

Defence and Security Public Contracts Regulations 2011

Chapter 10 – Research and Development

Purpose

1. This guidance explains how contracting for Research and Development (R&D) activities is governed by the Defence and Security Public Contracts Regulations (DSPCR) 2011.
2. In particular, it explains:
 - a. how R&D is defined for the purpose of the DSPCR;
 - b. the circumstances where the DSPCR does not apply to R&D contracts;
 - c. when you should use the non-competitive negotiated procedure without the prior publication of a contract notice for R&D contracts; and
 - d. which commercial strategies procurers might adopt when contracting for R&D activities, which are DSPCR exempt.

Key Points

3. If a requirement falls within the DSPCR's definition of R&D, the R&D contract will be either:
 - a. exempt under Regulation 7 of the DSPCR, in which case you may devise your own contract award procedure; or
 - b. not exempt, in which case you must award a contract using the non-competitive negotiated procedure¹ under Regulation 16.
4. This flexibility for the award of R&D contracts must not preclude fair competition in the production phase of a project.
5. However, procurers should be aware of the procurement law risks inherent in placing R&D contracts as set out in paragraphs 46 – 51 below.

What is R&D?

6. By R&D, we mean activities carried out by a contractor aimed at finding solutions to problems, creating new products or improving existing ones. This may be interpreted in many ways but the essence is the process of testing the validity of a theory through the controlled process of interaction and observation.

¹ The "non-competitive negotiated procedure" is the "negotiated without prior publication of a contract notice procedure". You are able, in some circumstances, to run a limited competition without placing a contract notice in the Official Journal of the European Union (OJEU) or the Defence Contracts Online (DCO) under this procedure. The acquisition team selects the tenderers in a non-discriminatory way from their knowledge of the market, see paragraphs 36 to 38 of this guidance.

This may involve the use of live experimentation which provides new knowledge about specific factors relevant to a particular decision. It may result in the generation of intellectual property. The DSPCR defines R&D as

“all activities comprising fundamental research, applied research and experimental development but does not include the making and qualification of pre-production prototypes, tools and industrial engineering, industrial design or manufacture”.

What is the legal framework?

7. Regulation 3 contains the definitions for “research and development”, “applied research”, “experimental development” and “fundamental research”.
8. Regulation 7(1)(l) of the DSPCR sets out the conditions for using the R&D services exclusion.
9. Regulation 16(1)(c) sets out the conditions for using the non-competitive negotiated procedure for:
 - a. R&D services other than those covered by the R&D services exclusion; and
 - b. the manufacture of R&D goods solely for the purposes of R&D but not where you are procuring the goods for quantity production to establish commercial viability or to recover R&D costs.

What activities does an R&D contract cover?

10. R&D, as defined in the DSPCR, must comprise at least one of the following three activities:
 - a. fundamental research to acquire new scientific and technical knowledge without any particular application or use in view;
 - b. applied research directed primarily at generating scientific and technical knowledge towards a specific particular aim or objective; or
 - c. experimental development which draws on existing knowledge to establish new processes, systems and services; or achieve a substantial improvement in materials, products, devices, processes, systems and services.
11. R&D, as defined in the DSPCR, does not include the making and qualification of pre-production prototypes, tools and industrial engineering, industrial design or manufacture.
12. An R&D contract under the DSPCR must fall within one of the above activities which can be broadly categorised as falling within the following [Technology Readiness Levels \(TRL\)](#). It should be noted, however, that subject matter judgment should be used when determining the appropriate categorisation of R&D activities:
 - a. Fundamental Research (TRL 1-4);
 - b. Applied Research (TRL 4-6);

c. Experimental Development (TRL 6-9).

In addition, for Experimental Development where activities may focus on the issues of integration of multiple systems / subsystems, determination of R&D activities may include consideration of the System Readiness Levels as appropriate.

