amendments.

1.14 There must be a demonstrable commercial purpose for agreeing to price a part of a contract distinctly from other such parts i.e. forming components. For example, in order to price an amendment which only affects part of the contract price, or because it makes commercial sense to use different pricing methods for different parts of the contract. This requirement is to prevent the parties from dividing and further subdividing the contract price for no reason other than to avoid application of the final price adjustment. The parties should carefully consider how they structure components as dividing the contract into small components will add complexity to both pricing and reporting. In addition, a disproportionate approach to componentisation may not be consistent with value for money for taxpayers and fair and reasonable prices for contractors.

1.15 Where a contract has two or more components, the price payable under the contract is the sum of the price payable in respect of each component. Where an aggregated cost risk adjustment or incentive adjustment has been applied (see section 9 of this guidance), this also forms part of the price payable under the contract.

1.16 There are specific reporting requirements associated with pricing or amending a contract which results in components being formed, such as the need to report profit and cost in a way which make up parts of a component in certain prescribed circumstances. The parties should familiarise themselves with these requirements when entering into or amending a contract in a way which results in components being formed. This is particularly important when making multiple contract pricing amendments, as whether each is treated distinctly for the purposes of pricing or not will determine the extent of the component level reporting that is required.

About the SSRO's pricing guidance

1.17 The SSRO issues guidance on the pricing of contracts under Sections 18(1), 20(1) and 35A of the Act. The SSRO may issue such guidance as it considers appropriate in relation to the application or interpretation of the Act or Regulations.

1.18 The Act also states that, in carrying out its functions, the SSRO must aim to ensure that:

a. good value for money is obtained in government expenditure on QDCs and QSCs; and

b. persons (other than the Secretary of State) who are parties to QDCs and QSCs are paid a fair and reasonable price under those contracts.

1.19 It is a legal requirement for the contracting parties to have regard to the guidance the SSRO issues:

a. about determining whether costs are allowable costs under qualifying defence contracts; and

b. in relation to any of the steps in the calculation of the contract profit rate.

1.20 The SSRO has provided separate guidance that will assist the contracting parties to determine the time of agreement for a particular QDC or QSC.[5]

1.21 This document updates the version published in March 2025[6] in line with the annual update of the baseline profit rate and capital servicing rates that apply for the financial year commencing 1 April 2026. The SSRO has provided separate guidance that will assist contracting parties to determine:

a. the contract profit rate; and

b. the allowable costs of a contract.

1.22 Where terminology used in the guidance is defined in the Act and the Regulations, it is explained where that might be helpful. The definitions of specific accountancy terms used can be found in the relevant accounting standards.[7] Other text in this guidance should be read in accordance with its natural and ordinary meaning. It is important for understanding and interpretation that specific parts of the guidance are not read in isolation from other relevant parts, but instead within the context of the complete text.

Statutory reports

1.23 In relation to any QDC (or QSC) the primary contractor (or sub-contractor) must provide statutory reports as described in Part 5 of the Regulations. Suppliers may also be required to provide statutory reports on overheads as described in Part 6 of the Regulations. The SSRO has provided separate guidance that will assist contractors and suppliers with preparing and submitting the reports required.[8]

5 SSRO reporting guidance on preparation and submission of contract reports, paragraphs 3.28 to 3.53, available at https://ssro.gov.uk/reporting-guidance-and-defcars/.
6 A guide to the changes which have occurred from the previous version is provided in Appendix A.
7 For example, those of the International Accounting Standards Board or Financial Reporting Council.
8 SSRO Reporting guidance on preparation and submission of contract reports available at https://ssro.gov.uk/reporting-guidance-and-defcars/

Contracts entered into prior to 1 April 2024

1.24 The price of a contract entered into prior to 1 April 2024 does not need to be redetermined unless the contract is amended in a way that affects the original contract price, in which case the new provisions will apply. As part of the legislative changes which came into force on 1 April 2024, the Profit on Cost Once (POCO) adjustment was removed from the contract profit rates and is now dealt with through a reduction to allowable costs. Contracts with a POCO adjustment determined under the previous six-step process are now subject to the new provisions to make an adjustment through allowable costs. Further guidance can be found in section 5 Part I of the Allowable costs guidance.

1.25 The SSRO funding adjustment has also been removed from the contract profit rate steps and contracts that are entered into or amended on or after 1 April 2024 will no longer be required to apply this adjustment. This change does not affect contract profit rates agreed prior to 1 April 2024.

Relevant records

1.26 In relation to a QDC, regulation 20 requires the primary contractor to keep 'relevant records'. In the case of a QSC, it is the sub-contractor who must do this. Section 23 of the Act defines relevant records as accounting and other records (whether in hard or electronic form) which the primary contractor or sub-contractor, as the case may be, 'may reasonably be expected to keep' and 'which are sufficiently up-to-date and accurate' for use by the MOD for specific purposes, such as verifying certain matters relating to the price payable under a QDC or QSC. Such matters may include the calculation of the contract profit rate, the determination of allowable costs or the calculation of any final price adjustment (where applicable) following contract or component completion.

Opinions and determinations

1.27 The Act and Regulations provide for the SSRO to give opinions and make determinations on matters related to the pricing of proposed or agreed qualifying contracts upon referral by specified persons. Further details of the matters that may be referred and how the SSRO responds to referrals can be found in the SSRO's related procedural guidance.[9]

Non-referral advice

1.28 The SSRO can provide independent and authoritative advice on a confidential basis on any matter related to the interpretation and application of the regulatory framework for single source defence contracts. Either party to a current or proposed qualifying contract may seek non-referral advice on the application of the regulatory framework to that contract. Further information on the SSRO's non-referral advice service can be found on our website.[10]

9 https://ssro.gov.uk/ssro-referrals/guidance-on-the-ssros-procedures-under-the-defence-reform-act-2014-and-single-source-contract-regulations-2014

10 https://ssro.gov.uk/ssro-referrals/non-referral-advice-service/

Key terms and definitions

Term name	Definition
Allowable costs	A term used for the costs incurred to deliver a QDC or QSC. Costs must be appropriate, attributable to the contract or component and reasonable in the circumstances to be considered allowable.
Alternative pricing method	An alternative pricing method is one of the seven non-default methods specified in the Regulations. These are: Commercial pricing, Prices determined in accordance with law, Previously agreed price, Novated contract price, Competed rates applied to uncompeted volumes, Agreed changes to the contract profit rate, and Aggregation of components.
Baseline profit rate (BPR)	Section 17(2) of the Act and regulation 11 require that the contract profit rate for any qualifying defence contract that uses the pricing formula must be calculated by applying four steps. The first step requires using the baseline profit rate which has been determined by the Secretary of State.
Capital servicing adjustment	A term used to refer to fixed capital servicing adjustment and positive or negative working capital servicing adjustments collectively.
Component	A component is a part of the contract that is to be treated distinctly from other such parts in determining the price payable under the contract. A part of a contract must be treated distinctly if the Regulations contain provision to that effect.
Contract pricing method	The method that has been used to determine the price of the contract or component. For a qualifying defence contract, or qualifying sub-contract, this must be one of the default pricing methods or one of the alternative pricing methods.
Default pricing method(s)	There are six default pricing methods, all of which determine the contract (or component) price by applying the formula: (Contract profit rate x Allowable Costs) + Allowable Costs = Contract (or component) price. The six methods are: Firm Pricing, Fixed Pricing, Cost-plus pricing, Estimate-based fee, Volume-driven pricing, and Target pricing.
Defence Reform Act 2014 (the Act)	The primary legislation applicable to qualifying defence contracts.

