

Defence and Security Public Contracts Regulations 2011

Chapter 9 – Research and Development

Purpose

1. This guidance explains how the Defence and Security Public Contracts Regulations (DSPCR) 2011 will handle Research and Development (R&D) contracts.
2. In particular, it sets out a detailed definition of R&D in the context of the DSPCR; provides guidance on the use of the general exclusion for R&D services; the use of negotiated procedure without publication of a contract notice for R&D contracts; and commercial strategies which procurers may adopt when contracting for R&D.

What is R&D?

3. By R&D, we mean “all activities comprising fundamental research, applied research and experimental development”. A further definition of the three elements is as follows:
 - a. Fundamental Research - undertaken primarily to acquire new knowledge, without any particular application or use in view.
 - b. Applied Research - directed primarily towards a specific particular aim or objective.
 - c. Experimental Development – work which draws on existing knowledge to establish new processes, systems and services or to achieve a substantial improvement in materials, products, devices, processes, systems and services.

What is the legal framework?

4. Regulation 3 contains the full definitions for “research and development” which covers “applied research”, “experimental development”, “fundamental research”. It also includes definitions for the related concepts of “life cycle” and “technological demonstrator”.
5. Regulation 7(1)(i) of the DSPCR sets out the R&D services exclusion.
6. Regulation 16(1)(c) allows you to use the negotiated procedure without publication of a contract notice for:
 - a. R&D services other than those covered by the R&D services exclusion; and
 - b. the manufacture of R&D goods solely for the purposes of R&D but not where you are procuring the goods for quantity production to establish commercial viability or to recover R&D costs.

What is the general approach to R&D?

7. Recital 55 of the Directive states:

“stimulating research and development is a key way of strengthening the European Defence Technological and Industrial Base The importance of research and development in this specific field justifies maximum flexibility in the award of contracts for research supplies and services”.

8. The DSPCR excludes certain contracts for R&D services from its scope and allows the use of non-competitive negotiated procedures for the award of other services and supply contracts for R&D. This applies to R&D contracts only up to the stage where you can reasonably assess and de-risk the maturity of the new technologies, i.e. the contract cannot go beyond the demonstration of the performance of a new concept or a new technology in a relevant or representative environment.

9. These flexible arrangements for the award of R&D contracts should not preclude fair competition in the later phases of the life cycle of a product.

10. R&D contracts under international co-operative programmes between two or more Member States for the development of a new product can go further. Contracts under these programmes may go right through to production and later phases, and still be excluded under Regulation 7(1)(c) (see Chapter 5 – General Exclusions in the DSPCR).

How do we identify R&D activity?

11. R&D essentially covers:

- a. “fundamental research” and “applied research” where scientific and technical knowledge is generated and advanced in a defence or security context; and
- b. “experimental development” where that knowledge is exploited to create new or improved materials, devices, architectures and systems.

12. Procurers must use an element of judgement in deciding whether to class the activity as R&D. This is often difficult as it is likely that most project phases will include some element of R&D. Often subjective assessments are required to separate “experimental development” from preparation for production.

13. R&D as defined in the DSPCR does not include the making and qualification of pre-production prototypes, tools and industrial engineering, industrial design or manufacture. For example, R&D would include a prototype to demonstrate the performance of a technology in a realistic environment but not a prototype to validate the industrial manufacturing process.

14. The key criteria for the activity to be classified as true R&D under the definitions in the DSPCR are that it is sufficiently new, novel or innovative to:

- a. add to the stock of existing knowledge including to establish new processes, systems and services or to substantially improve existing processes; and / or

- b. considerably increase or improve capability or utility of the end goods or services, including improving the capability of existing goods or services or both.

15. Application of these criteria within a defence and security context is often difficult and relies on the judgement of the project manager.

16. In terms of Technology Readiness Levels (TRL), R&D would typically include basic technology research (TRL1); research to prove feasibility (TRL2 / 3); technology development (TRL3-5); and technology demonstration (TRL5-6), i.e. devices demonstrating the performance of a new concept or a new technology in a relevant or representative environment.

