Review Board
for
Government Contracts

Decision of the Review Board
on contract reference 2009/2

9 June 2011

Contents

Appendices

1 Introduction

1.1 The Contract

1.1.1 The Contract subject to this Reference was placed at the end of 1999 for the delivery by the contractor to MoD of around 62% of the articles required under a wider non-competitive programme which ran over a number of years between 1995 and 2006.

1.1.2 This programme followed on from a contract for the design, development and initial production of the articles ("Design, Development and Initial Production Contract") which had been won by the contractor in a competitive tender. The Design, Development and Initial Production Contract was largely completed by the mid 1990s.

1.1.3 In contracting for the wider non-competitive programme MoD wanted to ensure that it would benefit from the economies of scale of the continuous manufacture of the articles throughout the programme so MoD and the contractor ("the parties") constructed a pricing framework that was intended to achieve that aim.

1.1.4 In April 1995 a price per article, using a profit margin of 9.23%, was agreed between the two parties under the pricing framework. The final price appeared to have been arrived at through commercial negotiation following the original quote by the contractor and a lower recommendation by PQS, the MOD's cost investigation division. It should be noted however, that the status of the pricing framework was never properly defined in any contract.

1.1.5 Articles produced as a result of the Design, Development and Initial Production Contract did not achieve the performance requirements of that contract. Therefore, in order to be able to deliver the full programme, the contractor was required to implement a performance standards programme ("PSP") to bring the performance of the article up to the required standards. The contractor was required to fund the PSP itself, as was made clear in documentary evidence provided to the Board.

1.1.6 The MoD and the contractor wanted to enter into the series production phase of the future production requirement as soon as possible, in order to avoid a production break. Following extensive discussions, in 1995 the two parties entered into Contract A for around 11% of the articles under the programme, to a reduced performance specification, while the PSP was carried out. To accommodate long lead items shortly afterwards Contract B for around 15% of the articles was procured by way of an amendment to Contract A ("Amendment 2"), to ensure continuity of production. It was also a term of the contract, and subsequent contracts, that if there were no further orders from MoD for the total anticipated quantity of articles, there would be a price adjustment, subject to a cap, in the contractor's favour. The MoD reserved the right to require the contractor to retrofit articles to reflect the higher performance achievable as a result of the PSP.

1.1.7 Following the announcement in 1992 of MoD's initiative to price contracts before the time of entering into a contract ("NAPNOC" or no acceptable price no contract) Contract A, and subsequent contracts under the programme, were priced using NAPNOC principles. The NAPNOC initiative included the introduction of Equality of Information

("EoI") Pricing Statements to be signed by both parties to a contract. Contract A was the first NAPNOC contract entered into by the contractor, although, in the event, the EoI Pricing Statement was never signed. There was no EoI Pricing Statement for Amendment 2, albeit contract amendments in excess of £250,000 required one. There were, however, signed EoI Pricing Statements for Contract C and Contract D, the other contracts included within the programme. There was a small residual part of the programme included in another contract that has not been considered as part of this Reference.

1.1.8 In the event, the PSP took longer than originally expected, costing £12.8 million, and the programme for series production was implemented through various contracts and contract amendments as shown below. The purpose of this appears to have been to enable the later contracts, Contract C and Contract D, to be contracted to take account of the improved specification following the successful conclusion of the PSP.

Description	Contract date	Pricing update	Proportion of articles %	Final Contract value £
Contract A	1995	1998	11	29,248,022
Amendment 2 (Amendment to Contract A)	1995	1998	15	38,638,628
Contract C	1997	n/a	11	31,069,472
Contract D	1999 (fixed price)	2001 (firm price)	62	191,438,348
Included in a subsequent contract			1	n/a
Total			**100**	**290,394,470**

1.1.9 The pricing update to Contract A/B in 1998 was to reflect updates to various costs, a revised GPF profit rate for the contractor and a reduced rate of production. The Contract D pricing update in 2001 was to reflect the movement from a "fixed" to a "firm" priced contract.

1.1.10 When Contract C was agreed in 1997, the covering letter to the contract stated that any further order beyond Contract C would be subject to the completion of various milestones demonstrating to MoD that the issues concerning performance had been addressed. If MoD decided to place a further order, at a point in time when the contractor could maintain an economic level of production, that order would be subject to a price set out in an annex to the covering letter. This price was based on the principles of the original pricing framework but with labour rates and labour overhead rates reflecting forecast 1999 economic conditions and with amendments to the materials and tooling and testing costs.

1.1.11 Following agreement of Contract C, a number of issues arose which would contribute towards a deadlock in negotiations over Contract D, including the following:

- The level of discount to be agreed in respect of a small number of articles in Contract A/B which had failed Acceptance Testing ("AT"), rather than reworking them;

- A resolution for a number of articles that were missing;

- The level of cost per article for a reduced level of annual production; and

- The form of liquidated damages clause to be incorporated into Contract D.

1.1.12 Following an impasse in negotiations, during which time the contractor had started production of articles at its own risk, the MoD and the contractor engaged in Senior Representative discussions which concluded just prior to entering into Contract D.

1.1.13 Elements of the agreement included:

- Agreement to use the previously agreed price arrangements to price Contract D with conversion to a firm price as soon as subcontractor prices were agreed;

- MoD acceptance of failed articles, after AT, at a discounted price;

- Amendment to production rates part way through the contract without adjustment to the pricing; and

- An agreed liquidated damages clause.

1.1.14 Contract D was placed at the end of 1999, on a fixed price basis, and was for the largest part of the production run, being for around 62% of the articles under the programme. The fixed value of the contract was £161.6 million with an expected profit of £14.3 million, equating to 9.7% (being the GPF rate applicable to the contractor in 1997) of the estimated contract cost ("ROCP").

1.1.15 It was always intended that the contract should move from a fixed to a firm pricing basis within a short space of time. However, it took nearly two years to agree the firm price terms and a firm price Contract D amendment was finally signed in late 2001 for a value of £190 million. The profit margin of 9.7% stayed the same, increasing the expected profit to £16.8 million. The price was subsequently revised through amendments to £191 million with an expected profit of £16.9 million.

1.1.16 In the event, the contractor recorded a final outturn profit for Contract D of £38.8 million (being 25.5% ROCP) on its cost certificate submitted to MoD in early 2007. In its post-costing report of mid 2008, MoD's Cost Assurance Services ("CAS") reviewed the cost certificate on behalf of MoD; this included investigating company records and questioning senior management of the company. In CAS's view, PSP and certain other costs that had been included in the cost certificate were not legitimate costs of the contract and should have been excluded. After excluding these costs CAS considered that the contractor's outturn profit was £50 million (being 35.6% ROCP). It was the opinion of CAS that the contractor had made excess profits on Contract D and that, prima facie, as a result of information regarding the treatment of Acceptance Test Contingency ("ATC") not being declared by the contractor, there was inequality of information when the firm price for Contract D was signed in late 2001.

1.2 Notice of Reference

1.2.1 Following receipt of the CAS post-costing report, MoD had a series of detailed exchanges with the contractor to try to agree a resolution acceptable to both parties. As a result of being unable to reach such an outcome, by notice dated 29 May 2009, MoD referred Contract D to the Review Board for Government Contracts (the "Board") on the grounds that *"Post Costing of the Contract has shown that* [the contractor] *have generated excess profit far beyond that contemplated in the Equality of Information Pricing Statement ("EOI Statement") in Annex G to the Contract. Furthermore, the true level of excess profit had been disguised by the inclusion of costs in the Cost Certificate, particularly in* [ATC]*") that have been inappropriately accounted for"*. The Annex G referred to in the Notice of Reference relates to the firm price, agreed in late 2001. ATC is an agreed level of contingency included in the programme, intended to cover the costs of rectifying articles which failed their ATs.

1.2.2 The MoD further contended specifically that *"the level of excess profit is unconscionable; that full Equality of Information was not present at the time of pricing and that the true profitability has been disguised because of the inclusion by* [the contractor] *in the Cost Certificate of substantial costs, which are a* [contractor] *liability. The MoD was therefore seeking from the Board a direction that* [the contractor] *make a substantial compensatory payment to the MOD."*

1.2.3 The MoD delivered a full Points of Claim on 6 October 2009.

1.3 Jurisdiction

1.3.1 At a first procedural meeting on 15 July 2009 the contractor was not able to accept that the Board had jurisdiction. As a consequence the Board requested at that meeting that the parties submitted in writing their respective positions.

1.3.2 The contractor contended that:

- Contract D was part of a suite of three contracts and that all three contracts should be viewed as call-offs against one overarching contract for the full delivery of the programme;

- By combining the outturn costs certified by the contractor for all three contracts in its Cost Certificates, the costs relating to these three contracts, in aggregate, did not exceed the threshold figure and therefore MoD was not entitled to make a reference under Clause (3)(a) of SC50 which deals with matters equivalent to paragraph 1.42 of the GPFAA; and

- That, in the context of Clause (3)(b) of SC50 which deals with matters equivalent to paragraph 1.43 of the GPFAA, there was nothing to suggest that this was an exceptional case or that the achievement of a fair and reasonable price was frustrated because the information on which it was based was proved to be

materially inaccurate or incomplete, nor had MoD presented any evidence to suggest otherwise.

1.3.3 After due consideration, the Board considered that the contract met the requirements set out in paragraphs 1.40 to 1.43 of the GPFAA and that the reference had been made within the relevant time limit and concluded that it had jurisdiction under paragraph 1.42 of the GPFAA to review and give rulings on Contract D arising from MoD's reference. The Board notified the parties of its decision on jurisdiction on 7 September 2009.

1.3.4 During the course of the reference, the contractor also contended that:

- Under a remedy limitation clause of the Contract in respect of the EoI Pricing Statement, the circumstances in which SC50 could be engaged were limited to conditions attaching to sub-clause (3)(b) of SC 50 (i.e. where the information on which the price was based could be shown to have been materially inaccurate or incomplete). If there was no inequality of information then there was no right to recover excess profits under NAPNOC.