Term name	Definition
Qualifying defence contract (QDC)	Those contracts that fall within the scope of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014, and that the Secretary of State has not exempted from being a QDC.
Qualifying sub-contract (QSC)	A qualifying sub-contract is a contract between a primary contractor and another contractor or between a sub-contractor and another sub-contractor where it meets the definition laid down in section 28 of the Act and has been assessed and notified as a qualifying sub-contract pursuant to the procedure under section 29 of the Act.
Single Source Contract Regulations (SSCRs or the Regulations)	Secondary legislation in the form of a Statutory Instrument, enabled by the Defence Reform Act 2014.
Single Source Regulations Office (SSRO)	The independent non-departmental public body established under the Defence Reform Act.

2. Alternative pricing

The methods of alternative pricing

2.1 This section explains the specific requirements in the legislation that must be met in order to use each of the alternative pricing methods.

2.2 Sections 15(2), (2A) and (2B) of the Act specify that the price payable under the contract or any component must be determined in accordance with either the pricing formula, or "another method" in such circumstances as specified in the Regulations. The Regulations and this guidance refer to the various other methods under this section as "alternative pricing methods". Regulation 9B(3) provides that the parties may agree to use an alternative pricing method to price a contract or component where the circumstances described in the method pertain. Some alternative pricing methods involve application of the pricing formula.

2.3 Regulations 19A to 19G within Chapter 3 of Part 3 of the Regulations (Pricing of Contracts), contain the pricing methods that may be used as an alternative to a default pricing method. The circumstances in which alternative pricing may be used are set out in the Regulations. Section 15(2B) of the Act also enables the Regulations to make provision requiring a particular method of alternative pricing to be used in specified circumstances. Where the circumstances for the purpose of alternative pricing do not apply, the price payable is to be determined using a default pricing formula.

2.4 The following seven alternative pricing methods are provided for:

a. Commercial pricing;

b. Prices determined in accordance with law;

c. Previously agreed price;

d. Novated contract price;

e. Competed rates applied to uncompeted volumes (CRUV);

f. Agreed changes to the contract profit rate; and

g. Aggregation of components.

2.5 The Regulations provide the circumstances that must apply in order to use each alternative pricing method. The Regulations also specify how the price is determined in each case.

2.6 An alternative pricing method may be used to determine the price payable under a contract or component. Where a contract is formed of two or more components, the same or different contract pricing methods may be used for each. More detail on components can be found in paragraphs 1.12-1.16 of this guidance.

3. Commercial pricing

Basis of commercial pricing method

3.1 Regulation 19A explains the circumstances in which this alternative pricing method may be used to determine the price payable under a QDC or QSC, or component of a QDC or QSC.

3.2 The circumstances are where:

a. The primary contractor (or sub-contractor) **has supplied** goods, works or services (GWS) to the same or substantially the same specifications:

i. to the MOD under a contract placed following a competitive process;

ii. to another party under a contract placed following a process which would have satisfied the requirements of a competitive process; or

iii. to any other person in an open market where such goods, works or services are offered for sale; or

b. The MOD is satisfied that a supplier (who may be the primary contractor or sub-contractor) **has supplied** goods, works or services under a contract to the same or substantially the same specification to other parties in a competitive environment.

3.3 To have supplied GWS means that a transaction in which the GWS are supplied to a paying customer has taken place. An offer of supply is not sufficient and nor is an invitation to tender.

3.4 The commercial pricing method cannot be used in cases where GWS are to be procured under a QDC or QSC and the MOD has made any direct payment for the development of those GWS. For the purposes of this guidance a direct payment means a consideration that relates, and which can be traced, to a discrete package of GWS specified under a particular contract. This might be, for example, where the MOD has explicitly funded in whole or in part the development of the GWS being procured. In such circumstances the use of this pricing method would not be permitted.

3.5 For the purpose of assessing if the conditions in paragraph 3.2 are met, a contract can be considered to have been placed following a competitive process if:

a. the contracting authority either:

- published a notice of intention to seek offers in relation to the provision of the GWS; or
- invited person(s) other than the party awarded the contract (or associated with that party) to negotiate or provide offers for the provision of the GWS; and

b. the contracting authority conducted a transparent and arms-length procurement process using appropriate evaluation criteria to identify the offer made by the party awarded the contract as the best offer, the material contract terms of the contract awarded were wholly or substantially the same as that best offer, and that the party awarded the contract did not or could not at the time of making the offer reasonably consider it likely that its offer would be the only one reasonably capable of being accepted by the contracting authority.

Application of commercial pricing

3.6 Application of the commercial pricing method requires the following to be established:

a. The basis upon which the GWS have previously been supplied – for example, under competition; and

b. The price previously paid for the GWS, and how this relates to the price to be paid under the contract or component in question – including, for example, whether this price satisfies the requirements of value for money and fair and reasonable prices, or serves as an appropriate starting point from which to determine the price payable under the contract or component.

Meaning of substantially the same specifications

3.7 Regulation 19A(3) allows for the use of the commercial pricing method where the MOD is satisfied that the GWS that are being sought under the contract or component have been provided "to the same or substantially the same specifications" in the circumstances described. Being to the same or substantially the same specifications includes:

a. GWS of an identical specification to those previously supplied, such that they reflect the same requirements, dimension, materials, performance or other relevant characteristics; or

b. GWS of substantially the same specification, to the extent that changes in the requirements, dimension, materials, performance or other relevant characteristics are immaterial to the price of the contract or component, whilst remaining substantially the same; or

c. GWS of substantially the same specification, but that differences in the requirements, dimension, materials, performance or other relevant characteristics of the GWS being procured justify a price differential which can be reliably determined using an approach permitted under the Regulations.

3.8 Judgements about the extent to which specifications are substantially the same may be made with reference to the impact on price that would result from a changed specification. If a difference in product specification alone, with all else unchanged, would lead to a significant change in the price then the specification is unlikely to be substantially the same for the purpose of complying with the Regulations. To make a judgement, the parties must agree if any price difference linked solely to altered specifications is considered to be significant. For example, the parties may agree that price changes below "X" percent are not considered to be significant for this purpose, although this example is only for illustrative purposes and the parties must come to their own view. Judgements on the significance or otherwise of price differences and changes in specification will depend on the facts and circumstances of the case, and are for the contracting parties to agree between them. **If the parties cannot agree that the GWS are of the same or substantially the same specification, then this method cannot be used to determine the price of a contract or component.** Where the parties are having difficulty agreeing if GWS are of the same or substantially the same specifications, they each have the option to approach the SSRO for non-referral advice (see paragraph 1.28 of this guidance) or to seek an opinion.

Circumstances of previous supply

3.9 To have previously supplied the GWS extends only to having sold, leased or licensed them. Paragraph 3.2 sets out the types of contractual transactions which can be used as evidence of previous supply in order for the commercial pricing method to be used.

3.10 The parties must agree that the circumstances apply based on the evidence the parties make available to one another. The party in possession of the relevant evidence may differ depending on the circumstances and the parties will need to be transparent with each other in relation to the evidence they hold in order that it can properly be verified.

3.11 Regulation 19A(7) requires that in demonstrating the matters referred to in paragraph 3.2 (a) and (b) the primary contractor (or sub-contractor) must provide to the MOD all information that is relevant and in its possession in order to determine the commercial price and to agree that it is reasonable. The MOD may also hold relevant information and transparency between the parties should be ensured where this information is used or could be used to inform the contract price. The following (which are not intended to be exhaustive) are examples of information that may be required to be disclosed and evidenced in order to demonstrate the requirements to apply this pricing method are met and for a price to be determined under it:

a. The agreed and final price paid in total or per unit of the GWS provided. This is the amount that was paid in exchange for the GWS being provided, i.e. labour rates may only be used as such a measure if the GWS being provided is labour;

b. Total volume and the agreed delivery timeline;

c. Date of commencement, delivery, and completion of any relevant contracts; and

d. Specification of the GWS provided.