13. All procurers must use an element of judgment in deciding whether to class an activity as R&D. This is often difficult as it is likely that most phases of a project will include some element of R&D. The Project Manager often has to make an intuitive judgment based on their personal knowledge of the project to separate “experimental development” from “preparation for production”.

What is an R&D service or supply contract?

Service contracts

14. In most cases, R&D contracts are likely to be service contracts. An R&D service contract is a contract within the scope of Regulation 6(1) that has a Common Procurement Vocabulary (CPV) from 73000000-2 to 73436000-7, in particular the defence and security CPV codes set out at Annex A.

Supply contracts

15. An R&D supply contract is a contract within the scope of Regulation 6(1) that covers the purchase or hire of goods manufactured solely for the purposes of R&D except where you are procuring the goods for quantity production to establish commercial viability or to recover R&D costs.

Mixed service and supply contracts

16. You must classify an R&D contract consisting of both supplies and services as a service contract only if, based on a genuine pre-estimate, the value of services exceeds the value of the goods. If the value of the supplies exceeds that of the services then you must classify the contract as an R&D supply contract.

R&D Contracts under the DSPCR

General commercial strategy

17. The general approach to contracting R&D is to compete wherever practical. However, you must first decide whether the R&D contract is a service or supply contract. The DSPCR exempts certain R&D services contracts and allows the use of the non-competitive negotiated procedure for other R&D activities (i.e. service contract not covered by the exclusion and supply contracts).

18. The award of such R&D contracts must not preclude fair competition in the production phase of a project. You must try to obtain sufficient Intellectual Property Rights (IPR) to be able to conduct a competition for any follow-on contract(s). If you fail to do so then you are likely to be unable to place the production contract without risking a breach of EU procurement law.

19. You cannot negotiate away IPR in order to be able to use sole source procurement for the follow-on contract under Regulation 16(a)(ii) on the grounds of exclusive rights. This is likely to be a breach of the DSPCR, and prohibited, under Article 11 of the Defence and Security Directive.

20. You are less likely to breach the DSPCR if you are acting in good faith but are unable to secure adequate rights from the contractor to enable a competition for the follow-on work. This might happen for example if access to the original contractor's background IPR is required but adequate licence rights cannot be secured.

Limits for R&D contracting

21. If you are to choose the correct method of contracting, it is important that you clearly understand whether your requirement falls within the DSPCR definition of R&D (see paragraphs 10 to 13 above).

22. If the R&D requirement does not fall within the DSPCR definition of R&D activities then you will not be able to rely on the general exclusion provided by Regulation 7(1)(l). You will have to compete the requirement under a DSPCR procurement procedure or place a single source contract if this can be justified on grounds other than Regulation 16(1)(c).

International co-operation

23. The exclusion at Regulation 7(1)(c) for procurements involving R&D services under international co-operative programmes amongst EU Member States is different from the R&D services exclusion under Regulation 7(1)(l). Procurement exempt under Regulation 7(1)(c) can include production and other later stages of the life cycle of a product.

24. If the UK has responsibility for contracting under these programmes, you may place contracts from R&D right through to production and later phases under the exclusion under Regulation 7(1)(c). Please see Chapter 5 – General Exclusions in the DSPCR for guidance on this exclusion.

25. This same flexibility for excluding R&D contracts does not apply under co-operative programmes between the UK and a State which is not an EU Member State, unless the process for tendering for contracts is governed by specific procedural rules:

- a. pursuant to the international agreement or arrangement (usually, a Memorandum of Understanding (MOU)) for the programme, see Regulation 7(1)(e)(ii); or
- b. of an international organisation of which only EU Member States are members (such as OCCAR), see Regulation 7(1)(e)(iii).

26. You must be aware if you wish to exclude a R&D contract under an MOU using Regulation 7(1)(e)(ii) that there must be specific procedural rules for contracting set out in the MOU (addressing, for example, where and with whom contracts under the programme can be placed). Otherwise, you will only be able to use Regulation 7(1)(l) or Regulation 16(1)(c) for R&D, as described in this guidance.