- The only cost variations raised by MoD in its Points of Claim and/or Reference to the Board related to labour hours and ATC, so any other cost variations fell outside the scope of the reference and therefore the Board's jurisdiction. Further, the Board does not have jurisdiction to direct a repayment of an excess profit in the absence of evidence of inequality of information and, as MoD brought the Reference, it is for MoD to prove inequality of information at the time of pricing.

1.3.5 DEFCON 643, as a contract condition, could not be applied to prices agreed before contract award, and so an alternative mechanism was needed to ensure that EoI would be achieved. This alternative mechanism was agreed by MoD and industry in 1995 and remains in use today. It was agreed that EoI be confirmed through the use of a simple Pricing Statement to be signed by both parties on conclusion of price negotiations. The obligations incorporated in this are binding on both parties. This statement is linked in the contract to a Remedy Limitation Clause (now numbered as DEFCON 652), which provides that any breach (by either party) of the principle of equality of information is a matter only for the Review Board for Government Contracts in accordance with its existing conventions, and not for a court of law except in the case of a fraudulent statement.

1.3.6 The Board did not agree with the contractor's interpretation of the effect of the remedy limitation clause of the Contract. The Board prefers to interpret the clause as limiting only the remedy available to the parties if they proceed under condition (3)(b) of SC50, so that a reference made under either of the grounds set out in SC50, and reflected in paragraphs 1.42 and 1.43 of the GPFAA, can lead to a determination by the Board as to whether the price is fair and reasonable and in an appropriate case to the award of a resulting payment.

1.3.7 The remedy limitation clause further indicated that neither party was entitled to rescission or avoidance of the Contract in the circumstances referred to in condition (3)(b).

1.3.8 In respect of the contractor's second contention, it is the Board's opinion that, once a reference has been accepted, it is the Board's role to establish whether the pricing of the Contract at the time of pricing was fair and reasonable, in the light of all the information

available. In order to fulfil the Board's task in accordance with paragraph 1.39 of the GPFAA, and to meet the requirements of paragraphs 1.45 – 1.47 of the GPFAA, the Board considers that it is acting as an expert and has the power:

- To make wide-ranging enquiries;
- To take responses to those enquiries into consideration in any determination that it might make; and
- To consider the surrounding circumstances, including the conduct of the parties.

1.3.9 Consequently the Board does not consider any of the contractor's arguments about jurisdiction have merit.

1.3.10 Although MoD was satisfied that the Board had jurisdiction, in response to the contractor's arguments, MoD sought to make the case that even if there had been equality of information between the two parties in the Reference, the Board still had the power to determine fairness and reasonableness simply on the grounds of excessive profit made by the contractor.

1.3.11 The Board is unable to accept this argument as it believes that it is confined to making a determination solely on whether the *price negotiated* was fair and reasonable, and in the light of this assessment to determine whether any payment, and if so, how much, should be made by one of the two parties to the other, in accordance with paragraph 1.39 of the GPFAA. There is a significant case history, as a consequence of previous references, and contextual interpretation of the Yellow Book that makes it clear that the Board's role is limited to assessing whether the price negotiated was fair and reasonable *at the time of pricing*, whatever the outcome on the contract.

1.3.12 The preliminary debates on the Board's jurisdiction have added time to the conclusion of the Reference and the Board believes it would be appropriate for MoD and the CBI to consider whether the language in the GPFAA and the DEFCONs needs to be clarified on the matter of jurisdiction, in the light of the points raised by the two parties, so establishment of jurisdiction becomes clearer.

1.4 Hearing and reporting on the Reference

1.4.1 This is the first reference conducted by the Board since 1986.

1.4.2 Pursuant to directions issued by the Board on 15 July 2009, and having satisfied itself over the issue of jurisdiction, the parties were invited to provide written submissions to the Board in which their respective contentions were set out. These, together with evidence relating to their contentions, were submitted by 13 January 2010. Following a further all party procedural meeting on 25 January 2010, the Board was not satisfied that the matters it considered important to the Reference had been adequately addressed by the parties and raised two rounds of further questions to which the parties responded by 30 April 2010.

1.4.3 A very substantial volume of evidence was produced, which the Board agreed should be collated in chronological order and made available to all the parties in advance of the hearing. In addition, further significant evidence became available during the hearing which was collated in the supplementary bundles. In all, the Board received over 3,000 pages of documentation which included evidence, pleadings and witness statements, of which 1,100 pages were provided during the hearing. In addition, both parties entered into correspondence with each other requesting further information and disputing points that the other party had made during the course of the reference.

1.4.4 Both parties applied for external legal representation which exceptionally, in the circumstances of the Reference, the Board accepted at an all party meeting held on 25 January 2010. Both parties were represented by solicitors and by leading and junior Counsel.

1.4.5 In June 2010, in anticipation of a hearing, the contractor submitted twelve witness statements and MoD four witness statements. Only one of MoD's witness statements provided evidence contemporaneous with the performance of the contract. Following encouragement from the Board, in August 2010 MoD submitted two further witness statements which were contemporaneous.

1.4.6 The Board had originally intended to hold a hearing in July 2010, but due to the unavailability of the parties, this was deferred until September 2010. In order to accommodate the number of witnesses put forward by the parties, the hearing took place over 11 days between September and November including opening and closing submissions made by the parties' leading Counsel.

1.4.7 During the hearing MoD was pressed to supply additional witnesses who might provide contemporaneous accounts of events from MoD's perspective. A number of potential witnesses were referred to in various documents but MoD appeared to be either unable or unwilling to supply these witnesses.

1.4.8 The Board recognises that there has been a significant passage of time since the events relevant to this Reference took place and inevitably this makes the recollection of events and the provision of clear evidence difficult. However, the Board feels inclined to make the following comments on the conduct of the two parties during the Reference:

- The Board noted that MoD found it hard to articulate its case, in part because it had failed to carry out the analysis necessary to assist the Board. Equally, the Board had to make many requests of and spend significant time discussing with and seeking explanations from the contractor, during the hearing, in connection with financial analysis of Contract D, including comparison with management forecasts. The contractor found it hard to provide explanations with the level of clarity required.

- With both parties represented by Counsel, the hearing became legalistic in character. The Board was however acting in the role of an expert and would have preferred to take a different approach, focussed more on establishing the facts of the Reference rather than on pursuing legalistic points which had little or no impact on the outcome.

- The Board noted that it had to extend the timetable a number of times, particularly at the request of the contractor, in order to accommodate the number of witnesses and the volume of documentation provided.

- During the reference, the Board had to press MoD to bring forward contemporaneous witnesses. Whilst MoD brought forward a limited number of witnesses, there were others it was unable or unwilling to supply. The absence of contemporaneous MoD witnesses made the role of the Board, in establishing the facts, considerably more difficult.

- Both parties continued to provide further information throughout the hearing, which the Board considered to be material to the Reference. There appeared to be instances of MoD witnesses, in particular, having documentation which had not been made available to the Board or the other party, which the Board determined to be material. Despite the Board having requested assurances from both parties that they had provided all material documents prior to the hearing, much of the evidence subsequently requested and provided during the hearing proved to be of a very material nature. As a consequence the Board was unable to assimilate the evidence in advance of discussing it with witnesses, and indeed it would have been helpful to have been able to discuss the evidence with other witnesses who had already provided oral evidence in advance of the evidence becoming available.

- Some of the activity of the two parties appeared to the Board to be based around discrediting the other, with the inevitable consequence that they became distracted from establishing the facts of the Reference and from providing directly relevant responses to the Board.

1.4.9 Notwithstanding the above, the Board has received voluminous evidence and considers that it has received sufficient relevant information to enable it to make its decision on the contract Reference.

1.4.10 For the hearing and determination of this case, the composition of the Board consisted of the Chairman and two other members of the Board selected in accordance with paragraph 1.48(b) of the GPFAA.

2 Fairness in the context of the GPF

2.1 Introduction

2.1.1 Paragraph 1.39 in Section 1 of the GPFAA states that in reviewing individual contracts on a reference the task of the Board *"is to assess whether the price negotiated was fair and reasonable, and in the light of this assessment determine whether any payment, and, if so, how much, should be made by one of the parties to the other."*

2.1.2 In its Decision on Contract References 1973/2 and 1973/3, the Board gave some consideration to the meaning of "fair and reasonable" in the context of the GPF:

> *13 When a contract is referred to the Board, it is the task of the Board to consider whether the price negotiated was in all circumstances "fair and reasonable" and, for this purpose, to have especial regard to the information available to each party at the time when the price was fixed (paragraphs 13 and 19 of the Memorandum of Agreement under which the Board was set up).*
>
> *There was thus a very close relationship between the concept of "fair and reasonable" pricing and the principle of "equality of information".*

2.2 EoI

2.2.1 The concept of EoI was introduced by the 1968 Profit Formula Agreement between Government and the CBI. Paragraph 9 of the Agreement included:

> *It is intended that as a result of equality of information the Government and the contractor will be in the same position at the time the price is fixed. The Government will not normally expect more information from a contractor than is available to him up to the time of fixing the price. The Government must have access to information adequate for price fixing purposes. In general, this will be information from the contractor's normal accounting system. The Government will therefore limit any demand for further information to what can reasonably be shown to be necessary for price fixing purposes.*

2.2.2 Equality of information is provided for in SC43 (now named DEFCON 643) which states that *"fair and reasonable prices shall be paid to the Contractor in respect of the Articles, such prices to be fixed as soon as practicable by agreement between the Authority and the Contractor."* It imposes an obligation on the contractor to maintain records of costs and, when requested by the MOD, to make these records available.

2.2.3 SC43 is a contract condition and its terms do not apply to periods before the contract. However, at the time of the 1968 Profit Formula Agreement it was envisaged that contracts would normally be priced as a result of negotiations after a contract was signed, so this did not cause any difficulty.

