

**EXPLANATORY MEMORANDUM TO
THE DEFENCE AND SECURITY PUBLIC CONTRACTS REGULATIONS 2011**

2011 No. 1848

- 1.** This explanatory memorandum has been prepared by the Ministry of Defence (MOD) and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

- 2. Purpose of the instrument**

2.1 This instrument implements the requirements of Directive 2009/81/EC of the European Parliament on defence and security procurement (the “New Directive”). Implementation of the New Directive is mandatory.

- 3. Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 Ambulatory references (references to a document as “amended from time to time”) are used in two instances in this instrument: firstly in the definition of “military equipment” and secondly in the thresholds for the value of contracts which fall within these Regulations (regulation 9(3)).

3.2 The definition of military equipment in this instrument refers to the Council Military List of the European Union. This is subject to frequent updates and amendments, most recently in February 2011. An ambulatory reference will avoid the need to frequently amend the definition of military equipment.

3.3 With regard to threshold amounts, incorporating an ambulatory reference mirrors the approach taken in the Public Contracts Regulations 2006 SI 2006/5 (the “PCR”) and will remove the need for amendment every time the threshold amounts and corresponding euro/sterling conversion rates are changed.

- 4. Legislative context**

4.1 The New Directive, which has to be implemented by 21 August 2011, for the first time creates regulations which are tailored specifically for defence and security procurement.

4.2 The New Directive is largely based on Directive 2004/18/EC (the “Classic Directive”). Therefore, to assist the defence and security procurement community, these regulations are closely based on the instruments that implement the Classic Directive in the UK. These regulations remove certain defence and security procurements from the existing regulatory regime (the PCR and the Scottish equivalent – the Public Contracts (Scotland) Regulations 2006 SSI 2006/1) and bring them within its scope.

4.3 The scope of these regulations also extends to contracting entities to which Directive 2004/17/EC (the “Utilities Directive”) applies if they procure equipment, works or services which are for security purposes and involve, require or contain classified information.

4.4 The EC Communication outlining its aims to improve the market was considered by the House of Commons (Hansard reference 24451 HC 63-xxiii 2002-2003) and cleared on 4

June 2003; the EC Green Paper on Defence Procurement was cleared by the House of Commons European Standing Committee on 8 February 2005 (Hansard reference 26019) and the House of Lords European Scrutiny sub-committee on 17 March 2005; the results of that consultation were cleared by the House of Lords European Scrutiny sub-committee on 16 March 2006 and European Standing Committee on 25 October 2006. The draft New Directive was considered by the House of Commons EU Scrutiny committee on 24 November 2008 (Hansard reference 29267).

4.5 A transposition note is attached as an Annex to this Explanatory Memorandum.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy Background

7.1 The New Directive was adopted by the EU Council of Ministers and the European Commission on 12 July 2009. It was published in the Official Journal of the European Union (OJEU) on 20 August 2009 and must be implemented by 21 August 2011.

7.2 Implementation of the New Directive is mandatory. However, certain aspects of the provisions permit Member States some flexibility in deciding how or in some cases, whether, to implement them. In such instances, the MOD has been careful to ensure that the least burdensome option is transposed, thereby mitigating any unnecessary effects on public authorities and industry.

7.3 The New Directive establishes new procurement rules specifically tailored to address the sensitive nature of procurements in the defence and security sectors. It was adopted following a proposal by the EC Commission to address concerns by Member States that the existing Classic and Utilities Directives do not always permit the acquisition of military or sensitive security capability as effectively as they could, or deal explicitly with key requirements for acquisitions such as security of information or security of supply.

7.4 The New Directive therefore sets out new common procurement rules for contracting authorities/entities which purchase defence and security equipment (and related goods, works or services) or where they purchase goods, works or services which require or contain classified information. The expectation is that this will enable defence and security procurements to be conducted more efficiently and that the European defence and security markets will be made more open and transparent.

7.5 The policy has not attracted major interest from the general public. However, it is of significant interest to those people working in the field of public procurement, specifically defence and security related procurement. The consultation exercises evoked useful feedback from around 30 organisations, comprising contracting authorities and industry representatives and including the main UK defence industry trade body. Media attention has been limited to the specialist defence media so far.

7.6 The policy is important, as it introduces defence and security procurement rules across the EU for the first time. Whilst the New Directive itself is politically noteworthy in that significantly more defence and security procurements are expected to be undertaken under the EU's single market, the implementation policy is not likely to be politically important.

8. Consultation Outcome

8.1 MOD has used two full public consultations to involve stakeholders in the decision making process. The first introduced MOD's proposed approach to implementation, highlighted the main new provisions, and sought stakeholder feedback on the optional elements of the New Directive. The second sought comments on the new draft Regulations and implementation decisions.