What R&D service contracts are exempt?

27. The exclusion for R&D services at Regulation 7(1)(l) states:

“(1) These Regulations do not apply to the seeking of offers in relation to a proposed contract or framework agreement for R&D services unless –

- (i) the benefits are to accrue exclusively to the contracting authority for its use in the conduct of its own affairs; and
- (ii) the services are to be wholly paid for by the contracting authority.”

28. The R&D services exclusion therefore applies if:

- a. the benefits of the R&D (e.g. the IPR) do not exclusively accrue to the procurer. For example, the supplier or a third party are able to exploit the IPR; and / or
- b. the R&D services are not wholly paid for by the procurer (e.g. the procurer and the supplier share the costs).

29. In practice, the sharing of R&D costs may not be a practical option. The supplier will need a return on its investment for the R&D funding (e.g. by participating in the production of developed goods). As a result, the supplier is unlikely to offer rights to the MOD that would enable the MOD to compete contracts for the pre-production and production phases.

30. You may use the R&D services exclusion for all service contracts for R&D up to TRL 6 where the MOD acquires user rights under DEFCON 705 in the results of the R&D as:

- a. the R&D activity is fully-funded by the procurer, who acquires user rights under the DEFCON in the results of the work which are normally sufficient to meet its needs; and
- b. the ownership of the IPR in the results is otherwise left with the contractor who (subject to any applicable third party, security or export control constraints) is then free to exploit them for wider commercial purposes.

31. On the other hand, the R&D services exclusion would not normally be available for service contracts for R&D work where you use DEFCON 703 in the contract instead of DEFCON 705, as the MOD wholly pay for the service and takes full ownership of the results. Under DEFCON 703, the MOD owns all the IPR in the results of the contract with no rights granted to the contractor to exploit.

How to place an exempt R&D service contract

32. If you use the R&D services exclusion, you are not obliged to use the procurement procedures in the DSPCR for the award of contracts. This gives you the opportunity to devise the contract award procedure in a way that offers sufficient flexibility, while providing the desired level of competition.

33. You may, for example, organise an open competition, invite chosen suppliers to participate in a limited competition or decide to award a single

source contract to a specific supplier. You may also award contracts in parallel to different suppliers in order to benefit from alternative approaches.

34. If you exempt an R&D contract under Regulation 7(1)(l), you will need to compete any follow-on production contract under the DSPCR unless an exemption applies to the contract or you can award it single source under the non-competitive negotiated procedure (but also see paragraphs 19 – 20 above).

What R&D contracts do you place under the DSPCR?

35. Procurers intending to award an R&D contract must award a contract under the non-competitive negotiated procedure in accordance with Regulation 16 (1)(c) that covers either or both:

- a. R&D services that are not covered by the exclusion; or
- b. R&D supplies, i.e. goods manufactured solely for the purposes of R&D.

How to place an R&D contract under the DSPCR

36. In the non-competitive negotiated procedure, the procurer is free to consult the supplier(s) of its choice and to negotiate the terms of contract with one or more of these. This means you can invite chosen suppliers to participate in a limited competition or decide to award a single source contract to a specific supplier. Procurers using this procedure must publish a contract award notice within 48 days of awarding the contract.

37. The general provisions of Regulation 5(2) on the principles of equal treatment, non-discrimination and transparency, are still applicable in the context of any procurement under the DSPCR.

38. If you award an R&D contract under Regulation 16(1)(c), you will need to compete any follow-on production contract under the DSPCR unless an exemption applies to the contract or you can award it single source under the non-competitive negotiated procedure (but also see paragraphs 19 – 20 above).

Combined R&D and Production Contracts

39. Procurers intending to contract for R&D services may opt from the outset to award a contract that goes beyond the R&D phase to include, for instance, the making and qualification of prototypes or other services or supplies related to the pre-production phase or even a combined development and production contract.