2.2.4 SC 43 is supported by the Board's Report on its first General Review of the GPF (dated October 1974) which contained a joint Government/Industry memorandum concerning the early pricing of risk contracts and which endorsed the need for discussions to be conducted in an atmosphere of mutual confidence. In its decision on Contract references 1973/2 and 1973/3 the Board provided further guidance on EoI and whilst recognising that SC43 provided no obligation on the contractor to volunteer information, it was inherent in the concept of EoI that there should be mutuality of frankness and confidence. Within its conclusion the Board made the following statement:

> *It should also be observed that, even within the confines of SC43, "inequality of information" could result, not from lack of readiness of a contractor to disclose the relevant information, but from failure of the Ministry to avail itself fully of the facilities afforded to it under SC43, eg by requiring the contractor to maintain records of a specified kind but then not calling for production of the relevant records. It would have to be considered, in that kind of situation, whether the contractor was under an obligation to make voluntary disclosure of information of which the Ministry remained in ignorance simply through failure to make full use of SC43, or whether the availability of information under SC43 relieves the contractor, pro tanto, from any positive duty of disclosure.*

2.2.5 The current Board interprets the use of the phrase "pro tanto" (broadly translated as "as appropriate") in these circumstances to suggest that if MoD required a contractor to maintain specific records for SC43 purposes, but MoD then failed to make full use of those records, then the Board would need to consider carefully whether the contractor was relieved from a positive duty of disclosure in relation to those specific records.

2.2.6 In the decision the Board went on to state that it intended to enter a wide ranging discussion on the practical scope of the equality of information principle with the Government and the CBI.

2.2.7 Following the Board's comments in its Decision on References 1973/2 and 1973/3 DEFCON Guide No 3 (Working Guidelines for the Pricing of Non-Competitive Risk Contracts, dated January 1977) was released which was prepared by MoD with the assistance of the CBI.

2.2.8 Annex B to DEFCON Guide No 3 is a note on equality of information and builds upon the protocols previously developed. Paragraphs 6 and 7 state:

> *6 In any price agreement there must be a presumption of good faith and it is believed that the flexibility so necessary for early price fixing will only be attained by encouraging greater reliance on that presumption and developing the mutuality of frankness and confidence which the Review Board rightly refers to as inherent in the concept of 'equality of information'.*
>
> *7 In this situation it is suggested that the problems exposed by the Review Board would best be solved by*
>
> *a. Recognising the mutuality of "Equality of Information", including the entitlement of the Contractor to information available to the Ministry which could have a bearing on price fixing.*

b. Relying on each party bringing to the notice of the other, at the time of the pricing, any additional information or change of circumstances of a material nature of which he is then aware and which should be made available if 'the Government and the Contractor are to be in the same position at the time the price is fixed'. If on post-costing it is revealed that such information in the hands of either party up to the time of price fixing has been withheld and has resulted in an inordinate profit or loss for that reason, then regardless of the fact that SC43 may have been duly complied with, the Review Board would have grounds for adjusting the price accordingly.

2.2.9 In Contract References 1986/1 and 1986/2 the Board considered the effect of DEFCON Guide No 3 and stated that "*The guidance document is not to be regarded as a contract condition, but in the Board's view it forms an important part of the background to the agreement of prices..."*

2.2.10 In its decision the Board also concluded:

- Where a Contractor is unaware of facts known elsewhere within the organisation: the Board considered that EoI could not be claimed in these circumstances; and

- Where there are contingent events that might materially affect the contract costs: the Board considered that these should be disclosed.

2.2.11 In July 1992 MoD introduced its NAPNOC initiative whereby high value fixed/firm priced contracts and contract amendments were to be priced at the outset rather than part way through the contract, which had been common practice prior to the initiative. The principal objective was to provide MoD with knowledge of its financial liability before it committed to the work. The MoD stated that the principle of EoI would continue to apply under NAPNOC.

2.2.12 The arrangements were largely welcomed by the Review Board and it stated in paragraph 702 of the Report on its 1993 General Review that *"This should be to the benefit of both MoD and contractors. MoD will certainly have certainty as to its financial liability before a project is committed. Contractors would also know precisely where they stand in commercial terms and will have the maximum incentive to reduce costs and thereby increase their profitability."*

2.2.13 In paragraph 704 the Board went on to comment:

704 The main practical problem to be addressed by MoD and contractors is the management of the increased risk that is inherent in a move to earlier pricing. Contractors have a higher degree of risk to the extent that there is a greater degree of uncertainty over the costs to be incurred on a contract. There must be an expectation that the outturn of NAPNOC contracts will show a greater degree of variability than would be the case if prices were not agreed until later. This also creates a risk for MoD: risk that a contractor might earn a profit which would appear excessive.

2.2.14 SC43 envisages that pricing will take place after a contract is signed and places an obligation on both parties to release information for the purpose of pricing. The introduction of the NAPNOC initiative meant that pricing would be expected to take

place at the same time as, or before, the contract was placed. This led to the introduction of the EoI Pricing Statement in order to place EoI obligations on both parties for the period prior to and up to EoI Pricing Statement signature to provide assurance that both parties had revealed all pertinent information for the purpose of price fixing. This is deemed to be the time the EoI Pricing Statement is signed. The EoI Pricing Statement includes an annex which sets out the bases and assumptions used to estimate the costs incorporated into the EoI Pricing Statement.

2.2.15 The current guidance on "Pricing – Equality of Information", is contained in MoD's "Commercial Toolkit" and states:

> *7 All non-competitive contracts are priced on the basis of equality of information (EoI). The principles in paragraph 9 of the 1968 Government Profit Formula Agreement, now carried forward in the 2006 Annual Review of the Profit Formula for Non-Competitive Government Contracts, remain the basis of all non-competitive pricing (including No Acceptable Price No Contract(NAPNOC)) between the MOD and Industry. These are set out below:*
>
> *a. It is intended that as a result of equality of information the Government and the contractor will be in the same position at the time the price is fixed.*
>
> *b. The Government will not normally expect more information from a contractor than is available to him up to the time of fixing the price.*
>
> *c. The Government must have access to information adequate for price fixing purposes. In general, this will be information from the contractor's normal accounting system.*
>
> *d. The Government will therefore limit any demand for further information to what can reasonably be shown to be necessary for price fixing purposes.*
>
> *8 No agreed definition of the phrase equality of information exists; the presumption is one of good faith between the parties to bring to one another's attention, information which is material to the agreement of a fair and reasonable price.*

2.2.16 The Board believes these principles should have pervaded all non competitive contracts entered into since the 1968 Government Profit Formula agreement, even if they were not documented as such.

2.3 Obligation to make enquiries

2.3.1 It is clear from the above there is a requirement for both parties to release relevant information to the other party at the time of pricing. This begs the question as to whether the existence of EoI obligations absolves the parties, particularly MoD, from making enquiries into information presented and representations made by the other party.

2.3.2 Three of the Board's previous decisions gave particular consideration to this issue:

Decision on Contract Reference 1973/1

2.3.3 In its decision the Board stated that it should not be regarded as providing an automatic safety net against the consequences of commercial imprudence. The Board considered that both parties should negotiate procurement contracts with the same degree of care and circumspection as one would expect to be exercised if the Board did not exist.

Decision on Contract Reference 1979/1

2.3.4 In its decision the Board considered it imperative that neither party should enter into a contract on what was at the time considered an unwarranted basis simply in the expectation that matters could always be put right by a reference to the Board.

Decision on Contract Reference 1986/1 and 1986/2

2.3.5 In its decision the Board considered DEFCON Guide No. 3 and noted the requirement for each party to bring additional information of a material nature to the notice of the other party. The Board considered that "*the guidance document's requirement does not relieve the Ministry from a duty to make enquiries regarding those matters of which it reasonably ought to be aware. Such an approach will not relieve from the party having the information the primary responsibility for disclosure but the Board will have regard to the enquiries made by the other party when determining the amount of any price adjustment.*"

Availability of information

2.3.6 The Board also notes that SC48 – Availability of Information (now named DEFCON 648), was a term of each of the contracts in the programme and SC48 entitles MoD to have access to data to assist in the pricing of follow-on contracts. Section 3 of SC48 states:

> *3 If at any time during the course of the Contract the Authority notifies the Contractor that the said records* [being the Contractor's normal cost and manufacturing records as detailed in SC48(1)] *are required for the purpose of assisting the Authority in fixing the prices of other articles of a similar or substantially similar kind to be supplied under any other contract (whether made or under negotiation) between the Contractor and the Authority the Contractor shall furnish the like summary...*

2.3.7 Therefore it appears that MoD could have required the contractor to provide additional data to assist in the pricing of contracts subsequent to Contract A at any time, had it deemed this to be appropriate.

2.4 Periods when EoI obligations apply

2.4.1 Whilst EoI applies up until the time the price is fixed, it is the Board's view that EoI obligations continue to apply at key points in the contract lifecycle.

2.4.2 In its decision on Contract Reference 1986/1 and 1986/2 the Board noted the difficulties that MoD had encountered in obtaining information from the contractor during post costing concerning reasons for the level of profits and the contradictory evidence that was eventually received. The Board commented as follows:

> *There has been no evidence submitted to the Board that the delays in post-costing have impeded the agreement of fair and reasonable prices on subsequent contracts. However, the rapid resolution of problems identified by post-costing has to be considered as an integral part of the price fixing process and the withholding of information relevant to post-costing can only undermine the presumption of good faith which is required if price fixing is to proceed smoothly.*
>
> *In the Board's view, the duty of disclosure does not cease with price fixing and the Board will, in determining the amount of any price adjustment, have regard to the conduct of both parties at all times but especially during the negotiation of prices and during post-costing.*

2.4.3 This suggests that there is also an EoI obligation during the post-costing period, such that the parties are expected to provide full and open answers to questions. The obligation would also be considered to apply, for example, during the period of a contract reference.

2.5 Summary

2.5.1 To summarise, the Board considers the following are fundamental in relation to fair and reasonable pricing:

- That the requirement for the negotiation of a "fair and reasonable" price is largely fulfilled through compliance with EoI obligations.
- That EoI suggests a mutuality of frankness and confidence between the parties.
- That information likely to affect pricing negotiations should be volunteered to the other party and should not be withheld.
- That, whilst not relieving the party having the information of the primary responsibility for disclosure, there is an obligation to make normal commercial enquiries. A party cannot simply rely on the other party's obligation to volunteer information.
- That there is an EoI obligation at the time of fixing the price of a contract and that this obligation continues, where appropriate, to be effective at other specific points in the contracting process, such as at post-costing.