3.12 The information must relate to a transaction involving the supply of GWS that has actually taken place (see paragraph 3.3). Depending on the circumstances under consideration, the parties may choose to give different weight to the various evidential requirements, which may relate to a single transaction or more.

Table 1: Circumstances of previous supply

Circumstance of supply by	Approach
the primary contractor to the MOD under a contract placed following a competitive process.	Both parties should make available their own records in order to provide assurances to the other party.
the primary contractor to another party under a contract placed following a competitive process (which would have satisfied the requirements of Regulation 59 had the primary contractor been a contracting authority).	The primary contractor should be the source of evidence regarding its own sales.
the primary contractor to other parties in an open market where such goods, works or services are offered for sale.	
another party, which may be the primary contractor, has supplied the GWS in an open market where such goods are for sale as a matter of commercial practice.	It is not expected that the primary contractor or MOD would hold detailed information or evidence about the prices and commercial terms of other unrelated entities, unless: • The MOD or primary contractor had previously procured the GWS from the supplier in question; or • The nature of the open market in which GWS are bought and sold means the price and terms of sale are visible. This may include commercially available pricing data. The parties should therefore ascertain if access to the relevant price information and detail on specifications can be gathered such that there is sufficient information to apply the method.

What is an open market or a competitive environment?

3.13 Where the commercial pricing method is used by reference to prices for GWS supplied in an "open market" or "competitive environment" (regulations 19A(3)(a)(iii) and (3)(b)) it must be established that those circumstances apply.

3.14 Both an "open market" and a "competitive process" (see paragraph 3.5) should be considered the same as or equivalent to a "competitive environment."

3.15 For there to be an "open market" price it must be demonstrated that the GWS under consideration are traded at an observable price which:

a. is accepted by multiple buyers to purchase a product in the market; or

b. is accepted by multiple suppliers to sell a product into the market, or

c. both of the above.

3.16 Multiple buyers or sellers means that more than one buyer or more than one seller respectively exists. This includes supplies to private or public entities. Evidence which can substantiate sales between only one buyer and one seller, even if on multiple occasions, is not sufficient for the purposes of applying this pricing method by reference to regulations 19A(3)(a)(iii) or (3)(b).

Determining the price payable under the contract

3.17 Having determined the circumstances of previous supply which allow the use of this method, the parties will need to agree a price payable under the contract or component. Regulation 19A(6) requires that the price of the contract or component is that price for which the GWS were supplied under the relevant contract as described in paragraph 3.2 (the 'observed commercial price') allowing for reasonable adjustments. For example, if the primary contractor has previously supplied the GWS to the MOD under a contract placed following a competitive process, then the price of the contract or component should be the same as that under the competed contract, plus or minus any permitted reasonable adjustments. The observed commercial price is an amount paid in exchange for the supply of GWS. Rates for inputs (such as labour) can only be considered an observed commercial price, if the contract or component being priced is itself for the supply of inputs to the same or substantially the same specification.

3.18 The circumstances in 3.2 may not give rise to a single price upon which the parties can determine the price payable under the contract or component. For example, the same GWS could have been supplied to the MOD multiple times at different prices, or the similar GWS may have been sold in an open market to differing specifications. As specified in regulation 19A(5), in such cases the parties will need to agree an approach to determine the price for the QDC or component based on a range of price data. It is a requirement that the price determined must be reasonable with reference to all of the relevant contracts for establishing the circumstances of previous supply, or as large a selection of those as is needed to be representative of the circumstances. Subject to the conditions on the circumstances of previous supply set out in Table 1, a relevant contract may include:

a. A contract between the MOD and the primary contractor;

b. A contract between the MOD and a contractor other than the primary contractor; or

c. A contract between the primary contractor and a third party.

Example 1 – commercial pricing based on a previous MOD contract competitively procured, and open market prices

The MOD seeks to purchase a number of "commercial off the shelf" (COTS) vehicles to modify for defence purposes. The contract to manufacture and supply the COTS vehicles is proposed to be priced using the commercial pricing method. The following evidence is shared between the parties to support the application of this method:

- evidence of existence of prior contracts under which the same vehicle had been purchased by the MOD under a previous competitive procurement;
- information (redacted where necessary) that demonstrates the price that the supplier's other customers are currently being charged to purchase the same vehicles; and
- prices under the previous procurement which were escalated using a suitable inflation index to reflect changes in economic conditions since that procurement took place and which are comparable to those currently being charged to the supplier's other customers.

The parties agree that on the basis of this evidence the escalated price from the previous competitive procurement is a suitable price for the new contract.

3.19 Information on these contracts may be held by either the MOD, contractor or both depending on the contract(s) in question. For example, if this method is being applied by relying on the contractor having previously supplied the GWS to other parties in a competitive environment, then the contractor must make available to the MOD sufficient relevant information about those contracts as a basis to justify reliance of the method and to establish a reasonable price under the QDC. The parties must be able to demonstrate the price is reasonable by reference to this information, and in the event of a referral on the matter, to the SSRO. The exact approach to be taken is a matter of commercial judgement, however greater weight should be placed on the most recent price data and that which most closely reflects the GWS being procured.

3.20 Regulation 19A(6)(b) sets out the adjustment factors in relation to which an addition or subtraction to the observed commercial price may be made. In all cases care must be taken to ensure that double counting of the same adjustment factor does not occur where adjustments for multiple factors are applied. For example, the reducing market price of laptop computing over time may be described in terms of a difference in specification, a change in technology or a change in economic conditions, and so adjusting for all three factors may overstate the price effect.

3.21 Either party may propose a price adjustment based on the factors listed in Table 2. There is no provision to adjust the price based on factors other than those in Table 2. The party proposing the adjustment will need to explain their approach to determining the adjustment. The amount of any adjustment may be determined in accordance with:

a. any of the contract pricing methods provided for under the Act and Regulations; and

b. a method consistent with the contractor's normal commercial practices in contract pricing and demonstrated to the MOD's satisfaction.

3.22 Adjustments are deemed reasonable to the extent they reflect that the GWS being procured are the same or substantially the same specification as those supplied in the relevant circumstances described in paragraph 3.2. Adjustments that demonstrate otherwise are not permitted as the GWS will not meet the requirements under regulation 19A(2) for this method to apply.

3.23 The parties should consider if sales of GWS which occurred some time ago are suitable comparators for the GWS being priced. If significant time has passed, the process of adjustment required (for example to reflect changes in technology and economic conditions over a long time period) may be too significant for the transaction to reflect a reliable current market price.

Table 2: Factors justifying adjustment to the observed price

Adjustment factor	Approach
Volume	The price may take account of differences in the amount of GWS procured and any accompanying economies or diseconomies of scale.
Specification	Differences of higher or lower specification may justify a price differential. Account should be taken of an additional cost or saving to the contractor of developing and implementing the new specification specifically for the purposes of the contract.
Other terms of supply	Where the terms of supply other than the volume and specification differ from those under which the original price was set, these may justify a higher or lower price. Other terms of supply may include terms and conditions of the contract that are material to the price, e.g. delivery dates, location and warranties. Not all differences will justify a price adjustment.
A change in economic conditions	Changes in economic conditions which are reflected in higher or lower prices for particular types of GWS may need to be accounted for in an adjustment of the price. The parties should be able to demonstrate how particular economic conditions have impacted the price for the GWS. For example, specific inflation in the price of the GWS being priced (and not just general inflation).

Adjustment factor	Approach
Change in technology	Differences in technology embedded in the GWS, or affecting its production, may justify a change to the price. Advances in technology can result in both lower and higher market prices. For example, by generating efficiencies in production processes bringing the costs and price down, or making production more technically challenging driving up cost and price. Account should be taken of any additional cost or saving to the supplier of developing and implementing the technological changes specifically for the purpose of the contract.
A change in performance of the goods, works or services	Higher or lower performance may justify a price differential. Account should be taken of any additional cost or saving to the contractor of developing and implementing the performance change specifically for the purpose of the contract. Consideration should be given to whether the change in performance is captured under a change in technology or specification.