17. Clear delimitation of R&D activities is crucial for choosing the right method of contracting under the DSPCR.

What does the R&D services exclusion cover?

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

“(1) These Regulations do not apply to the seeking of offers in relation to a proposed contract or framework agreement —

(l) for R&D services unless —

(i) the benefits are to accrue exclusively to the contracting authority for its use in the conduct of its own affairs; and

(ii) the services are to be wholly paid for by the contracting authority.”

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

a. the benefits of the R&D (e.g. intellectual property rights (IPR)) do not exclusively accrue to the procurer (e.g. the rights are available to the supplier or a third party to exploit); or

b. the R&D services are not wholly paid for by the procurer (e.g. the procurer and the supplier share the costs); or

c. both a. and b. above apply.

20. The R&D services exclusion will cover service contracts where MOD acquires user rights including DEFCON 705, i.e.

a. in the contract the R&D activity is fully funded by the procurer who acquires user rights in the results sufficient to meet its needs; and

b. the ownership of the IPR in the results is otherwise left with the contractor who is then free to exploit them for wider commercial purposes.

21. The R&D services exclusion is different to the exclusion available for procurements involving R&D services under international cooperative programmes at Regulation 7(1)(c), which can include production and other later stages of the life cycle of a product.

What about R&D contracts that mix R&D services and supply?

22. The nature of the R&D contract not only determines whether the R&D services exclusion applies but also if you need to use a procurement procedure under the DSPCR.

23. You should class a contract consisting of both goods and services as a service contract only if the value of services, based on a genuine pre-estimate, exceeds the value of the goods. If the value of the goods exceeds that of the services then you need to class it as a research-related supplies contract. An exclusion from the DSPCR will apply for a service contract but not for a supply contract. The supply contract will be subject to the DSPCR.

24. If the contract is subject to the DSPCR, and the R&D exclusion does not apply, it is possible to place the R&D contract using the non-competitive negotiated procedure set out at Regulation 16.

What commercial strategies can you adopt for national R&D contracts?

25. Procurers that intend to award a R&D contract have a choice between three main strategies depending on the nature of the requirement and the funding model:

- a. award a contract that covers only R&D services by using the R&D exclusion at Regulation 7(1)(l). You will need to compete any follow-on production contract under the DSPCR unless an exclusion applies or you can award it sole source under the non-competitive negotiated procedure; or
- b. award a contract under the non-competitive negotiated procedure in accordance with Regulation 16 that covers either or both:
 - (1) R&D services that are not covered by the exclusion; or
 - (2) R&D supplies (i.e. goods manufactured solely for the purposes of R&D).

You will need to compete any follow-on production contract under the DSPCR unless an exclusion applies or you can award it sole source under the non-competitive negotiated procedure; or

- c. award a contract that combines R&D with pre-production or production phases under the:
 - (1) restricted procedure;
 - (2) competitive negotiated procedure; or
 - (3) competitive dialogue procedure, in the limited circumstances where it is available.

26. You must not adopt any element in your commercial strategy (e.g. not seeking user rights in intellectual property) for the R&D contract with the aim of circumventing the requirements under the DSPCR for competition for the production contract.

Placing exempt R&D contracts

27. Procurers may choose to use the R&D services exclusion for service contracts if:

- a. the benefits (e.g. intellectual property rights) of the R&D service do not exclusively accrue to the procurer;
- b. the R&D services are not wholly paid for by the procurer (e.g. the procurer and the supplier share the costs); or
- c. both a. and b. above apply.

28. In practice, the sharing of R&D costs may not be a practical option. The supplier will need a return on its investment for the R&D funding (e.g. by participating in the production of developed goods) and this will conflict with the requirement of open competition for pre-production and production phases.