3 Contentions of the two parties

3.1 Introduction

3.1.1 The MoD's principal contentions were brought together in its Closing Statement and built on the original Notice of Reference, on the Points of Claim and on arguments developed during the course of the Hearing. The contractor's defence was summarised in its Closing Statement drawing on its previous arguments.

3.2 MoD contentions

3.2.1 The MoD's main points of contention were as follows:

- Contract D was a separate contract to the earlier contracts of the programme.
- There were two pricing points, being in late 1999 and late 2001, at which there were EoI obligations relating to Contract D which were not complied with by the contractor.
- The contractor's internal management information and forecast of costs on Contract D demonstrated that, at the point that the EoI Pricing Statements were signed in late 1999 and late 2001, the contractor was expecting to incur fewer costs than those envisaged in each EoI Pricing Statement signed.
- A profit exceeding the upper point of reference had been made on the Contract.
- The costs reported under ATC in the contractor's cost certificates were not legitimate costs to Contract D.
- The contractor failed to produce relevant documentation during the course of the reference.

Relief Sought

3.2.2 The MoD contended that if the information provided and confirmed in the EoI statements had been correct at the time of pricing then the contractor would have expected a profit on predicted outturn costs of 9.7%. The MoD contended that the contractor should therefore be entitled to 9.7% of the actual outturn costs being £13,693,434. The MoD sought relief to the extent of the difference between the actual profit of £50,230,365 and the £13,693,434 being £36,536,931.

3.2.3 The MoD contended that there should be very little recognition by the Board of any efficiencies made by the contractor in determining the appropriate sum for repayment.

3.2.4 The MoD also noted that there had been considerable slippages in the timetable throughout the programme which, to it, did not indicate that the contractor had performed with outstanding efficiency.

3.2.5 The MoD considered that the existence of delay in this case, and the fact that the contractor had, in MoD's view, sought to disguise that it had not used the ATC, merited the award of interest within any amount awarded to MoD.

3.3 The contractor's defence

3.3.1 In responding to MoD's contentions, the essential elements of the contractor's defence are as follows:

Time of price fixing

3.3.2 The price for the full programme was fixed in mid 1995 and subsequently amended in early 1997.

3.3.3 The contractor was committing to a long term price should the full programme materialise.

3.3.4 The MoD pricing investigation for the price in 1995 was very extensive. The incorporation of a learner curve calculation into the cost estimate used for the calculation of an average price per article suggested an intention to retain the price throughout the programme, as the higher costs of earlier articles would be recovered by the contractor towards the end of the programme.

3.3.5 The contractor cited a number of documents indicating that the price was fixed in mid 1995 and amended in early 1997 and that negotiations relating to subsequent contracts were not intended to involve the renegotiation of the 1995 and 1997 base prices.

NAPNOC and EoI obligations

3.3.6 The MoD took a deliberate decision not to ask for recorded cost information. The implication being that in the contractor's view MoD needed to make specific requests for information and that the contractor did not have an obligation to volunteer it.

3.3.7 By signing the 1999 EoI Pricing Statement, both parties were certifying the price for the full programme which had been struck in early 1997.

3.3.8 The contractor's interpretation of the final paragraph of the 1999 EoI Pricing Statement was that its sole purpose was for the parties to check that there had been no material change in the data underpinning the price in the period of up to a fortnight between agreeing the price and the signing of the contract.

3.3.9 Even if the Board decided that the price was not fixed in 1995 and amended in 1997, there is no evidence of inequality of information at either late 1999 or late 2001.

PSP

3.3.10 The PSP costs were incurred in order to comply with the requirements of Contract A/B, Contract C and Contract D. As such, the contractor considered that it was correct to allocate PSP costs to Contract D on the cost certificate as costs incurred directly related to the contract. The contractor made it clear that the costs of the PSP were not actually charged to MoD.

Article Discount

3.3.11 The Article Discount related to articles included within Contract A/B and was paid directly by way of a deduction from the Contract D price in lieu of re-working articles which had failed AT. The Article Discount was therefore a cost in place of re-work and, as such, should be allowable within ATC.

Liquidated Damages

3.3.12 Since liquidated damages resulted from the failure to pass AT, it was entirely appropriate for these costs to be reported as ATC.

Use of CFFs

3.3.13 The contractor contended that the January 2000 Contractor's Financial Forecasts ("CFF") could not be used to identify variances from the Contract D EoI Pricing Statement known by the contractor at the time of signing Contract D (Fixed) in late 1999 as it was an internal management tool prepared on a different basis to the EoI Pricing Statement.

Onus of proof

3.3.14 As the Reference was brought by MoD it was for MoD to prove that there was inequality of information at the time of pricing.

The standard of efficiency

3.3.15 The contractor provided the Board with some detail concerning the efforts the company went through in order to improve its efficiency.

3.3.16 Improvements in the performance of the article, which resulted from PSP and which were over and above the level required by MoD, led to MoD savings on a separate equipment contract which the contractor estimated at over £50 million.

The degree of risk

3.3.17 In determining whether any repayment should be made the Board is required, pursuant to paragraph 1.46 of the GPFAA, to take into account the degree of risk involved in performing the contract. The contractor contended that the risk it assumed during the course of performing the contract was very high, in particular there was a risk in relation to latent defects arising from the manufacture of kits, which became necessary owing to the failure of a manufacturing component.

4 Considerations by the Board

4.1 Introduction

4.1.1 This chapter of the report sets out the areas the Board considers to be key in making its decision on this Reference and its conclusions in respect of these areas.

4.2 Relationship between Contract A, Amendment 2, Contract C and Contract D

4.2.1 The first consideration to be determined by the Board was the relationship between Contract A, Amendment 2, Contract C and Contract D.

4.2.2 It appeared from the evidence provided that the initial intent of MoD was that there should be one contract and preliminary discussions were held on this basis.

4.2.3 Ultimately, however, the programme was divided between Contract A, Amendment 2, Contract C and Contract D, and there remained a close connection between these because of the overall programme requirement, the need for continuity of production and the pricing framework, which was continuously referred to.

4.2.4 It is clear to the Board that, because of the way they originated, the three contracts, Contract A/B, Contract C and Contract D, were intimately related but the Board has found no evidence that there was any direct contractual linkage, or that these contracts were somehow captured by an umbrella contract that might make it appropriate for these to be considered a single contract, even if that happened to be the original intent.

4.2.5 The Board was surprised to note, however, that neither party appeared to have given great consideration to the consequences of a change in the contractual construction under the programme particularly in respect of pricing and EoI Pricing Statements at various pricing points in the programme. The Board believes that Contract D should be looked at on its own merits, but that in considering Contract D it has been necessary to consider the circumstances and evolution of all the contracts related to the full programme, given their close relationship, in order to understand properly the circumstances of Contract D.

4.2.6 It follows, therefore, that in looking at the threshold above which a reference may be heard in accordance with paragraph 1.42 of the GPFAA, the Board is satisfied that it only needs to look at the threshold in connection with Contract D, standing on its own and not, as contended by the contractor, the aggregation of three contracts.

What was the effect of the NAPNOC arrangements?

4.2.7 The concept of NAPNOC was introduced in 1992 and it is believed that Contract A was the first contract entered into by the contractor to adopt NAPNOC principles. The purpose of NAPNOC was to place more emphasis, in respect of non-competitive

contracts, on what work should cost in an efficient environment rather than the previous approach of pricing contracts part way through to reflect what the work cost in the prevailing circumstances.

4.2.8 NAPNOC can only be successful if work is properly defined by mature, stable and comprehensive specifications, otherwise there is a risk that pricing will be 'padded' through contingencies to take account of the inherent uncertainty that pervades the contract.

4.2.9 The full programme was priced using NAPNOC principles, both at the outset of the programme and in respect of each new contract or amendment, as a consequence of which EoI Pricing Statements were, or should have been, signed in respect of each new contract and, where appropriate, each material amendment.

4.2.10 The Board believes that neither party gave sufficient consideration to the consequences of pricing under NAPNOC in the case of the programme as it evolved. In particular, it appears that both parties believed, to a certain extent, the pricing framework, as discussed below, formed the basis for pricing each contract under NAPNOC principles and was a "package deal". However, what both parties seemed to ignore were the implications of this in the context of EoI Pricing Statements signed at the time contracts and contract amendments were entered into.

4.2.11 Given the risks involved in the full programme, the Board questions whether the time was right to follow NAPNOC pricing principles or whether consideration could have been given to other pricing models, which might ultimately have provided better value for money.

What was the effect of the pricing framework?

4.2.12 The pricing framework underpinned all contracts and amendments relating to the programme. Both parties subsequently accepted the need for revisions to the base cost underpinning the pricing framework to reflect:

- MoD's change to its annual production requirements;
- Changes to economic conditions;
- The incremental work required to produce enhanced articles following the PSP; and
- A number of other small changes.

4.2.13 However, the Board has seen no evidence that the pricing framework was intended to be formally incorporated into any of the contracts in a way that adopted the price without further EoI enquiry. Whilst this may have been the stated intent in the contractor's initial quote in December 1994, there is no evidence that MoD accepted this position.

4.2.14 It is the Board's opinion that this is an area where MoD was complicit in instilling the idea that the pricing framework was to be adopted throughout the programme without further detailed enquiry.

4.2.15 In particular, the cover letter to Contract C, signed in early 1997, stated that any further orders, following Contract C, would use the prices set out in the Annex to that letter. Similarly, the Senior Representatives' Agreement referred to the original framework price. At the same time the evidence provided by the contractor is consistent in implying the price was part of an overall package underpinned by the pricing framework.

4.2.16 It was also of great surprise to the Board that MoD appeared to make no successful enquiry as to performance against the framework price at any point in the programme, until after the programme had been substantially contracted. A number of opportunities to review costs arose throughout the programme.

4.2.17 The Board has noted that PQS, following its initial investigation into the pricing framework in 1995, carried out further investigations into aspects of the contracts but was never requested to look at a comparison of outturn costs against pricing framework costs, despite PQS signposting issues that might have caused the original pricing to be revisited.

4.2.18 In addition, MoD forwent the opportunity to carry out post-costing on a timely basis, which might also have shown the appropriateness of the original pricing basis for later contracts.