8.2 The first consultation ran for 12 weeks between December 2009 and March 2010. Over 30 groups were consulted and responses were received from trade associations, the general public, Other Government Departments (OGDs), devolved administrations and other stakeholders. The main outcomes from the first consultation were decisions that:

8.2.1 In general, the New Directive provisions which are substantively the same as corresponding provisions in the Classic Directives and the Remedies Directives (2009 No. 2992), both in respect of mandatory and discretionary provisions, would be implemented in the same way as the PCR 2006.

8.2.2 With regard to sub-contracting, the MOD decided to transpose Article 21(3) of the New Directive as an option and not to transpose Article 21(4). These decisions were made following close consultation with stakeholder groups and industry, including small and medium sized enterprises (SMEs). The sub-contracting options attracted many comments during consultation, which are reflected in 8.2.3 and 8.2.4 below.

8.2.3 Article 21(3) allows the contracting authority to require the contractor to use specific rules in the regulations to place subcontracts where it has indicated that they intend to subcontract to a third party. The MOD intends to transpose Article 21(3) as an option for contracting authorities as opposed to a mandatory provision. This will allow each contracting authority to decide on a case by case basis whether such measures will deliver value for money and create opportunities for SMEs and will avoid nugatory bureaucracy for the authority and industrial stakeholders where such measures are inappropriate.

8.2.4 Article 21(4) allows the contracting authority to require the contractor to sub-contract up to a maximum of 30% of the contract to third parties, even where the contractor originally intended that the work would be carried out in-house or by a related company. Consultation responses indicated that such provisions are likely to affect each tenderer differently, as they will have different in-house and supply chain arrangements and might result in difficulties for the contracting authorities in demonstrating that they have complied with their duties not to discriminate and to treat all tenderers equally. Some suppliers, in particular SMEs, might also find it difficult to cope with the additional administrative burden of complying with the sub-contracting rules, whilst other suppliers might find it difficult to sustain their business operations if they have to sub-contract 30% of contracts.

8.3 The second consultation ran for 12 weeks between December 2010 and March 2011. The consultation mainly confirmed the proposed policy options although some changes were

made to the draft Regulations, supporting papers and guidance following consideration of the responses. The highlights of the second consultation were:

8.3.1 Article 1 (Regulation 3(1)) – Following several conflicting consultation responses on the definition of classified information MOD has amended the definition in the Regulations to be based more closely on the definition set out in the New Directive.

8.3.2 Article 6 (Regulation 10) – Several stakeholders commented on whether the obligation imposed on the contracting authority to protect confidential information may be made subject to domestic law, in particular the Freedom of Information Act. MOD reviewed and amended the wording of the regulation in the light of the comments and recent case law.

8.3.3 Article 11 – Although MOD did not seek comments on this article of the New Directive, one group queried whether the proposed implementation approach, i.e. not to transpose Article 11, is correct. Following consideration of the comments, MOD revisited the proposed approach and remains of the view that the article does not need to be transposed and that the provision would require elaboration which would risk gold-plating if transposed into UK law.

8.3.4 Article 56 (5) (Regulation 57(2)) – Following consultation, it was thought appropriate to depart from the equivalent wording of the PCR in the implementation of this Article to allow the test for granting interlocutory injunctions to take particular account of defence and security interests, as specifically allowed in the new Directive.

9. Guidance

9.1 In order to explain how the new Regulations will be applied, overarching pan-government guidance was made publicly available on the MOD consultation website¹ at the same time as the second public consultation.

9.2 Detailed pan-government guidance is also being developed which takes into account comments made during the second public consultation. Furthermore, MOD has worked closely with OGDs to refine this guidance and has assisted OGDs in the production of specific departmental guidance. Once finalised, this detailed guidance will be made publicly available through the MOD website.

9.3 Notices to inform stakeholders of the key issues and implications of the new Regulations have been placed on internal and external MOD and OGD websites and in publications such as the Defence Contracts Bulletin. Announcements have also been made in internal MOD and OGD publications including a Cabinet Office Procurement Policy Note.

9.4 A number of online training modules have also been developed for MOD procurement staff. Access to this training will be made available to OGDs.

10. Impact

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<http://www.mod.uk/DefenceInternet/AboutDefence/CorporatePublications/ConsultationsandCommunications/PublicConsultations/200981EcSecondConsultation.htm>

10.1 There is no impact on charities or the voluntary sector as the new rules do not impose any obligations on these sectors. The impact on businesses is examined in greater detail in the Impact Assessment.