Example 2 – commercial pricing based on sale to other parties in an open market

The MOD seeks to purchase several "modified off the shelf" (MOTS) products to integrate with other existing defence systems. The contract to supply the MOTS products are proposed to be priced using the commercial pricing method. The following evidence is shared between the parties to support the application of this method:

- prices for various configurations of the base equipment procured and paid for by more than one overseas government under competitive procurements;
- prices in relation to a previous MOD competitive procurement for two of the items being purchased, but of a lower specification; and
- information on the cost of the higher specification of the two items previously competitively procured by the MOD.

The parties agree that on the basis of this evidence, the previous price paid by the MOD should be adjusted to reflect the cost of the higher specification. For the remainder of the products, the price paid by foreign governments is agreed as a suitable price to the MOD due to similarity of the specifications in both procurements. Any UK specific adjustments to the price paid by foreign governments may be applied using the pricing formula, or another pricing method.

Example 3

The MOD needs to place a three-year software support contract for all of a supplier's software products used across the MOD. The contract would run on from an existing three-year contract with the same supplier. The following evidence is shared between the parties to support the application of this method:

- the prices of the new contract will be a continuation of the prices in the current contract;
- the proposed MOD contract prices are shown to be less than prices charged to other private sector customers; and
- the associated support and design costs for the supplier's product set were part of a commercially available public sector offering, and the prices negotiated by the MOD as part of the contract fell below both these known costs.

The parties agree that on the basis of this evidence, the price paid by the MOD under the current contract can be agreed as the price under the follow-on contract.

Components

3.24 Where parties make pricing amendments to contracts or components priced under this method, certain types of amendments may necessitate the formation of components. Further detail can be found in paragraph 14 of the Schedule to the Regulations.

4. Prices determined in accordance with law

Basis of prices determined in accordance with law method

4.1 Regulation 19B sets out the circumstances that must apply in order for the contracting parties to use this alternative pricing method, and the approach to pricing contracts under this method.

4.2 This method of determining the price payable under a QDC or QSC (or component of such a QDC or QSC) may be used if the price of the goods, works or services must be set in accordance with a "relevant law", which is in conflict with the pricing requirements of the Act and Regulations.

Application of the method

4.3 This pricing method only applies where there is an inconsistency between the pricing requirements of the relevant law and those of the Act and these Regulations. The method cannot be used in circumstances where both the relevant law and the pricing requirement of the Act and Regulations can be complied with under a QDC or QSC (i.e. they are not in conflict).

4.4 A relevant law includes:

a. statutes, rules, regulations, codes of practice, or requirements of regulatory authorities whether of the United Kingdom or otherwise;

b. compliance with which is mandatory for at least one of the parties; and

c. which applies to the provision of GWS under the contract or component.

4.5 Examples of circumstances in which this pricing method may be used to determine the price payable under a QDC or QSC (or component thereof) include:

a. where there is an existing legal framework in the United Kingdom (other than the Act and Regulations) which governs the price payable – for example, regulated utilities; and

b. where the price to the contractor is intractably set by a law or regime in another country that constrains or determines the price at which it must sell to the MOD.

4.6 In order for this method to be applied the parties must have identified a relevant law which is in conflict with the pricing provisions of the Act and Regulations. It is the responsibility of the contracting parties to ensure a qualifying contract is priced in accordance with all applicable laws.

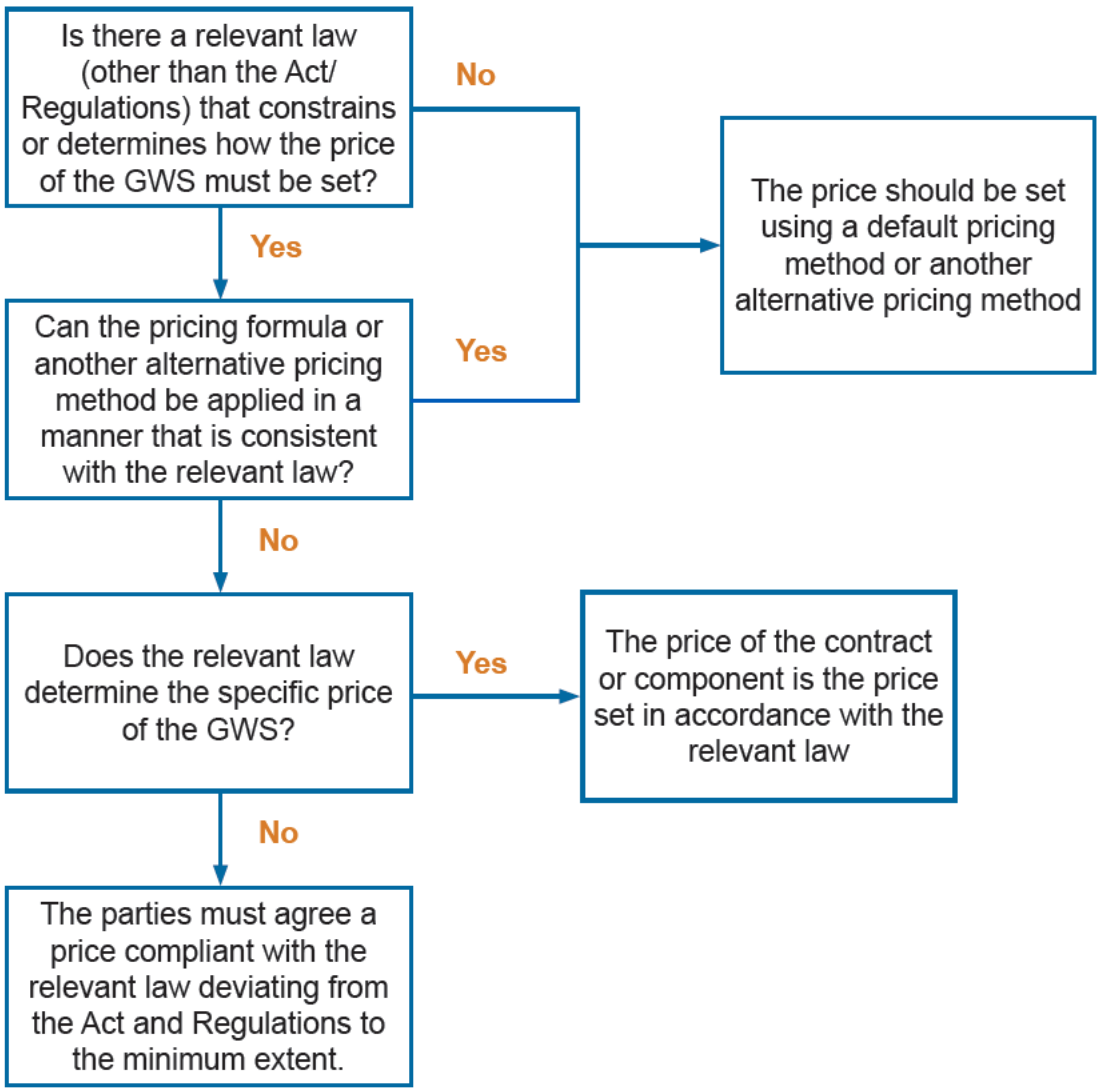
4.7 Where the requirements of pricing under the relevant law are not in conflict with the Act or Regulations, this pricing method cannot be used. In such circumstances the price payable under the contract or component should be determined using one of the other contract pricing methods set out in the Regulations.

4.8 This method does not apply in circumstances where a law exists which determines the price payable for specific customers that are not the MOD. For example, laws of non-UK countries which govern the price payable of contracts with the government of said countries. This method cannot therefore be used to price a QDC or QSC using the United States Federal Acquisition Regulation (FAR) or Defense Federal Acquisitions Regulations Supplement (DFARS) as an alternative to the Act and Regulations.