40. Recital 55 of the Directive explicitly mentions the following option:

“the contracting authority / entity should not have to organise a separate tender for the later phases if the contract which covers the research activities already includes an option for those phases and was awarded through a restricted procedure or a negotiated procedure with the publication of a contract notice, or, where applicable, a competitive dialogue”.

41. Procurers may choose to place a combined R&D and production contract if:

- a. the procurer will use an evolutionary, incremental or spiral acquisition strategy that will contain a mix of development and production activities; or

- b. the procurer and the supplier will share the costs of the R&D, as competition for follow-on production would act as a powerful disincentive for suppliers to invest shareholders' funds in R&D.
42. In such a case, the procurer would award the contract using the restricted, competitive negotiated or competitive dialogue procedure (where available), subject to the applicability of any relevant exclusion.
43. The subject of the contract, as described in the contract documents, should comprise all services, supplies and work for all phases covered by the contract. Contract conditions related to later phases might take the form of:
- a. fixed obligations, subject to technical performance;
 - b. conditional obligations; or
 - c. options.
44. Procurers should be aware of the difficulties of this approach, especially for complex contracts, as changes to the requirement could arise over the period of the contract and result in uncertainty over pricing, specification and other contract provisions. You may therefore have to amend the original contract, which may require a new contract award procedure if these amendments are materially different in character from the initial contract provisions.
45. To avoid practical and legal uncertainties and any consequent amendments, procurers must provide as much detail as possible at the outset, for example, by agreeing on a basic scheme or formula for determining prices for services and supplies in later phases.

What are the risks of placing R&D contracts?

46. The DSPCR provides flexible methods for awarding R&D service and supply contracts. This does introduce some risk into the procurement, as you will have a choice of options.
47. During the implementation of the Directive, the European Commission declined to comment on whether our treaty obligations on equal treatment, non-discrimination and transparency apply to exempt R&D service contracts. Their own guidance implies they do not apply, as it provides for single source procurement for such contracts.
48. It is possible that a Court could decide that our treaty obligations apply to exempt R&D service contracts or that a contract awarded under Regulation 16(1)(c) should be subject to competition.
49. Government policy states that you should seek to use the maximum degree of competition where possible. You may therefore to decide to use competition to place R&D service contracts to mitigate the risk of a future challenge to the current position. However, there will be circumstances (e.g. restrictions arising from international co-operation or from foreign export control laws) where competition is not a practical option.
50. You must recognise that no procurement is without some degree of risk. You may decide to tolerate the risks associated with how a Court may view our

TFEU obligations in the context of R&D but you should only do this after you have considered what mitigation is practicable.