10.2 The impact on the public sector is examined in greater detail in the Impact Assessment.

10.3 The Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on www.legislation.gov.uk.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is to transpose the least burdensome option whenever available and appropriate. This follows detailed consultations and discussions with industry bodies representing defence and security firms, including SMEs, as explained in section 8 above.

11.3 The basis for the final decision on what action to take to assist small business is to ensure that the least amount of regulatory burden is placed upon SMEs, whilst also ensuring that the UK complies with the New Directive.

12. Monitoring and review

12.1 The intended outcomes of this instrument are:

12.1.1 To implement the New Directive into national law, by the transposition deadline of 21 August 2011, thereby achieving compliance with our obligation as a member of the European Union; and

12.1.2 To implement the new Directive in the way that works best for UK stakeholders, having regard to the views expressed in the public consultations.

12.2 The European Commission is required to review the implementation of the New Directive by 21 August 2016. The UK plans to participate actively in this review at European level and will also review the instrument in accordance with the provisions of Regulation 2 within five years of the day on which the instrument comes into force.

13. Contact

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Transposition Note

Directive 2009/81/EC of the European Parliament and of the Council of 13th July 2009

Defence and Security Public Contracts Regulations 2011

1. Directive

1.1 Directive 2009/81/EC of the European Parliament and of the Council of 13 July 2009 sets out the rules which will apply to certain procurement in the fields of defence and sensitive security and which closely follows Directive 2004/18/EC (the “Classic Directive”) and Directives 89/665/EEC and 92/13/EEC, as amended by Directive 2007/66/EC (together “the Remedies Directive”).

2. Introduction

2.1 The Regulations that this transposition note accompanies implement Council Directive 2009/81/EC (‘the New Directive’) concerning the coordination of procedures for the award of certain works, supply and services contracts by contracting authorities and entities in the fields of defence and sensitive security procurement.

2.2 The Regulations do what is necessary to implement the New Directive, including making consequential changes to existing domestic procurement regulations to ensure its coherence in the areas to which they apply.

2.3 The general approach in these Regulations has been to follow, as far as possible, the wording and structure of the Public Contracts Regulations 2006 (PCR 2006) where these are substantively the same but also taking into account changes to the law and particular defence and security issues where appropriate.

2.4 The important elements of the New Directive implemented in these Regulations are as follows:

Directive Article	Objective	Implementation
Article 1 - Definitions	Establishes definitions and key terms which are used throughout the Regulations.	<p>Regulation 3 (Interpretation) – sets out definitions which are used throughout the Regulations.</p> <p>Regulation 4 (Contracting authorities) – sets out which bodies fall within the meaning of “contracting authority”.</p> <p>Regulation 5 (Economic operators) – sets out the definition of an “economic operator”.</p>

Directive Article	Objective	Implementation
Article 2 - Scope	Establishes whether particular contract award procedures will fall within the scope of the Regulations.	Regulation 6 (Application) – sets out the application of the Regulations and which parts apply to particular contract award procedures.
Article 3 - Mixed contracts	Sets out what rules apply in the event that a contract falls within the scope of two or more Directives.	Regulation 6(4) - 6(6) (Application) – sets out which procurement regulations should apply in the event that a particular contract falls within more than one set of regulations.
Article 4 - Procurement principles	Sets out the principles to which contracting authorities/entities must adhere when awarding contracts to economic operators under the new Directive.	Regulation 5 (Economic operators) – sets out the duties owed to economic operators under the Regulations.
Article 6 - Confidentiality obligations of contracting authorities/entities	Sets out confidentiality obligations which contracting authorities are to comply with.	Regulation 10 (Confidential information).
Article 7 - Protection of classified information	Allows contracting authorities to put in place arrangements to protect classified information which is communicated throughout the tendering and contracting procedure.	Regulation 11 (Classified information) - provides that contracting authorities may impose confidentiality obligations on economic operators and require that they are also imposed on sub-contractors.
Articles 8/9 - Threshold amounts and methods for calculating	Sets out the threshold amount for contracts above which the New Directive will apply and the method for calculating the estimated value of contracts and framework agreements.	Regulation 9 (Thresholds) - provides amended threshold amounts for supply, services and works contracts and sets out the method for calculation of threshold amounts in a similar way to the PCR 2006.
Article 10 - Central purchasing bodies	Allows contracting authorities to purchase works, goods or services from or through a central purchasing body, including a European public body.	Regulation 22 (Central purchasing bodies) – sets out that a contracting authority may purchase from a central purchasing body and when it is deemed to have complied with the Regulations in so doing.