4.2.19 At the time Contract D was signed, and following extensive negotiation, both sides signed an EoI Pricing Statement based on prices that had been agreed in early 1997, some 2½ years previously. Whilst there was clearly an obligation on the contractor to disclose any major changes to the pricing assumptions, it should also have been incumbent on MoD to enquire as to the validity of the costs, at that time, given the long passage of time since they had been set. Indeed, given the number of changes that had been made to the costing parameters over the course of the programme, it is difficult to comprehend why the base costs were not more closely scrutinised.

4.2.20 It seems to the Board that MoD's principal focus was on:

- Maintaining the original pricing framework;
- Maintaining an appropriate rate of production and stock level; and
- Operating within budget and cash flow constraints;

whilst ensuring the ongoing viability of the contractor. It does not seem to have occurred to MoD that it should have made enquiry into the base cost during the programme given that any possible reductions in base costs could have mitigated any incremental costs put forward by the contractor.

4.2.21 It is clear to the Board that the pricing framework was intended to be a constant in the entire production programme at the outset of the programme, but that the pricing framework was insufficiently defined for use in the programme and had no binding impact. The Board believes that both parties were equally misguided in their view that the pricing framework should remain the unquestioned basis for pricing throughout the entire programme without appropriate periodic investigation.

When was the price fixed?

4.2.22 The Board is clear that the relevant point for price fixing in the context of determining a fair and reasonable price is at the acceptance of a contract or contract amendment which should be contemporaneous with the EoI Pricing Statement. This price may well be based on previous discussions and agreements, as was the case with Contract D, but unless those discussions and agreements are formally bound into a contract and the contract is specific as to a price fixing point at some time other than the date of the signing of the contract, this must be the date which is relevant for determining a fair and reasonable price.

4.2.23 The Board recognises that it would be possible for an EoI Pricing Statement to be signed at some date other than the acceptance of a contract or contract amendment which would lead to an ambiguity in the date of when the price was fixed. The Board considers that inclusion of the EoI Pricing Statement as part of the contract, rather than it being a separate document requiring a separate signature as is currently the case, would remove any ambiguity as to when the price of a contract is fixed.

4.2.24 The Board has seen no evidence to suggest any discussions or agreements between the parties relating to price were formally bound into Contract D causing any different view to be taken.

4.3 Equality of Information

4.3.1 EoI is the bedrock of non-competitive contracting and is underpinned by the demonstration of good faith. It applies across all non-competitive contracts, and as already discussed, is applied in a very specific way for NAPNOC contracts, through the provision of an EoI Pricing Statement, signed by both parties to the contract and annexed to the contract.

4.3.2 During the course of the Reference it appeared to the Board that there were different interpretations as to what the EoI Pricing Statement meant or represented in the context of Contract D.

4.3.3 It is the Board's opinion that for each contract entered into there should be equality of information at the time of entering into the contract. In normal circumstances, where there is one contract for one set of deliverables, this should be a straightforward process as pricing should be almost contemporaneous with entering into the contract.

4.3.4 In the case of a programme where the articles are delivered through a series of contracts against a perceived single pricing framework, the situation has the potential to become confused.

4.3.5 Both parties had identified that the prices for Contract D had been agreed in 1997 as a consequence of the covering letter to Contract C, and as expressed in Paragraph 1 of the EoI Pricing Statement to Contract D, dated late 1999.

4.3.6 The Board does not agree with this view and believes that the price for Contract D was agreed as a consequence of the Senior Representatives' Agreement in November 1999, and that therefore this was the point at which there should have been equality of information.

4.3.7 The final paragraph of the EoI Pricing Statement states "*To the best of the knowledge of each of us the foregoing is correct and there have been no material changes to the information set out or referenced in appendix 1 to this Statement between the time of the price agreement and the date of signature below.*"

4.3.8 Therefore, it was necessary for there to be equality of information up to the time of price agreement, whenever that may have been, and from that point up to the signing of the EoI Pricing Statement in late 1999.

4.3.9 The Board does not consider that in order to provide EoI between the point of price agreement and the signing of the EoI Pricing Statement it would be expected that a full re-pricing exercise would have to be undertaken. Rather, there is a requirement to identify whether there are reasons that would cause a material change in the agreed price. This may be by reason of price changing events, further information becoming available or assumptions subsequently proving to be inaccurate, which would cause the basis of the price to change. Clearly, the longer the period of time between the initial price agreement and the signing of the EoI Pricing Statement, the greater the likelihood that changes will have taken place.

4.3.10 The impression of the Board, confirmed by the evidence provided, was that the EoI Pricing Statement was signed by both parties in December 1999 merely as part of the process of recording the price within the contract, following agreement of the price as part of the Senior Representatives' Agreement which in turn had been informed by the Contract C covering letter dated early 1997.

4.3.11 It should have been clear to both parties that changes in the bases and assumptions underpinning the pricing might have occurred since early 1997 and enquiries should have been made and discussed. If this was not the case, this was clearly a failure of MoD and the contractor either to make appropriate enquiries or to consider their obligations properly, or both.

4.3.12 A further EoI Pricing Statement was signed in late 2001, when firm prices for Contract D were agreed. This was by way of an amendment to Contract D, but because of the size of the amendment there was a requirement for a separate EoI Pricing Statement.

4.3.13 An SPS report was issued at the time of firm pricing but it appears to have been limited to providing advice against economic growth factors applied by the contractor in its firm price quote. In its conclusion on equality of information, SPS reserved its position in that it had not had the opportunity to re-examine cost figures against recorded cost information.

4.3.14 Further, the SPS report was accompanied by a note which alerted readers to the fact that the contractor was using 'old' overhead absorption rates which did not take account of factory rationalisation. The note suggested that by applying the new rates, which had been agreed with the contractor for another contract, there could be a substantial reduction in the overhead cost for MoD. It appears this advice was not acted upon.

4.3.15 There was an attempt to limit the EoI Pricing Statement at the time of firm pricing, as the contractor wished only to take account of the totality of costs for the purposes of firm pricing and not each individual cost element. This was accepted by MoD and an amendment was made to the annex to the EoI Pricing Statement. The EoI Pricing Statement showed the fixed costs as set out in the late 1999 EoI Pricing Statement together with the escalation adjustments. The EoI Pricing Statement was signed in late 2001.

4.3.16 It seems to the Board that again the purpose of the EoI Pricing Statement was misunderstood and neither party had a clear understanding of what equality of information meant in the context of a contract amendment.

4.3.17 The extent of disclosure required by the EoI Pricing Statement in relation to a contract amendment is not clear to the Board. Is it merely in respect of the cost items directly related to the amendment or more widely to all of the costs related to the contract? As written, the EoI Pricing Statement would suggest that disclosure should be in respect of all costs, which might suggest a full pricing review, which might inhibit otherwise desirable amendments. The Board recommends that this is considered in more detail by MoD and the CBI and is clarified.

4.3.18 The Board believes that the EoI Pricing Statement has a vital role in ensuring there is equality of information in respect of fixing the price of NAPNOC contracts. If needs be the parties should take appropriate legal advice to understand fully what their obligations are in unusual circumstances. This did not happen in respect of Contract D.

4.3.19 The Board believes that both parties failed to address the EoI Pricing Statement appropriately in considering whether there was further information that should be declared in respect of EoI or taking account of information or advice that existed within their respective organisations.

Was there EoI?

4.3.20 Neither party has contended that there was inequality of information up to the agreement of Contract C in 1997 and the Board has therefore assumed that there was equality of information up to this point.

The contractor's management accounts

4.3.21 During the course of the hearing, the Board was provided with the CFF dated January 2000 which showed an estimate of the expected outturn profitability of Contract D and formed part of the contractor's internal management reporting system.

4.3.22 The CFF was prepared using the contractor's normal accounting bases and the contractor has contended that it was not directly comparable with the EoI Pricing Statement format. The costs incorporated in the CFF represented the direct costs attributable to a specific contract (i.e. it excluded indirect costs) and also incorporated certain costs disallowed under GPF contracts which would not have been included in the pricing calculation.

4.3.23 The Board was led to believe that the January 2000 CFF was the closest available CFF to the pricing point for Contract D (Fixed). The Board believes that this CFF is likely to be a reasonable reflection of the contractor's expected cost and revenue outturn for Contract D

in late 1999 because the January 2000 CFF will have been informed by outturn data up to November 1999 and there is no evidence that any material changes in expectations were likely to have arisen between November 1999 and January 2000.

4.3.24 Because the CFF and the EoI Pricing Statement were not directly comparable, the Board sought to obtain a reconciliation of the contractor's January 2000 CFF to a format consistent with the Contract D EoI Pricing Schedule signed in late 1999 but it received only a partial reconciliation because the contractor no longer had the necessary detail to perform an accurate reconciliation.

4.3.25 The Board has therefore used the information in the January 2000 CFF together with other oral and documentary evidence presented to it during the course of the hearing to determine its own estimate of the contractor's expected cost and revenue outturn on Contract D when the contract was signed in late 1999. The Board has then compared this with the costs underpinning the Contract D fixed EoI Pricing Statement in order to determine whether there appeared to be equality of information at the time of pricing Contract D (Fixed) in late 1999.

4.3.26 In order to reconcile the January 2000 CFF to the Contract D fixed EoI Pricing Statement, the Board has made a number of adjustments based on evidence presented to it during the hearing and subsequent to the hearing. Because of the uncertainties in the evidence provided, the Board has been conservative in its analysis and believes that its estimate of the contractor's Contract D profit forecast as at January 2000 included in this report is at the lower end of the possible range of estimates.

4.3.27 The Board has estimated that:

- The costs and the revenues per the late 1999 EoI Pricing Statement as adjusted for the contracted VOP mechanism and using outturn indices are £155 million and £170 million respectively giving a profit of £15 million (9.7% ROCP); and

- The contractor's forecast costs at completion at January 2000, derived from the January 2000 CFF but presented on a like for like basis as the EoI Pricing Statement, would have been in the region of £149 million, which, against a revenue of £170 million, would give a profit of £21 million (14.5% ROCP).

4.3.28 The Board has therefore estimated that the contractor's forecast profit would have exceeded the profit envisaged in the EoI Pricing Statement, as adjusted for VOP, by £6 million.