29. The procurer can consider fully funding the R&D work under the R&D service exclusion and then procuring the follow on work under the DSPCR. Alternatively, the procurer should consider using competitive procurement following an advertisement in OJEU to award a contract that covers not only the R&D phase but for the subsequent follow-on phases.

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

31. Procurers may, for example, organise a limited competition, conduct negotiations with several potential suppliers, or even decide to award the contract directly with a specific supplier. They may also award research contracts in parallel to competing for providers for specific phases, in order to benefit from alternative approaches.

32. After awarding a R&D contract under the R&D services exclusion, you will probably have to award any follow-on contract(s) for the pre-production and production phases, by applying the normal competitive procedures i.e. the restricted, competitive negotiated or competitive dialogue procedure (where available) unless an exclusion applies or there is justification to use the non-competitive negotiated procedure.

33. We therefore strongly advise procurers to obtain sufficient intellectual property rights to be able to conduct the award procedures on any follow-on contract(s) when awarding the R&D contract.

34. The negotiation away of intellectual property rights by the procurer with the principle aim of being entitled to use the sole source negotiation of the follow-on contract under Regulation 16(a)(ii) is likely to be treated as a breach of the DSPCR, and prohibited, under Article 11 of the Defence and Security Directive.

Placing single source R&D contracts

35. In the non-competitive negotiated procedure, the procurer is free to consult the suppliers of its choice and to negotiate the terms of contract with one or more of these. The general provisions of Regulation 5(2) on the principles of

equal treatment, non-discrimination and transparency, are still applicable in the context of any procurement under the DSPCR. Moreover, procurers using the non-competitive negotiated procedure must publish a contract award notice within 48 days of awarding the contract.

36. If you award a R&D contract under Regulation 16(1)(c) and intend to conclude follow-on contracts for the pre-production phase or production phase, you must apply the normal procurement procedures under the DSPCR for the follow-on contracts. This usually means that you have to award such contracts in open competition across the European Union (EU).

Placing competitive R&D contracts using OJEU

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

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

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

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

- a. the procurer will use an evolutionary, incremental or spiral acquisition strategy that will contain a mix of development and production activities; or
- b. the procurer and the supplier will share the costs of the R&D, as competition for follow-on production would act as a powerful disincentive for suppliers to invest shareholders' funds in R&D.

40. In such a case, the procurer would award the contract using the restricted, competitive negotiated or competitive dialogue procedure (where available), subject to the applicability of any relevant exclusion.

41. The subject of the contract, as described in the contract documents, should comprise all services, supplies and work for all phases covered by the contract. Contract conditions related to later phases might take the form of:

- a. fixed obligations, subject to technical performance;
- b. conditional obligations; or
- c. options.

42. Procurers should be aware of the difficulties of this approach, especially for complex contracts, as changes to the subject matter could arise over the period of the contract and result in uncertainty over pricing, specification and other contract provisions. All this may necessitate substantial amendments to essential provisions of the contract, which may require a new contract award procedure if these amendments are materially different in character from the initial contract provisions.

43. To avoid practical and legal uncertainties and any consequent amendments, procurers must provide as much detail as possible at the outset, for example, by agreeing on a basic scheme or formula for determining prices for services and supplies in later phases.

What are the key issues for procurers?

1. The importance of R&D in the fields of defence and security justifies maximum flexibility in the method of awarding contracts.
2. This flexibility for the award of R&D contracts should not preclude fair competition in the later phases of the life cycle of equipment.
3. Clear identification and delimitation of R&D activities is crucial for choosing the right procurement route, that is:
 - a. under the R&D services exclusion; or
 - b. the non-competitive negotiated procedure.
4. Procurers should consider competing under the DSPCR a combined R&D and production contract if:
 - a. evolutionary, incremental or spiral acquisition strategies are used; or
 - b. the procurer and the supplier will share the costs of the R&D.
5. You must maintain an audit trail of any decision to use the R&D services exclusion in case of a legal challenge.