4.9 The method cannot be used in circumstances where the laws relevant to the price of the GWS exist, but are not in conflict with the pricing requirement of the Act and Regulations. An example of this might be where a law relevant to the pricing of the GWS exists but both this relevant law and the requirements of the Act and Regulations can be satisfied by pricing the GWS using the commercial pricing method.

4.10 Figure 1 below provides an overview of this pricing method.

Figure 1: Prices determined in accordance with law



Determining the price payable under the contract

4.11 Having determined that this pricing method may be used, the parties will need to agree a price payable under the contract or component.

4.12 Where the relevant law specifies the price which must be paid for the GWS, the price shall be as so specified by the relevant law.

4.13 Where the relevant law does not specify the price which must be paid for the GWS (for example if only the profit is specified), a price for the contract or component must be agreed that:

a. complies with the pricing requirements of the relevant law; and

b. is as close as possible to the price which would have been agreed between the parties in accordance with the Act and Regulations but for the application of the relevant law.

4.14 In order to meet these requirements, the price should be determined in accordance with the Act and Regulations insofar as it is possible to do so (i.e. disapplying them only to the minimum extent possible), given the requirements of the relevant law. For example, the relevant law may only govern the approach to contract profit in a way which is not compatible with the four-step process under section 17 of the Act, but may not preclude the determination of a price based on allowable costs under section 20. In this case the requirements of allowable costs should be applied in determining the price.

Example 4 – Prices regulated under UK law

The MOD proposes to procure a service which is regulated under UK law. The law includes a price cap framework designed to regulate the prices the supplier can charge to its customers, including the MOD. The components of the framework are:

- A rate of return that the supplier is allowed to earn based on its weighted average cost of capital (WACC), which represents the cost of financing its operations;
- An assessment to ensure that prices are set based on reasonable costs; and
- A price cap that limits the maximum that can be charged for the services being procured based on the cost assessment and the allowed rate of return.

The parties agree that the pricing provisions of the Act and Regulations cannot be applied in such a way that is consistent with the requirements of the framework on the rate of return or the price cap. However, the requirements for a cost assessment are not considered to be in conflict with the requirements that costs recovered under the contract meet the requirements of allowable costs. The parties therefore agree the costs of the contract in accordance with the requirement of allowable costs under the Act and Regulations, and set the profit in accordance with the price cap framework. Hence, the price is set as close as possible to the price which would have been agreed between the parties in compliance with the Act and Regulations had the conflicting parts of the statutory pricing framework not applied.

Example 5 – A relevant law which can be accommodated using another alternative pricing method.

The MOD proposes to procure a commoditised product, the price of which is set by regulations under UK law and is charged to all customers for that product. The price cannot be achieved through the application of the pricing formula.

However, the circumstance in which the product is supplied into the market means there is no conflict with the commercial pricing method. Accordingly, the price for the product is determined at the regulated price under the commercial pricing method, and the provisions of the prices determined in accordance with law method do not apply.

5. Previously agreed price

Basis of the previously agreed price method

5.1 Regulation 19C sets out the circumstances that must apply in order for the contracting parties to use this alternative pricing method, and the approach to pricing contracts (and their components) under this method. Regulation 19C confirms that the previously agreed price method does not apply to QSCs.

5.2 This method applies where:

a. the parties agree an amendment to an existing contract which results in that contract becoming a QDC under section 14(4) or 14(5) of the Act. We refer to these as a 'QDC by amendment', or

b. two QDCs have been amended so an obligation to provide GWS under one of those contracts is instead to be performed under the other contract. The price and obligations under one contract are transferred to another.

5.3 For the purposes of paragraph 5.2a above, section 14(4) and (5) of the Act describes two circumstances in which an existing contract will become a QDC by amendment when the parties agree. Broadly, these are:

a. where the contract was entered into before 18 December 2014, the award was not the result of a competitive process, and the contract is amended on or after 18 December 2014; and

b. where the contract, regardless of when it was entered into, was awarded as a result of a competitive process, the contract is amended on or after 18 December 2014, and the amendment is not the result of a competitive process.

5.4 In both cases:

a. in amending the contract, the MOD and the contractor must agree that the contract is to be converted to a QDC; and

b. the remaining conditions set out in section 14(2)(a)-(c) of the Act must also be satisfied in relation to the contract.

5.5 For the purposes of regulation 19C, the date on which the contract becomes a QDC by amendment is referred to as the date of conversion. This date is the same as the date of the amendment. The SSRO has provided separate guidance on identifying the date of amendment.[11]

5.6 In respect of paragraph 5.2b above, both contracts will be amended to reflect the transfer of obligation from one contract to the other.

11 See paragraph 3.9 of the SSRO's Reporting guidance on preparation and submission of contract reports available at https://ssro.gov.uk/reporting-guidance-and-defcars/

5.7 Regulation 65(9ZB) confirms that the previously agreed price method does not apply to QSCs.

Question 1 – Can the previously agreed price method be applied to QSCs?

No, the previously agreed price method does not apply to QSCs as confirmed by regulation 65(9ZB) which disapplies regulation 19C. Therefore, the previously agreed price method cannot be used for a QSC or a component of such a contract because a sub-contract cannot become a QSC upon amendment.

Application of this method

5.8 A QDC by amendment may have distinct parts of the specification and price that have already been agreed prior to the date of conversion. This alternative pricing method may apply to those elements. Under this method the agreed parts will become a component at their agreed amounts reflecting the agreed specification prior to conversion, and will not be subject to repricing unless the parties agree otherwise. The remaining part(s) of the contract will be priced in accordance with another contract pricing method of the Act and Regulations.

5.9 Where an obligation to provide GWS is transferred from one QDC to another, this alternative pricing method may apply to the element that has been transferred. Under this method the agreed parts will become a component at their agreed amounts reflecting the agreed specification prior to being transferred, and will not be subject to repricing unless the parties agree otherwise.

5.10 This pricing method does not apply where an amendment to a contract results in the creation of a new qualifying contract in the following circumstances:

a. in accordance with regulation 7A (meaning of a new contract); and

b. in common law, when the effect of the amendment is to rescind the existing contract.[12]

Pricing under this method

5.11 Central to the pricing under this method is that the previously agreed parts of the contract specification and price are not redetermined, unless agreed otherwise.

5.12 Where this pricing method is applied under the conditions described in paragraph 5.2a, the Regulations provide that:

a. for goods, works or services provided under the contract prior to the date of conversion, the price shall be that which was agreed between the parties before the date of conversion in respect of those goods, works or services; and

12 See SSRO's Reporting guidance on preparation and submission of contract reports, paragraph 3.70 available at https://ssro.gov.uk/reporting-guidance-and-defcars/

b. for goods, works or services in respect of which the parties had agreed a price before the date of conversion but which have not been provided at that date, the price shall be, at the parties' election, either—

i. the price so agreed; or

ii. the price re-determined at the date of conversion in accordance with another contract pricing method.

5.13 Where this pricing method is applied under the conditions described in paragraph 5.2b, the price for the transferred element is the price immediately before it was transferred to the other contract.

5.14 The contracting parties will need to be in possession of relevant records (see paragraph 1.26) regarding the agreements that have been made in respect of the contract prior to the date of conversion. Where a clear position cannot be established in respect of an agreement related to a part of the QDC on conversion, another contract pricing method must be applied to determine the price payable under that part.

5.15 Where an obligation (or obligations) to provide GWS under one QDC is to be performed under another QDC, the contracting parties will need to be in possession of relevant records regarding the agreements that have been made in respect of those obligations. Where a clear position cannot be established in respect of an agreement related to the relevant obligations as part of the QDC, another contract pricing method must be applied to determine the price payable for performance of those obligations.