4.3.29 The Board believes that the difference between the profit envisaged in the EoI Pricing Statement and the contractor's internal forecast profit at the time of signing Contract D (Fixed) is of sufficient magnitude that the contractor ought to have brought this to the attention of MoD in order for equality of information to be preserved.

4.3.30 The contractor's forecast total costs on Contract D did not change significantly between January 2000 and December 2001 as it continued to forecast ROCP in excess of the 9.7% envisaged in the EoI Pricing Statement. Therefore, in agreeing a firm price in late 2001, any amount agreed over and above the contractor's forecast sales of £170 million, incorporated into its January 2000 CFF, would automatically convert to profit. The

Contract D firm price agreed in late 2001 was £186 million giving rise to an increased profit of approximately £16 million.

4.3.31 As a consequence, the Board believes that the contractor ought to have brought the increase in forecast profit to the attention of MoD before signing the Contract D firm EoI Pricing Statement.

Origin of excess profit

4.3.32 The Board has analysed the difference between the outturn profit and the profit envisaged in the EoI Pricing Statement (excluding ancillary items) and has determined that the outturn profit can be broadly summarised as follows, assuming that PSP and other costs included under ATC are disallowed:

	Contract D Profit £m
Profit envisaged at EoI (9.7% ROCP)	17
Savings against EoI costs known at Dec 1999	6
Profit resulting from firming of price	16
Subsequent savings	9
Total	**48**

4.3.33 The profit of £17 million is the profit envisaged on the Contract D firm contract after amendments and excluding ancillary items.

4.3.34 The Board considers that the overall saving of £6 million, which it has concluded the contractor should have been aware of at the time it entered into Contract D (Fixed), was the result of a number of favourable and adverse variations, most notably savings of £6 million on Risk and £5 million on Overheads, offset by adverse variances of £5 million on Materials.

4.3.35 The Board believes profits were enhanced by approximately £16 million as a consequence of moving from a fixed to a firm price, because the Board believes the contractor had already factored cost increases, netted against cost savings into its original forecast in January 2000 and therefore cost inflation had in effect already been factored into its original profit forecast.

4.3.36 The balance of £9 million of savings was made by the contractor progressively over the remainder of the contract. The Board has found no evidence that these savings were generated other than through the contractor's own efficiencies or the release of contingency provisions.

Use of contingencies

4.3.37 Contingencies are a particular area of concern to the Board and are therefore separately considered here. Under the GPFAA, it is recognised that *"reasonable and justified"* contingencies are required in estimating costs for the purposes of fixing prices and that

they should be separately identified and justified. The GPFAA also recognises that consistent over provision for contingencies cannot be regarded as a legitimate means of obtaining above average profits.

4.3.38 The Board is required to examine contingencies only from the aspect of the situation at the time of price fixing and shall have especial regard to whether a similar provision was required in a previous comparable contract or on the basis of previous experience or the length or complexity of the contract or the degree of technical innovation involved in the performance of the contract.

4.3.39 In the case of this programme, the Board has identified contingencies of at least 9.3% of the article price initially agreed for the programme, which therefore will also have been reflected in Contract D price. The most significant elements were:

- The 7.5% commercial material risk contingency to cover the risk of disruption to the manufacturing process as a result of faulty subcontractor goods for which the subcontractor did not accept liability

- The 2% material risk contingency, the purpose of which was to cover higher than anticipated scrap costs, minimum order quantities and material loss (shrinkage); and

- The ATC to cover the cost of article rework in the event that articles failed their acceptance tests.

4.3.40 These were all reviewed and agreed by PQS at the time the pricing framework was agreed and the Board is satisfied that there was equality of information at this time. As far as the Board is aware, no further investigation was made into the use of the contingencies during the remainder of the programme, the assumption being that the contractor was taking the residual risk on these items.

4.3.41 During the course of the programme the Board would have expected the contractor to have recorded its utilisation of contingency costs but this appears not to have been the case and any contingency related costs were recorded against the normal line items or alternatively the contractor did not need to draw on its contingency provisions. Consequently, when post-costing was carried out, there was minimal charge against the contingency line items, save ATC which is discussed below.

4.3.42 Evidence provided by the contractor suggests that very limited contingency had been required in Contract A/B and Contract C and therefore, by the time the contractor entered into Contract D, it knew that the contingencies included in its cost estimates could provide a significant favourable variance. The Board recognises that there was still risk in the contract, for which a contingency was appropriate but the point the Board would make is that the fact that contingencies used in the earlier contracts were lower than the amounts provided should have been raised with MoD, so that both parties were in receipt of the same information.

4.3.43 The Board believes, therefore, that the contractor would have had knowledge, at the time of signing the Contract D EoI Pricing Statement, that its use of contingencies had been below that anticipated on previous contracts and, if the trend continued, its profit on Contract D would be enhanced accordingly. Had this been disclosed, the two parties

would have been in receipt of the same management information and would have been able to have discussed the way forward accordingly.

Conclusion on whether there was EoI

4.3.44 Taking account of the current MoD guidance on "Pricing – Equality of Information", which the Board believes captures the EoI principles that should have existed throughout the programme, and the matters referred to above, the Board is satisfied that there was inequality of information and a failure of good faith by the contractor to bring to MoD's attention information which was material to the agreement of a fair and reasonable price. The Board believes that the contractor would have known at the time of signing the EoI Pricing Statements that the profits on Contract D were likely to exceed by a material amount the amounts agreed between the parties in the Contract D EoI Pricing Statements at the time that Contract D was entered into and when it was subsequently amended for firm pricing.

4.3.45 Had the two parties been transparent as to their understanding of the pricing regime and the obligations of equality of information, and documented and agreed this understanding, many of the differences of opinion between the parties that have subsequently arisen would have been avoided.

4.4 Commerciality of MoD and its obligation to make sufficient enquiry

4.4.1 In a previous reference, the Board considered that MoD was not relieved from a duty to make enquiries regarding those matters of which it ought reasonably to be aware. Such an approach will not relieve from the party having the information the primary responsibility for disclosure but the Board will have regard to the enquiries made by the other party when determining the amount of any price adjustment.

4.4.2 The Board believes there were a number of areas where MoD failed to make adequate enquiry in respect of the pricing of Contract D and where MoD failed to show commercial acumen.

4.4.3 When MoD changed the programme from a single contract procurement to a multi contract procurement, there appeared to be no consideration of the implications in the context of the pricing framework, equality of information and post-costing. It appears that the protocol was made up as the programme evolved and was not discussed or clarified with the contractor. Equally, it does not appear that the contractor sought any such clarification.

4.4.4 The MoD achieved a clear commercial advantage by breaking the programme down into a number of contracts and contract amendments, which gave it the opportunity to monitor costs during performance and if necessary to reset prices. However, MoD did not make use of the advantage it had gained, even though on a number of occasions MoD personnel recommended that base costs should be re-examined. One example of this is a MoD internal note dated December 2000 in which surprise is expressed that MoD had not taken

the opportunity to update pricing data from recorded costs of earlier orders and it recommended that further information should be obtained for EoI purposes.

4.4.5 It appears that where these recommendations were made, they were ignored, and as far as the Board can ascertain, this was in part due to the many different MoD personnel involved in contract management over the period of the programme, the continuous change of key personnel and inadequate briefing of new personnel and a general lack of accountability and lack of coordination between different individuals and different functions.

4.4.6 It also appears that MoD had a blind faith in the sanctity of the pricing framework and seemed unable to consider whether this remained relevant despite the many changes to the pricing basis, the changes to the specification, the changes to production rates, the significant element of contingency included in the price and the impact of inflation on the price. Because of delays in the programme, the production period also lasted for longer than was intended.

4.4.7 The Board has been unable to understand why, when EoI Pricing Statements were being signed with new contracts and amendments, there was so little enquiry as to actual performance against the original pricing framework which could have informed subsequent pricing negotiations. This seems, to the Board, the most basic enquiry that any procurement authority should make.

4.4.8 The Board has noted the PQS reports that were prepared during the programme were limited in scope but that a number of valid recommendations were made.

4.4.9 As a consequence, PQS was unable to be conclusive on the subject of equality of information and its conclusions were hedged. A quote from the PQS report dated December 2000 on the contractor's quote for the conversion of prices from fixed to firm stated "*During this and our earlier investigations, we have not had the opportunity to re-examine these figures against recorded cost information. Significant cost data for labour and materials will now be available to the Contractor and there has been major restructuring of the company since the original price was struck. With this in mind, we are most decidedly not able to confirm that we have had full equality of information.*" In the Board's view all open items and recommendations by PQS should have been closed out formally.

4.4.10 The Board has also noted the time it took to complete post-costing exercises and believes that MoD should have pursued its rights and acted on a timely basis to get a clear idea of the recorded costs before embarking on the major part of the programme.

4.4.11 Even if it did not pursue post-costing on a timely basis, MoD still had rights under SC48 to enquire into and understand the contractor's cost base, but at no time was it raised whether these rights would be exercised. Further, in the PQS report referred to above, there is a statement which says that the contractor has "*indicated a willingness to provide information. Our requests for various items of information however, appeared to have been ignored"*. There were other similar statements within evidence provided to the Board. The Board is unable to understand these statements because of the contractual obligations placed upon a contractor under SC43 and SC48 to furnish information to MoD as might reasonably be required.

4.4.12 It appears to the Board that, in essence, MoD had an undue focus on process, maintaining production and operating within budget, and that the contracts were looked at in a piecemeal and somewhat "micro" way. It is not obvious to the Board that anyone appeared to have sufficient visibility to take responsibility for the commercial aspects throughout the programme and whether it was being procured at the best price, or if they did, they failed to take advantage of the opportunities open to them – i.e. to have the "macro" view.

4.4.13 The Board would add, however, that MoD put a lot of energy into maintaining the production programme, often in difficult circumstances and in certain respects negotiated hard and successfully, especially in an environment where contractors are constantly seeking ways to improve their positions.

4.4.14 The Board can only conclude, however, that MoD contributed considerably to the significant profits earned by the contractor in excess of the profit rate agreed within Contract D and has taken this into account in making its decision.