Directive Article	Objective	Implementation
Article 12 - Contracts awarded pursuant to international rules	Allows contracting authorities to exempt contracts awarded pursuant to certain international rules (including both treaties and memoranda of understanding) from the New Directive.	Regulation 7 (General exclusions) – sets out the scope of this exemption as it applies to contracting authorities.
Article 13 - Specific exclusions	Allows contracting authorities to exempt certain contract award procedures from the provisions of the New Directive in addition to those under Article 12.	Regulation 7 (General exclusions) – sets out the applicable exemptions in an equivalent manner to the PCR 2006 and includes new exemptions which are specific to the defence and security sector.
Articles 15/16 - Service contracts listed in Annexes I and II	Establishes the categories of service contract, the award procedure for which is subject to either the full or the limited application of the New Directive.	Regulation 6 (Application) and Schedule 2 Parts A and B (Categories of Services). Regulation 6 provides that the regulations apply in their entirety to those service categories listed in Schedule 2 Part A in an equivalent manner to the PCR 2006 but includes certain additional defence and security-specific categories and other categories previously categorised as Part B services. Schedule 2 Part B - provides that the regulations apply to a limited extent to those service categories listed in schedule 2B in an equivalent manner to the PCR 2006.
Article 18 - Technical specifications	Provides for the manner in which contracting authorities may lay down and define technical specifications.	Regulation 12 (Technical specifications in the contract documents) - includes provision that technical specifications must be defined, subject to any compulsory or interoperability requirements.
Article 20 - Conditions for performance of contracts	Allows contracting authorities to impose special conditions, in particular relating to security of supply and security of information.	Regulation 36 (Conditions for performance of contracts) – sets out the ability of contracting authorities to impose special conditions, in particular relating to security of supply and security of information.
Article 21 - Subcontracting	Sets out the rules relating to sub-contracting.	Regulation 37 (Sub-contracting) - the rules have been transposed to the extent set out below.

Directive Article	Objective	Implementation
Article 21(2)	Provides contracting authorities with the ability to ask tenderers to indicate what share of a proposed contract is to be sub-contracted and to indicate changes in sub-contractors during contract performance.	Regulation 37(2) - decisions as to whether to require tenderers to indicate share or changes are at the discretion of contracting authorities.
Article 21(3)	Requires contracting authorities to oblige tenderers to award proposed sub-contracts to unconnected third parties in general through open competition or transpose as an optional provision exercisable by contracting authorities.	Regulation 37(3) - decisions as to whether to require tenderers to award sub-contracts to unconnected third parties is at the discretion of contracting authorities.
Article 21(5)	Provides that contracting authorities may reject sub-contractors selected by tenderers either at contract award stage or during contract performance.	Regulation 37(4) – enables contracting authorities to control identity of sub-contractors to a similar extent as they are able at prime contract level. The ability to use is at the discretion of the contracting authority.
Article 22 - Security of information	Establishes non-exhaustive security of information provisions which contracting authorities may require economic operators to comply with.	Regulation 38 (Security of information) - sets out the non-exhaustive security of information provisions which contracting authorities may require economic operators to include in their tenders.
Article 23 - Security of supply	Establishes non-exhaustive security of supply provisions which contracting authorities may require economic operators to comply with.	Regulation 39 (Security of supply) - sets out the non-exhaustive security of supply provisions which contracting authorities may require economic operators to include in their tenders.
Article 25 - Procedures to be applied	Establishes that the default procedures under the New Directive are the negotiated with notice procedure and the restricted procedure but that the negotiated without notice procedure and competitive dialogue procedure are available in limited circumstances.	Regulation 15 (Selection of contract award procedures) - sets out the default procedures and the circumstances in which the negotiated without notice and competitive dialogue procedures may be used. The available procedures are exercisable in virtually the same way as those under the PCR 2006.

Directive Article	Objective	Implementation
Article 28 - Cases justifying use of the negotiated procedures without publication of a contract notice	Sets out the circumstances in which the use of the negotiated procedure without publication of a contract notice is available in including defence and security specific circumstances.	Regulation 16 (Use of the negotiated procedure without prior publication of a contract notice). This provision closely follows the equivalent provision in the PCR 2006 but also includes the application of the procedure to research and development contracts which are not otherwise exempted from the Regulations and contracts for the supply of air and maritime transport services for forces on deployed operations.
Article 29 - Framework agreements	Establishes procedures for awarding framework agreements but now allows for a duration of up to 7 years as standard.	Regulation 20 (Framework agreements).
Article 35- Information for candidates and tenderers	Sets out the information which must be given to tenderers and candidates in respect of the contracting authority's award decision.	Regulation 30 (Notification) and Regulation 33 (Information about contract award procedures). The reasons given for rejection may include defence and security specific reasons relating to security of information and security of supply.
Article 39 - Personal situation of the candidate or tenderer	Provides for the criteria relating to the personal situation of the candidate which may be taken into account as part of the qualitative selection process.	Regulation 23 (Criteria for the rejection of economic operators) - largely mirrors the PCR 2006 but updates the list of offences for all UK regimes and includes defence and security specific mandatory and discretionary exclusions.
Article 42 - Technical and/or professional ability	Provides for the criteria relating to the technical or professional ability of the candidate which may be taken into account as part of the qualitative selection process.	Regulation 25 (Information as to technical or professional ability) – mirrors the equivalent PCR 2006 Regulation. Defence and security-specific evidence relating to security of information and security of supply which may also be taken into account.