Components

5.16 Application of this method will result in separate components being formed for the parts of the contract related to the GWS whose price was agreed either under another contract (where the conditions described in paragraph 5.2b apply) or before the date of conversion (paragraphs 5.12a and 5.12b(i)), and those for which a price was not agreed (paragraphs 5.9 and 5.12 (b)(ii)).

5.17 For GWS in respect of which the parties had agreed a price before the date of conversion but which have not been provided at that date and to which paragraph 5.12b applies, this must be treated as a component, the price of which is determined in accordance with the contract pricing method under which the price of the transferred element was determined immediately before it became a transferred element.

5.18 Where parties make pricing amendments to contracts or components priced under this method, certain types of amendments may necessitate the formation of components. Further detail can be found in paragraph 14 of the Schedule to the Regulations.

6. Novated contract price

Basis of the novated contracts method

6.1 Regulation 19D sets out the circumstances that must apply in order for the contracting parties to use this alternative pricing method, and the approach to pricing under this method. For this method to be applicable the existing contract before novation must be a QDC or QSC. This method cannot be used to bring non-qualifying contracts into the regime on amendment using section 14(4) or (5) of the Act, since non-qualifying contracts cannot become qualifying contracts through novation (regulation 7(f)).

6.2 Novation occurs when a party to a contract changes. Novation extinguishes the original contract and replaces it with another, under which the incoming party takes up rights and obligations which duplicate in all material respects those of the outgoing party. This can occur in different situations, including when a company undergoes a merger, acquires another company, or is itself acquired.

Application of this method

6.3 Under a novation, an existing QDC or QSC would be replaced with an equivalent new QDC or QSC ("the new QDC or QSC"). This alternative pricing method may be applied to ensure that the price for the new QDC or QSC does not need to be redetermined, and can remain as it was under the original QDC or QSC.

6.4 In order to use this method the following must apply:

a. a contract (B) has replaced a contract (A);

b. the purpose of contract B is to ensure the performance of contractual obligations which were to be performed under contract A;

c. contract A was a qualifying defence contract;

d. at least one of the parties to contract A is also a party to contract B;

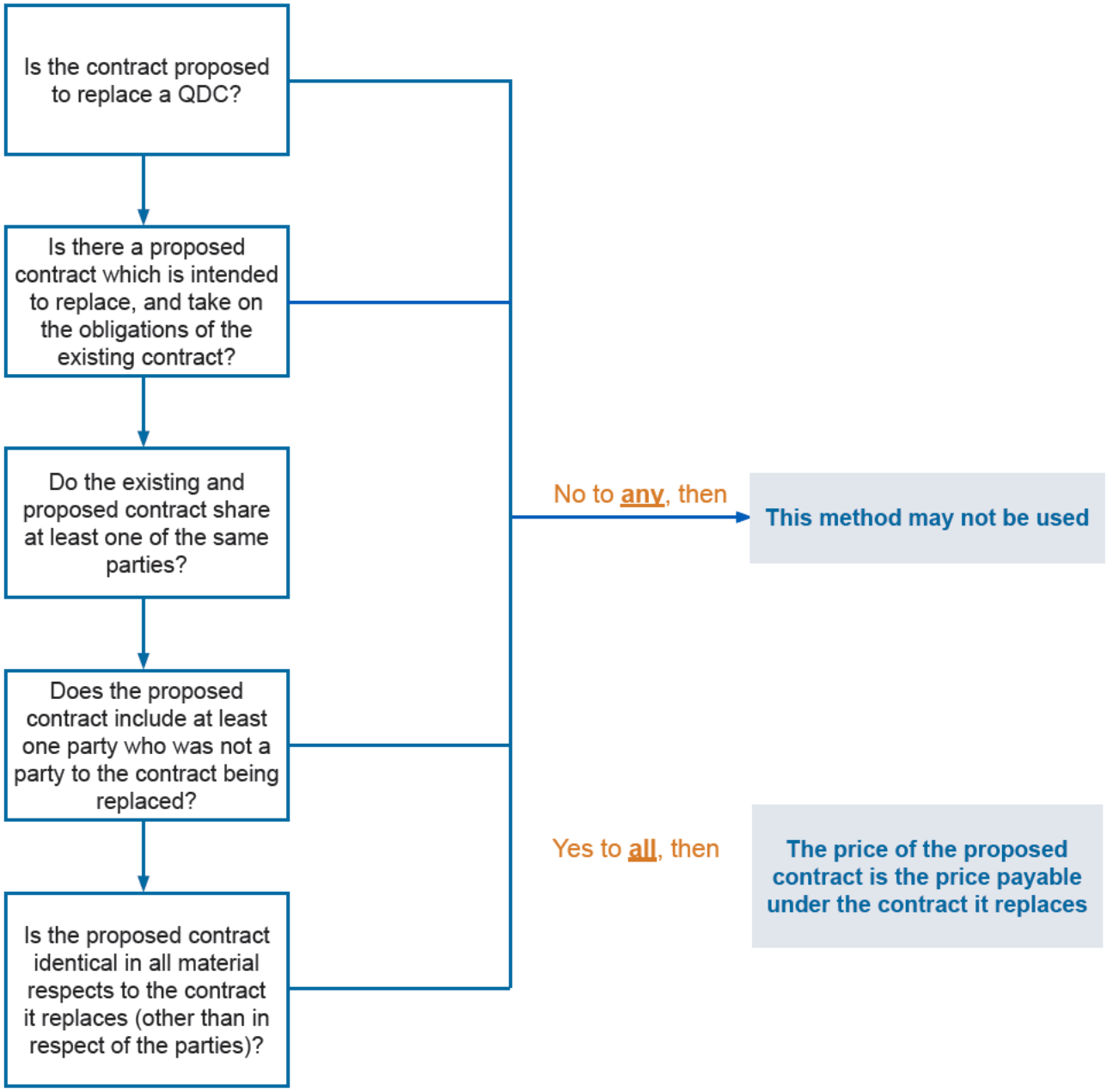
e. at least one of the parties to contract B was not a party to contract A; and

f. contract B is in all material respects (save for the identity of the parties to the contract) identical to contract A.

Pricing under this method

6.5 Under this method, subject to conditions set out in paragraph 6.4, the price under the new QDC or QSC must be the same as the price payable under the QDC or QSC it replaces. The process of pricing under this method is illustrated in Figure 2. If the conditions in paragraph 6.4 are not met, then this pricing method may not be applied.

Figure 2: Novated contract price method



7. Competed rates applied to uncompeted volumes (CRUV)

Basis of competed rates applied to uncompeted volumes method

7.1 Regulation 19E sets out the circumstances that must apply in order for the contracting parties to use this alternative pricing method, and the approach to pricing under this method.

7.2 If a competed framework agreement exists which specifies the unit price or rates of goods, works or services being provided under the QDC or QSC (which has been awarded in accordance with that framework agreement), this method allows the price payable under the contract or component to be determined by using the applicable unit prices or rates provided for in the framework.

Application of this method

7.3 The CRUV method may be used if:

a. a framework agreement is entered into in accordance with regulation 9(1) or 60(1);

b. the contract is awarded in accordance with regulation 9(1) or 60(1);

c. in relation to the goods, works or services to be provided under the contract:

i. the price will be agreed using the applicable unit prices or rates contained within the framework agreement “the competed rates or prices”; and

ii. the volume of the GWS to be provided will not have been subject to a competitive process; and

d. the conditions in regulations 9(3) or 60(3) apply to the framework agreement.