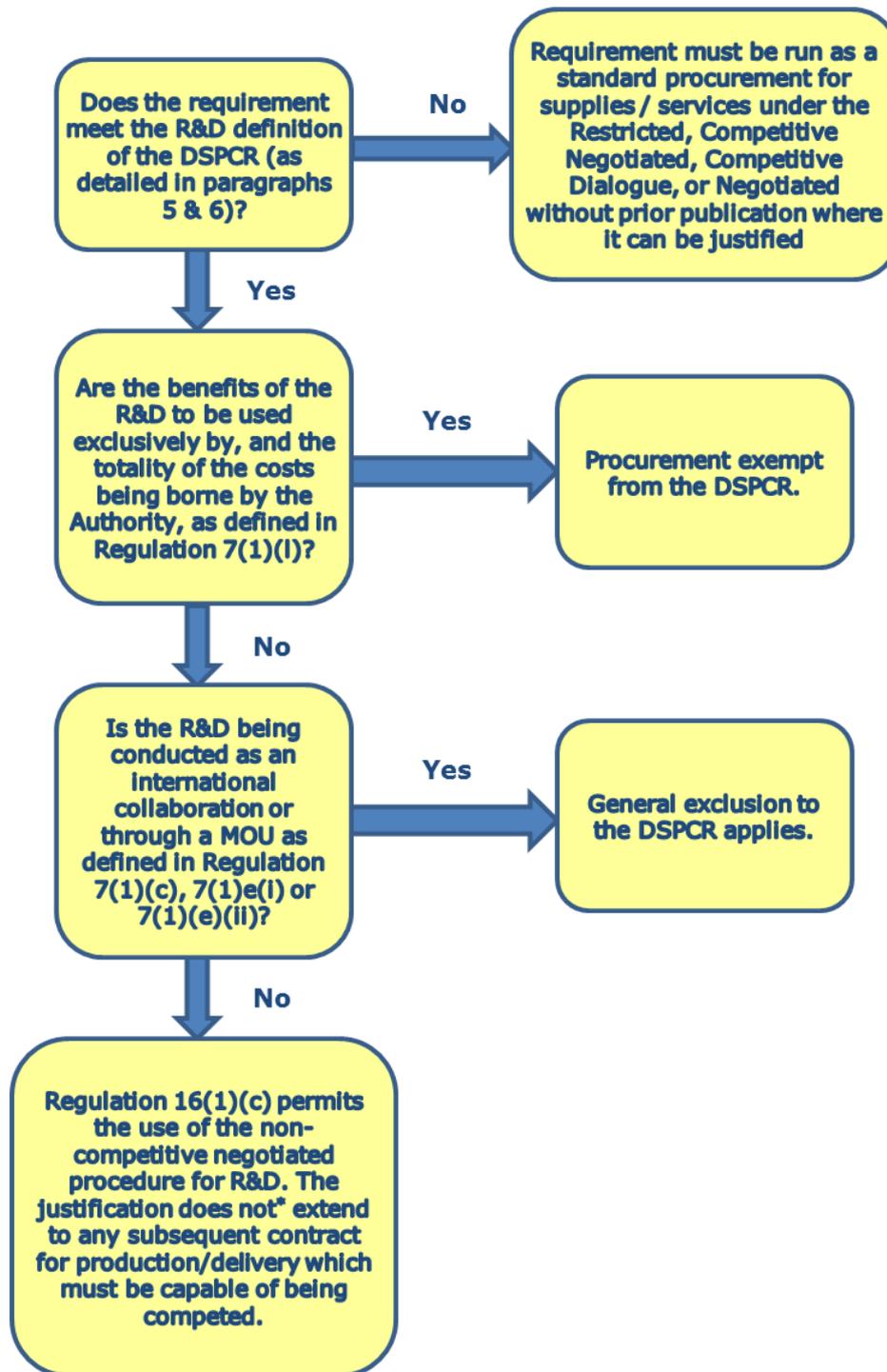
51. MOD procurers should contact DIPR or CLS-CL for further assistance. For all other government department procurers you should contact your own legal department.

Annex A

Defence and Security CPV Codes

CPV CODE	DESCRIPTION
73400000-6	R&D services on security and defence materials
73410000-9	Military research and technology
73421000-9	Development of security equipment
73422000-6	Development of firearms and ammunition
73423000-3	Development of military vehicles
73424000-0	Development of warships
73425000-7	Development of military aircrafts, missiles and spacecrafts
73426000-4	Development of military electronic systems
73431000-2	Test and evaluation of security equipment
73432000-9	Test and evaluation of firearms and ammunition
73433000-6	Test and evaluation of military vehicles
73434000-3	Test and evaluation of warships
73435000-0	Test and evaluation of military aircrafts, missiles and spacecrafts
73436000-7	Test and evaluation of military electronic systems

Annex B – R&D Procurement Procedure Process



*The Directive recognises that issues may be caused by not permitting a follow-on production contract. To overcome the problem, you may consider placing a contract under the restricted, competitive dialogue or competitive negotiated which combines the R&D element with future options in the Contract Notice for production and any In-service support.