4.4.15 In summary, areas the Board would have expected to have seen greater engagement by MoD would include:

- A better definition of the pricing framework.
- A discussion with the contractor as to how the NAPNOC principles were to be applied in the context of pricing amendments and of inter-related contracts.
- Use of post-costing after the initial Contract A/B.
- A review of the contractor's base cost before entering into new contracts and also before moving from fixed to firm prices.
- A review of the use of contingencies in the light of actual experience.
- A more diligent approach to EoI Pricing Statements.
- Formal closure of points raised by advisory teams within MoD.
- Clearer accountability, in particular for the macro view of the programme.

4.5 Cost certificates and post-costing

4.5.1 Post-costing is a powerful, albeit retrospective, tool for MoD and one which should be utilised effectively. The Board has often made comment in its annual and general reviews over recent years that it does not believe MoD takes adequate advantage of this important right.

4.5.2 Post costing is currently carried out by CAAS, and previously by predecessor bodies for the following purposes:

- In pricing follow-on contracts, as an essential element in equality of information;

- To enable departments to check the accuracy of their estimating procedures;
- To provide the information for a selective scrutiny of the outcome of particular contracts so that a reference may be made by either side to the Board; and
- To provide verification of outturn costs for fixed or firm prices where contract terms require a sharing of the outcome of a cost over or under-run.

4.5.3 The first post-costing request was made by MoD in 1997 in respect of Contract A/B but the contractor objected to this being done in isolation rather than as part of the full programme. The MoD did not formally respond until 2001 when it requested cost certificates for Contract A/B and Contract C.

4.5.4 Post-costing was carried out following receipt of the contractor's cost certificate at the end of 2001 albeit the post-costing report was not finalised until 2004 and formally closed out until early 2005.

4.5.5 The post-costing exercise on Contract A/B and Contract C concluded that the investigation did not uncover any areas where there had not been EoI. MoD also commented that post-costing could not be completed until the outturn of Contract D was investigated. It should be noted that the cost certificates included costs relating to ATC, the nature of which were subsequently disputed by MoD in the post costing review of Contract D.

4.5.6 MoD requested the Contract D cost certificate in 2006, which the contractor provided in the early part of 2007. CAS was requested to carry out a post-cost review in the latter part of 2007 and issued its report in mid 2008.

4.5.7 The Contract D post-costing exercise revealed significant variances between the outturn profit and the profit envisaged in the EoI Pricing Statement. CAS, carrying out the investigation for MoD and following explanations from the contractor, concluded that costs reported under ATC in the cost certificate were not legitimate costs under Contract D. This was despite the fact that the ATC treatment was consistent with that used and accepted at the Contract A/B and Contract C post-costing exercise.

Recording of costs in ATC

4.5.8 The Board has considered each cost attributed to ATC to determine whether the cost was legitimately incurred in the execution of the Contract D. In the event that costs recorded under ATC were deemed to be legitimate, the Board has considered whether it was appropriate to amortise the costs across the programme.

4.5.9 ATC as extracted from the Contract D cost certificate was as follows:

	Total £
Liquidated Damages	478,933
Article Discount	2,606,378
PSP	7,878,637
Other	44,819
Total	11,008,767

Liquidated Damages

4.5.10 It is the Board's view that any penalty payment should be excluded from a cost certificate other than as a disallowable separate line item, as, by its nature, it will not have been taken into account in the EoI Pricing Statement.

4.5.11 The Board therefore considers that the Liquidated Damages should not have been recorded as a cost on any contract under ATC in any cost certificate.

Articles Discount

4.5.12 The Articles Discount represented the reduction of payments by MoD to the contractor as a result of MoD accepting articles despite their failing AT.

4.5.13 The failed articles formed part of Contract A and Amendment 2.

4.5.14 The Board considers that the discount relates specifically to Contract A/B and therefore should not have been recorded in the Contract D cost certificate.

Performance Standards Programme

4.5.15 The Board considers that it is clear that the PSP should not have been included as a cost in the cost certificate, save as a disallowable separate line item.

4.5.16 The Board considers that the inclusion of the PSP costs, in particular, in the cost certificate within ATC masked the magnitude of costs incurred that were to be compared to the EoI Pricing Statement. That said, the contractor made clear the nature of the costs that were charged to ATC, and on enquiry, it would have been clear that these costs needed to be considered separately from ATC. The MoD has accepted, in giving its evidence, that it was incorrect to accept these costs as ATC costs when it carried out its post-costing exercise on Contract A/B and Contract C.

4.5.17 As a consequence MoD correctly identified the fact that the PSP, Liquidated Damages and Articles Discount should not have been included in the Contract D cost certificate for comparison with the EoI Pricing Statement.

4.5.18 The Board does not accept MoD's logic that as a consequence of disallowing these costs, and thus increasing the derived ROCP to 35.6%, there was necessarily inequality of information.

4.5.19 As a general point, the Board does not believe there was adequate briefing of the PFG or CAS teams prior to carrying out the post-costing exercise and the post-costing exercises tended to be limited to a comparison with the EoI Pricing Statement rather than considering and analysing the broader issues. The Board does not believe that the reports produced were fit for purpose in terms of meeting the post-costing purposes outlined above.

4.5.20 During the hearing there was some dispute between the parties as to what costs should be recorded in a cost certificate produced by a contractor, for the purposes of post-costing. The contractor considered that all costs incurred against a contract should be recorded, whereas MoD believed it should only be those costs that were relevant for comparison with the EoI Pricing Statement.

4.5.21 The Board notes that there will be instances where there are contract costs which are disallowed under the GACs but which from a contractor's point of view are genuine contract costs. The Board's view is that the cost certificate presented by the contractor for post-costing should compare costs directly with those incorporated into the EoI Pricing Statement. It is open to the contractor to include other costs incurred, provided they are shown clearly as separate line items not to be compared against the EoI Pricing Statement.

4.5.22 The Board can envisage situations where it would be helpful for a contractor to inform MoD of costs that it has incurred that were not envisaged or were disallowed at price fixing, which might be relevant when considering the pricing of subsequent contracts.

4.6 Maintenance of adequate records

4.6.1 SC48, Availability of Information, included as a condition of Contract D, placed a requirement on the contractor to maintain its normal records of cost, manufacturing facilities and production plans in relation to Contract D for a period of two years after final payment or three years after final delivery, whichever expired sooner.

4.6.2 The Board has seen no evidence to suggest that the contractor did not maintain adequate records during the course of the contract, and the post costing exercises have not made any reference to a failure. However, the Board has been frustrated by the lack of meaningful analysis available to explain the differences between outturn and expected profits and variances in key line items, which it would have expected to be the norm in a manufacturing organisation.

4.6.3 Whilst it was not a requirement of the contractor to furnish MoD with forecasts of outcomes during the course of a contract, it would have been appropriate to have made MoD aware if any forecast, before or at the time of pricing, was different from costs agreed at pricing. As previously discussed, this does not appear to have been the case for Contract D.

4.6.4 The Board also observes, as a matter of general principle, that it must be unhelpful for contractors and MoD to prepare accounts on bases that are so different that reconciliation becomes difficult or impossible. The Board recommends that MoD should give consideration to requesting or mandating a standard chart of accounts, or a standard methodology for reconciling accounts with EoI Pricing Statements.

4.7 Standard of efficiency

4.7.1 The contractor made a considerable effort to demonstrate its efficiency in relation to the programme and particularly to Contract D. The Board recognises that there may have been efficiencies achieved for which it should be rewarded, but these can only be subjective and it has not been possible to quantify the effect of them.

4.7.2 The Board is not aware that MoD currently monitors the efficiency of contractors on MoD contracts. The Board believes that MoD would benefit considerably by implementing processes to gather data on efficiency as such data could assist MoD in other and future MoD procurements.

5 Decision of the Board

5.1 General conclusions

5.1.1 For the reasons set out in Section 4 of this report, the Board believes that the contractor failed to exercise good faith and there was inequality of information at the time of pricing Contract D. Therefore the price negotiated was not fair and reasonable.

5.1.2 The Board recognises the circumstances at the time of pricing were unclear and that both parties were under the impression that the original pricing framework, as amended by subsequent agreement, was still the basis of pricing. Additionally both parties possibly felt that the price had been fixed as a consequence of the cover letter to the Contract C dated early 1997 and as accepted in subsequent correspondence dated April 1997 and in the Senior Representatives' Agreement, which was concluded in November 1999. The Board also notes that the EoI Pricing Statement forming Annex C of Contract D referred back to the contractor's quote of March 1997 and the agreed fixed price.

5.2 Calculation of the amount to be awarded

5.2.1 The Board has considered, therefore, what course events might have taken if there had been such a conversation at the time Contract D (Fixed) was signed.

5.2.2 The Board considers that, if there had been more informed discussions, the parties might have agreed different prices but it is not possible to be definitive about what the final outcome of the discussions would have been.

5.2.3 The Board therefore looked at a number of different scenarios and has determined what, in its opinion, and based on the information available, a fair and reasonable outcome would have been for both parties.

5.2.4 The Board has had to make a number of assumptions in coming to its decision in the absence of more definitive information, and recognises the degree of uncertainty in doing this. However the Board believes the assumptions it has adopted are reasonable in the light of information available.

5.2.5 If, at the time of Contract D, both parties had brought to one another's attention information which was material to the agreement of a fair and reasonable price then it is the Board's view that the contractor should have presented a forecast that was underpinned by the same information that went to inform its January 2000 management forecast.

5.2.6 There would also have to have been a discussion around contingencies to reflect experience to date and this would have required a reassessment of the contingency provisions included in Contract D.

5.2.7 The Board has already estimated in Section 4 that the contractor's forecast cost in January 2000, on a like for like basis with the EoI Pricing Statement, would have been £149 million.

5.2.8 It had been the original intention of the two parties to move to firm prices shortly after the Contract D (Fixed) was entered into, and this was dependent on agreement of the subcontractors' revised prices for materials.

5.2.9 The contractor had received subcontractors' quotes by April 2000, and at this point it would have been able to update its forecast to reflect firm prices from subcontractors. The contractor's management forecast at December 2001 showed that subcontractor costs were forecast at £91.4 million, some £4 million higher than shown in the January 2000 CFF, and the Board has used this as a proxy for subcontractors' firm prices at April 2000.