7.4 For the condition identified in paragraph 7.3.c.i to be met, the goods, works, or services to be supplied under the contract or component must be specified in a way that allows the price payable under that contract or component to be determined solely by applying the competed rates or prices to the volume of goods, works, or services supplied. For example, if the competed rates or prices within the framework agreement relate to units of labour, the goods, works or services to be provided under the contract or component would also need to be specified in units of labour for the CRUV method to be applicable. Where the competed rates or prices within the framework agreement cannot be applied in this way the CRUV method may not be used.

7.5 Regulation 9 specifies the competitive process for contracts made under a framework agreement. Regulation 60 specifies the competitive process for sub-contracts made under a framework agreement.

7.6 Where a framework exists that was let by an entity other than the MOD, for example another government department, and the MOD is allowed to access the framework, then this method may still be used if all other conditions to use this method are met.

Pricing under this method

7.7 Under this method the price of the contract or component must be agreed using the applicable unit prices or rates contained in the framework agreement for the GWS being provided under the QDC or QSC. Those unit prices or rates must not deviate from the terms of the framework agreement, or this pricing method cannot apply. Where the framework agreement contains agreed price escalation factors or other provisions for the unit price or rates to change, these may be included in accordance with the terms of the framework agreement. If the framework agreement does not contain such terms then the unit price or rates must be as specified in the framework agreement, and the parties cannot introduce means of adjusting prices other than by first amending the framework agreement.

7.8 To determine the price:

a. estimate the volume of GWS required; ensuring that these volume estimates are appropriate, attributable to the contract, and are reasonable in the circumstances; and

b. multiply the estimate in (a) by the relevant competed unit prices or rates in accordance with the terms of the framework agreement, to arrive at the price payable under the contract or component.

8. Agreed changes to the contract profit rate

Basis of agreed changes to the contract profit rate method

8.1 Regulation 19F sets out the circumstances that must apply in order for the contracting parties to use this alternative pricing method, and the approach to pricing under this method.

8.2 The Regulations allow for the rate of profit on a contract or component to be changed after the time of agreement in circumstances where:

a. an error has been identified in the determination of the contract profit rate. This may apply, for example, where the wrong baseline profit rate has been used in the calculation; or

b. the parties agree that an adjustment should be applied to the contract profit rate, in accordance with regulation 11(6) – the incentive adjustment.

Application and pricing under this method

8.3 This method may be applied where a contract or a component has been priced in accordance with the pricing formula under section 15(4) of the Act. Where a contract or component is not priced using a pricing method which involves the application of the four-step contract profit rate process (or the previously in force six-step process), this method cannot be applied.

8.4 Where an error has been identified in the contract profit rate the parties should calculate what the contract profit rate would have been if the error had not been made. Errors are limited to unintended mistakes. This method cannot be used to remedy matters that were not fully concluded to the parties' satisfaction at the time the contract was entered into. For example, pricing amendments which "firm up" provisional prices would need to be given effect in accordance with the Schedule to the Regulations, and not by using this method. The corrected price should reflect the circumstances at the time of agreement as defined in regulation 2. The price should then be adjusted by an amount which ensures the price is as it would have been if the error had not been made.

8.5 Where the intent is to include within the price an incentive adjustment, the price should be increased by an amount equal to the amount of the incentive adjustment agreed between the parties. For guidance on the setting of the incentive adjustment, see section 5 of the guidance on the baseline profit rate and its adjustment.[13]

13 https://ssro.gov.uk/price-costs-and-profit/contract-profit-rate/

9. Aggregation of components

Basis of the Aggregation of Components Method

9.1 Regulation 19G sets out the circumstances that must apply in order for the contracting parties to use this alternative pricing method, and the approach to pricing under this method.

9.2 This method allows for the parties to agree that the price of a contract comprising multiple components can be adjusted within specified limits to reflect financial risk, or to provide an incentive for the contractor, that has not otherwise been captured in the step 2 cost risk adjustment or step 3 incentive adjustment which may have been applied in calculating the profit rate of each component. Such adjustments are referred to as contract level adjustments or, individually, as the contract level incentive adjustment or contract level cost risk adjustment.

9.3 Guidance on components is provided at paragraph 1.12-1.16 of this document.

Application of this method

9.4 This method of pricing requires the price of each of the components of the contract to be combined by summing the price of each component (the result of which is “the total component price”), and the value of any contract level adjustment agreed under this method to arrive at the price payable under the contract.

9.5 The method may only be applied where:

a. the contract contains more than one component; and

b. where further conditions associated with each type of adjustment (for financial risk or to provide incentive for the contractor) apply, the parties agree to make an adjustment.

9.6 Subject to the further conditions set out in the remainder of this guidance, the aggregation of components method allows for two adjustments to be made to the total component price:

a. the total (i.e. contract level) cost risk adjustment; and

b. the total (i.e. contract level) incentive adjustment.

9.7 Either one or both of the adjustments may be applied, and if no adjustment is made then the adjustment is zero.

Contract level cost risk adjustment

9.8 A contract level cost risk adjustment (CRA)[14] can only be applied where:

a. the contract contains more than one component; and

b. the primary contractor is required to integrate outputs from different components of the contract.

9.9 The component outputs and the integration activity in respect of those outputs must be tangible and clearly defined in order to apply this method. The integration activity must form part of the contract being priced.

9.10 Subject to the relevant conditions being met, the parties may agree to adjust the total component price (see 9.4) to reflect the financial risk to the primary contractor of entering into the contract, taking into account the particular types of activities delivered under that contract and the integration of outputs from any component.

9.11 The amount of the adjustment must not exceed the maximum amount permitted by the Regulations.

9.12 The maximum amount of the adjustment is that which, when added to the sum of all cost risk adjustments agreed in respect of all components of the contract, equals the sum of all cost risk adjustments under the contract had the parties agreed an adjustment of plus 25 per cent of the baseline profit rate when pricing each component of the contract. The Act and Regulations only provide for a contract level cost risk adjustment to be agreed for contracts that include at least one component using a contract profit rate calculated under regulation 11. The adjustment itself is made to the sum of all components, irrespective of the pricing type each uses.

9.13 Examples of calculating the maximum amount of the contract level cost risk adjustment:

a. If the aggregate of all cost risk adjustments under the contract had the parties agreed an adjustment of plus 25 per cent of the BPR was £25 million, and the aggregate of all cost risk adjustments actually applied was £15 million, then the maximum amount of the contract level cost risk adjustment (the contract level CRA 'pot') would be £10 million.

b. If no cost risk adjustments had been agreed under the components, the maximum contract level cost risk adjustment would be the additional amount of profit achieved by applying the maximum CRA of plus 25 per cent on all those components to which a CRA could have been applied.

c. If the full plus 25 per cent cost risk adjustment had been applied to all components, then the maximum amount of the contract level cost risk adjustment would be zero.

14 The name ascribed to this in the Regulations is the "total cost risk adjustment"

9.14 A more detailed worked example is provided below which shows how the maximum should be calculated.

9.15 For some default pricing methods (e.g. cost plus) the total component price is determined through the life of the contract as allowable costs are incurred. Therefore, the maximum amount of the aggregate cost risk adjustment is not known until all of the allowable costs under the contract are agreed.

9.16 The amount of the contract level cost risk adjustment may be specified as a fixed value or a percentage of the total component price, subject to the amount of the adjustment not exceeding the maximum amount permissible.

9.17 When determining the contract level cost risk adjustment, the parties should ensure that the adjustment only reflects risk that is not already accounted for in the cost risk adjustments applied in the contract profit rate of each component. Risks that are already reflected in the component level cost risk adjustments should not be considered in the agreement of the contract level cost risk adjustment.

9.18 The adjustment may be positive when risk arises due to the integration of the outputs of individual components that cannot, or have not, been accounted for in the cost risk adjustment of those components. In all other circumstances, the contract level cost risk adjustment should not apply.