Directive Article	Objective	Implementation
Article 47 - Contract award criteria	Sets out the non-exhaustive criteria which may be taken into account in awarding the contract.	Regulation 31 (Criteria for the award of a contract) - mirrors the equivalent PCR 2006 Regulation whilst including defence and security-specific criteria relating to security of supply which may be taken into account.
Article 51 - Principles	Sets out the principles applicable to the award of sub-contracts when a contracting authority has mandated the use of the rules in Articles 52-54 in accordance with Article 21(3).	Regulation 41 (Principles) – provides that a successful tenderer must act transparently and treat all potential sub-contractors in an equal and non-discriminatory way.
Article 52 - Thresholds and rules on advertising	Sets out the applicable thresholds and rules on advertising sub-contract requirements when a contracting authority has mandated the use of the rules in Articles 52-54 pursuant to Article 21(3).	Regulation 42 (Thresholds and rules on advertising) and Regulation 43 (Award of a sub-contract without publication of a sub-contract notice) - provide for the detailed rules on advertising sub-contract requirements and the circumstances in which the award of a sub-contract does not require a sub-contract notice.
Article 53 - Criteria for qualitative selection of subcontractors	Sets out rules regarding the criteria for qualitative selection of sub-contractors when a contracting authority has mandated the use of the rules in Articles 52-54 pursuant to Article 21(3).	Regulation 44 (Criteria for qualitative selection of sub-contractors) – provides for the rules applicable by a successful tenderer in respect of qualitative selection criteria.
Articles 55-64 – Rules to be applied to reviews	These Articles set out the scope and availability of review procedures together with the provision of a standstill period prior to contract award. They follow closely the provisions of the Remedies Directive except where indicated below.	Regulations 34 (Standstill period) and 50-65 (Applications to the Court) - contain the remedies provisions and are closely aligned to the equivalent provisions in the PCR 2006, except as set out below. In contrast to the PCR 2006, the duty owed by contracting authorities to World Trade Organisation Agreement on Government Procurement (GPA) economic operators is not replicated in the Regulations as defence and security procurements are exempted from the GPA. In addition, as these Regulations apply to Scotland, provision has been made for procedural differences in that jurisdiction.

Directive Article	Objective	Implementation
Article 55 - Scope and availability of review procedures	Provides the general requirement that decisions taken by contracting authorities should be subject to effective review. Article 55(5) allows for an obligation on the part of the economic operator to inform the contracting authority of alleged breach and intention to bring proceedings.	Regulation 52 (Enforcement of duties through the Court) – reintroduces the requirement for a pre-litigation notice in contrast with the PCR 2006.
Article 56(5) – Interim measures	Provides that the Courts, when deciding whether or not to grant interim measures, may be required to take into account all interests which are likely to be harmed, in particular defence and security interests.	Regulation 57(2) (Interim orders) – sets out what is considered to be a broader test than the American Cyanamid-based test which currently applies to challenges under the PCR 2006. This specifically requires the Court to take into account the public interest and, in particular, defence and security interests.
Article 59 - Time-limits for applying for review	Sets out the general time limits for applying for review.	Regulation 53 (General time limits for starting procedures) – this regulation differs from that in the PCR 2006 in order to comply with the European Court of Justice (ECJ) ruling in Uniplex v NHS Business Services Authority.
Article 60 - Ineffectiveness	Establishes the remedy of ineffectiveness, the grounds to be satisfied for a finding of ineffectiveness and at Article 60(3) the general interest grounds for not making a declaration of ineffectiveness.	Regulation 61(1) and (5) (General interest grounds for not making a declaration of ineffectiveness) - includes the ability not to set aside a contract where there are grounds to do so where defence or security interests require the effects to be maintained or where to do so would endanger the existence of a wider defence or security programme essential for the UK's security interests.