5.2.10 As a consequence of the above, the Board has assumed that anticipated costs, on a nominal basis, might have increased to approximately £153 million.

5.2.11 Given that the prevailing GPF profit rate had increased to 11.07% at this time, and a number of adjustments were being made to other aspects of the price, the Board believes it appropriate that this rate should be used in making a determination.

5.2.12 The Board also believes that it is appropriate to allow the contractor a premium for inflation risk, once prices had moved to firm, but not at a significant level.

5.2.13 Based on the above, the Board estimates that a firm contract price of £171 million would have been fair and reasonable and would have given the contractor a forecast outturn profit of £18 million or 11.8% ROCP.

5.2.14 This would result in an award to MoD of £15 million before considering any mitigating factors, the £15 million being the difference between Contract D (Firm) price agreed in late 2001 of £186 million (plus a further £5 million for additional items) and the £171 million deemed by the Board as what would have been a fair and reasonable price.

5.3 Additional matters

5.3.1 In the Board's view, there are a number of further issues that need to be taken into account in determining the extent of the repayment to be made by the contractor.

5.3.2 These are:

- The role played by MoD;
- A restatement of contingencies on earlier contracts as a result of the reduction of contingency on Contract D;
- Efficiencies delivered by the contractor;
- The wider suite of contracts making up the full programme;

- PSP and other costs;
- The article exceeding specified performance levels; and
- Interest.

5.3.3 The Board has noted previously in this report the role played by MoD in the agreement of pricing Contract D. As in previous references, the Board considers that MoD is not relieved of a duty to make appropriate enquiries regarding those matters of which it reasonably ought to be aware. The Board also believes that MoD failed to demonstrate the commercial acumen that would have been appropriate for a major procurement body. MoD's failure to make appropriate enquiry or to close out significant points during the programme might have implied to the contractor that MoD considered that the contractor was fulfilling its obligations. However, the Board emphasises in the strongest terms that this should not, in any way, have relieved the contractor of the obligation to disclose any matters of which MoD ought to have been aware as part of the EoI process.

5.3.4 In particular, the Board considers:

- The MoD, as the procurement body, failed to clarify sufficiently the relationship between the original pricing framework and the EoI Pricing Statements and indeed might not have given sufficient or any thought to this.
- The MoD failed to exercise proper accountability for the contract, resulting in a fragmentation of responsibilities and consequently failure to heed the advice adequately, in particular, of members of PQS and successor bodies.
- The MoD implied its acceptance of the prices agreed in 1997 to the contractor at the time of fixing Contract D prices and failed to make further enquiries as to whether these remained appropriate in 1999.
- The MoD appeared to be very much process driven and failed to look at the wider picture and the commercial implications of the decisions it took. The MoD was dilatory in following up actions necessary as part of good contract management.

5.3.5 Consequently the Board considers that MoD must take significant responsibility for the excess level of profit earned by the contractor.

5.3.6 It is possible that had MoD initiated discussions with the contractor around contingencies, then the contractor would have argued that the contingencies would have been profiled differently as part of the original framework agreement and that provision for contingencies would have been weighted to earlier in the contract. The Board considers this argument has some merit and has taken it into consideration in its deliberations.

5.3.7 The Board has also considered the evidence presented to it concerning efficiencies delivered by the contractor, and recognises that, under a fixed/firm priced contract, these should be to the benefit of the contractor provided there was equality of information at the time of pricing. In this contract it is difficult to segregate efficiencies from other factors in the contract, but the Board is mindful of the way the contract was carried out and managed by the contractor, and believes that on balance there might have been efficiencies for which the contractor should receive benefit.

5.3.8 The Board has considered the interaction of Contract D with the other related contracts that the contractor had carried out to date. Although the Design, Development and Initial Production Contract was a loss making contract, it was competitively let and should not therefore form part of the Board's consideration. Contract A/B and Contract C were carried out under the original pricing framework and were profitable, both exceeding the agreed profit rate. The Board does not consider it necessary to make any allowance in respect of these contracts.

5.3.9 The Board, as previously stated, does not consider it appropriate to take account of the Articles Discount, the PSP or Liquidated Damages costs when considering the profitability of Contract D. Consequently MoD is correct in its assertion that these items masked the true profitability of Contract D by recording them on the Post-Costing Certificates under the heading of ATC.

5.3.10 The Board has considered the contractor's evidence that the article exceeded the specified performance levels required under the Design, Development and Initial Production Contract but since this was not a contractual requirement, it is not appropriate to make any allowance for this in calculating the amount to be awarded.

5.3.11 It is not the intention of the Board to make a separate award for interest but in reaching its decision on the award as a whole it has considered whether there has been some unusual degree of delay in dealing with the Reference and the reasons for such a delay. To the extent there might have been any delay, the Board would attribute this to the conduct of both parties in this Reference.

5.3.12 Taking all the above into consideration, and in particular the role played by MoD, the Board believes that it would be appropriate to reduce the award to MoD of £15 million by 40%, resulting in an aggregate payment by the contractor to MoD of £9 million.

5.3.13 Whilst a payment of £15 million by the contractor would have resulted in it attaining an outturn profit of £33 million, or ROCP of 23.7% on the contract, a payment of £9 million will result in an outturn profit of £39 million, or a ROCP of 28.0%. The difference between the outturn profit of £39 million and the profit the contractor would have forecast at the time of price fixing of £18 million is due to:

- Savings generated during the course of the contract following the January 2000 CFF totalling £15 million, from efficiency and non-usage of contingencies; and

- £6 million deducted from the repayment in recognition of mitigating factors.

5.4 Implementation of the Board's decision

5.4.1 The Board notes that under paragraph 5 of Standard Condition 50, incorporated into Contract D (now known as DEFCON 650) a decision on a contract reference by the Board is agreed by the parties to be *"final and conclusive"*, and the parties agree *"to take all necessary steps to give prompt effect to that decision"*.

5.4.2 It is the Board's expectation that the payment due will be effected with maximum promptitude following the publication of this decision to the two parties.

John Price

Chairman of the Board

Appendix 1: Glossary of terms

Term	Meaning
Amendment 2	Amendment 2 to Contract A agreed in late 1995 for around 15% of the articles under the programme.
AT	Acceptance Testing.
ATC	Acceptance Test Contingency, an agreed level of contingency included in the programme, intended to cover the costs of rectifying articles which fail their AT.
Board	The Review Board for Government Contracts.
CAAS	Cost Assurance and Analysis Service, a branch of MoD. In recent years the body undertaking these services has been known as PQS, SPS, PFG, CAS and CAAS.
CAS	Cost Assurance Services, a branch of MoD. In recent years the body undertaking these services has been known as PQS, SPS, PFG, CAS and CAAS.
CBI	Confederation of British Industry.
CFF	Contractor's Financial Forecast. The contractor's internal financial estimate document showing the expected profitability of individual contracts.
Contract A	Contract agreed in mid 1995 for around 11% of the articles under the programme.
Contract A/B	Contract A including Amendment 2 and subsequent amendments for around 26% of the articles under the programme.
Contract C	Contract agreed in early 1997 for around 11% of the articles under programme.
Contract D (Fixed)	Contract agreed in late 1999 for around 62% of the articles under the programme.
Contract D (Firm)	Firm Price Amendment to Contract D (Fixed) agreed in late 2001.
Contract D	Contract for around 62% of the articles under the programme agreed in late 1999 and subsequent amendments (including Firm Price Amendment agreed in late 2001).
DASA	Defence Analytical Services and Advice, a professional analytical, economic and statistical service provider to MoD, other Government departments and the public.
DEFCONs	Standard defence contract conditions which are inserted into MoD contracts when appropriate. DEFCONs replaced Standard Conditions (SCs).
DEFCON Guides	These were working guidelines for the pricing of GPF contracts and are no longer current. Equivalent guidance documents are currently contained in MoD's internet based Commercial Toolkit.
Design, Development and Initial Production Contract	Contract for the design, development and initial production of the articles.
EoI	Equality of Information.
EoI Pricing Statement	Equality of Information Pricing Statement.
Firm price	A price, agreed for the articles or services, or both, which is not subject to variation.
Fixed price	A price, agreed for the articles or services, or both, that is subject to variation in accordance with the variation of price provision of the contract.
GACs	Government Accounting Conventions, the accounting conventions used for the determination of costs and capital employed attributable to GPF contracts.

GPF	Government Profit Formula, the formula for the pricing of non-competitive Government contracts.
GPFAA	Government Profit Formula and Associated Arrangements. References in this document are to the version reflecting the status of the agreement between Government and industry as it stood following implementation of the 2010 General Review of the Government Profit Formula.
MoD	Ministry of Defence or Secretary of State for Defence.
NAPNOC	No Acceptable Price No Contract, an initiative introduced by MoD in July 1992 whereby MoD's aim was to price contracts before they were placed.
Nominal and real bases for stating costs	Stating costs on a real basis removes the effects of price changes over time, i.e. inflation, whereas stating costs on a nominal basis does not.
PFG	Pricing and Forecasting Group, a branch of MoD. In recent years the body undertaking these services has been known as PQS, SPS, PFG, CAS and CAAS.
PQS	Pricing & Quality Services, a branch of MoD. In recent years the body undertaking these services has been known as PQS, SPS, PFG, CAS and CAAS.
Pricing framework	The agreement reached between MoD and the contractor in April 1995 for an article price based on the continuous production of the full programme.
PSP	Performance Standards Programme.
Review Board	Review Board for Government Contracts.
ROCP	Return on Cost of Production.
SC	Standard Condition. Standard contract conditions inserted into MoD contracts when appropriate. SCs have been replaced by DEFCONs.
SC43	Standard Condition 43 – Pricing, now DEFCON 643.
SC48	Standard Condition 48 – Equality of Information, now DEFCON 648.
SC50	Standard Condition 50 – Referrals to the Review Board, now DEFCON 650.
SPS	Specialist Procurement Services, a branch of MoD. In recent years the body undertaking these services has been known as PQS, SPS, PFG, CAS and CAAS.
VOP	Variation of Price.
Yellow Book	General term for the GPF rates and methodology and any annual or general review by the Review Board for Government Contracts.