Example 6 contract level cost risk adjustment (CRA)

A company has a price QDC formed of 3 components:

- Component 1 is firm priced, using the pricing formula. It has a CRA of +25 per cent of the baseline profit rate (BPR), a capital servicing adjustment (CSA) of 1.73 per cent and estimated allowable costs of £50m.
- Component 2 was priced using the commercial pricing method and is priced at £50m*.
- Component 3 is also firm priced using the pricing formula, with a CRA of -10 per cent of the BPR, a CSA of 1.41 per cent and allowable costs of £100m.

The BPR is 8 per cent. No incentive adjustment (IA) has been applied to any component. The calculations for the contract profit rates (CPR) for the two components using a default pricing method are shown in the following table.

CPR steps	Component 1	Component 3
BPR (a)	8%	8%
CRA (b)	+25% of the BPR (2pp)	-10% of the BPR (-0.8pp)
IA (c)	-	-
CSA (d)	1.73%	1.41%
CPR (e)	**11.73%**	**8.61%**

*Components using the commercial pricing method do not use the four-step contract profit rate formula and therefore do not have a step 2 cost risk adjustment that may be applied.

	Component 1	Component 2	Component 3	Total	
Allowable cost (f)	50	N/A	100		
Profit (g)	5.87	N/A	8.61		f x e
Price	55.87	50	108.61	214.48	f + g

The total component price is 214.48. This amount may now be adjusted by applying a contract level CRA up to the maximum permitted.

CPR steps	Component 1	Component 3	Total	
Allowable costs (f)	50	100	-	
Maximum CRA (h)	+25% of the BPR	+25% of the BPR	-	
Maximum value of CRA(i)	1	2	3	f x a x h
Actual CRA (b)	+25%	-10%		
Actual value of CRA (j)	1	-0.8	0.2	f x b x h
Maximum Contract level CRA pot	0	2.8	2.8	i - j

The maximum amount of the contract level CRA is taken by deducting the actual amount of the CRA applied at component level (j) from the maximum amount of the CRA (i).

The maximum contract level CRA is 3 – 0.2 = £2.8m

This allows a contract level CRA of up to 1.31%** of the total component price (2.8/214.48), resulting in a maximum price payable under the contract of 214.48 + 2.8 = 217.28

**this % is expressed assuming no contract level incentive adjustment is made and reflects the price at the time of the calculation. Irrespective of the application of a further adjustment, the contract level CRA cannot exceed the maximum amount permitted which in this example is 2.8.

Contract level incentive adjustment (IA)

9.19 Subject to the relevant conditions being met, the parties may agree to increase the total component price (see paragraph 9.4) to provide a particular financial incentive to the primary contractor as regards the performance of the provisions of the contract. The inclusion of a contract level incentive adjustment is at the MOD's discretion and is not an entitlement.

9.20 The amount of the adjustment must not exceed the maximum amount permitted by the Regulations.

9.21 The maximum amount of the contract level incentive adjustment is:

a. the total of any incentive adjustments that might be made in respect of the individual components of the contract that have been priced in accordance with a default pricing method, less

b. the amount of all of the incentive adjustments that have been determined in accordance with regulation 11(6) (incentive adjustment) in respect of that contract.

9.22 For QDCs the maximum amount of any incentive adjustment is 10 percentage points. For QSCs (or any component of a contract which is a QSC) the maximum amount of any incentive adjustment is 2 percentage points.

9.23 For example, if applying the maximum ten percentage point incentive adjustment on all applicable components of a QDC (i.e. those using a default pricing method) would have resulted in an amount of profit of £10 million, and the amount of profit related to the actual application of the incentive adjustment was £4 million, then the maximum contract level incentive adjustment (contract level IA 'pot') would be £6 million. A more detailed example is provided below showing how to calculate the maximum envelope for the contract level incentive adjustment and the application of the adjustment.

9.24 For some default pricing methods (e.g. cost plus) the total component price is determined through the life of the contract as allowable costs are incurred. Therefore, the maximum amount of the contract level incentive adjustment is not known until all of the allowable costs under the contract are agreed.

9.25 The amount of the contract level incentive adjustment may be specified as a fixed value or a percentage of the total component price, subject to not exceeding the maximum amount permissible.

9.26 When determining the contract level incentive adjustment the parties must ensure that:

a. the adjustment relates to performance of provisions of the contract across more than one component. Performance which relates to only one component should be incentivised using the incentive adjustment applied to that component only; and

b. the adjustment should only relate to performance that is not otherwise incentivised by an adjustment on an individual component.

9.27 Once it has been agreed by the MOD that a contract level incentive adjustment is appropriate, the maximum possible envelope for contract level incentive adjustment must be determined.

Example 7 contract level incentive adjustment (IA)

A company has a contract formed of 3 components:

- Component 1 is firm priced using the pricing formula. It has a cost risk adjustment (CRA) of +10 per cent of the baseline profit rate (BPR), an IA of 4 percentage points, a capital servicing adjustment (CSA) of 1.8 per cent and estimated allowable costs of £50m.
- Component 2 is priced using the commercial pricing method, and is priced at £25m*.
- Component 3 is also firm priced using the pricing formula, with a CRA of +20 per cent of the baseline profit rate, incentive adjustment of 5 percentage points, a capital servicing adjustment of 2.0 per cent and allowable costs of £125m.

The baseline profit rate (BPR) is 8 per cent. The calculations for the contract profit rates for the two components using a default pricing method are shown in the following table.

CPR steps	**Component 1**	**Component 3**
BPR (a)	8%	8%
CRA (b)	+10% of the BPR (0.8pp)	20% of the BPR (1.6pp)
IA (c)	4pp	5pp
CSA (d)	1.8%	2%
CPR (e)	**14.60%**	**16.6%**

* Components using the commercial pricing method do not apply the four steps contract profit rate formula and therefore do not have a step 3 incentive adjustment that may be applied.

	Component 1	**Component 2**	**Component 3**	**Total**	
Allowable cost (f)	50	N/A	125		
Profit (g)	7.3	N/A	20.75		f x e
Price	57.3	25	145.75	228.05	f + g

The total component price is 228.05. This amount may now be adjusted by applying a contract level incentive adjustment up to the maximum permitted.

CPR steps	**Component 1**	**Component 3**	**Total**	
Allowable costs (f)	50	125	-	
Maximum IA (h)	+10pp	+10pp	-	
Maximum value of IA(i)	5	12.5	17.5	f x h
Actual IA (c)	+4pp	+5pp		
Actual value of IA (j)	2	6.25	8.25	f x c
Maximum contract level IA pot	3	6.25	9.25	i - j

The maximum amount of the contract level incentive adjustment is taken by deducting the actual total value of IA applied at component level (j) from the maximum total value of IA (i).

The maximum total IA is 17.5 – 8.25 = 9.25

This allows a contract level IA of up to 4.05%** of the aggregate contract price (9.25/228.05), resulting in a maximum price payable under the contract of 228.05 + 9.25 = 237.30

**Rounded down for example purposes. This % is expressed assuming no contract level cost risk adjustment is made. Irrespective of the application of a further aggregate adjustment, the total IA cannot exceed the maximum amount permitted which in this example is 17.50. The same principle would also apply where components applied different baseline profit rates.

Appendix A: Changes from previous version

A.1 The table below highlights changes from version 1.3 of the guidance to this version. References in footnotes have also been updated to the latest applicable versions.

Key to changes:

No change
Deleted
Revised
Added

Section/paragraph 2026 v1.3	Section/paragraph 2026 v1.4
1. Introduction	
2. Alternative Pricing	
3. Commercial pricing	
4. Prices determined in accordance with law	
5. Previously agreed price	
6. Novated contract price	
7. Competed rates applied to uncompeted volumes (CRUV)	
8. Agreed changes to the contract profit rate	
9. Aggregation of components	
NA	9.22
9.22	9.23
9.23-9.26	9.24-9.27
Example 7	Example 7