

C O R

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CORRUPTION RISKS SERIES

Single Sourcing

A multi-country analysis of
non-competitive defence
procurement

O N

R I S K S

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Content

Executive summary	3
Introduction	11
Country analysis	17
United States	18
European Union	28
Bulgaria	31
Latvia	34
Poland	36
Slovakia	38
Slovenia	42
United Kingdom	46
Focus on armament procurement	55
Actions	56

Executive summary

Full and open competition is one tool for governments to help ensure best value for money. Yet previous studies highlight that the defence sector is poor in this respect. This report explores trends in the award of non-competitive or single-source contracts in defence.

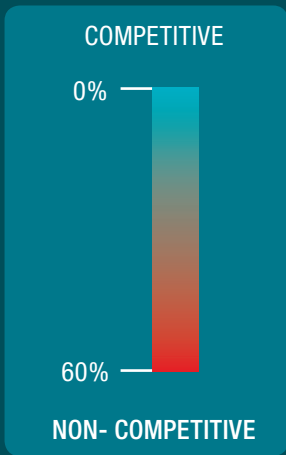
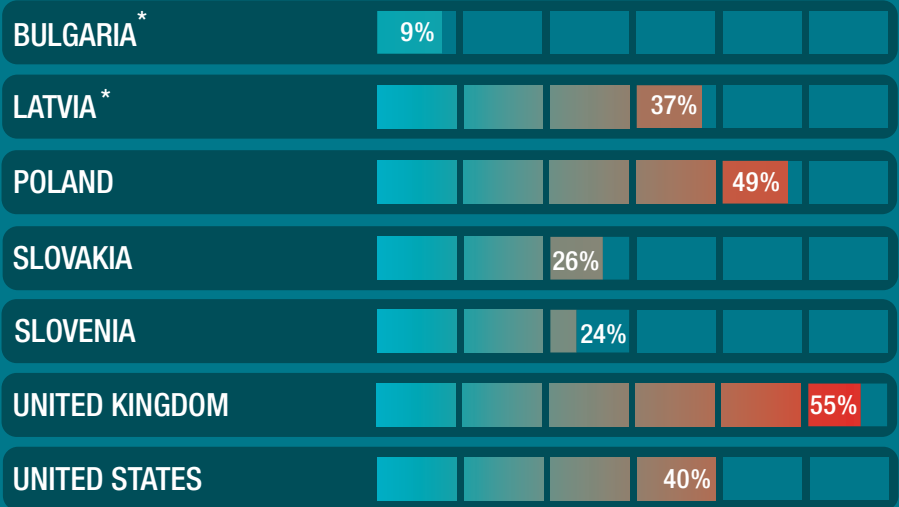


FIGURE 1 | NON-COMPETITIVE DEFENCE CONTRACT AWARD BY VALUE OVER A 3-YEAR PERIOD



* Based on data for 2010 and 2011 only.

Single-source procurement is the non-competitive purchase of goods or services that takes place after negotiating with only one supplier. The award of single-source or non-competitive contracts in the defence sector has garnered an increasing level of critical attention in the last few years. In an era of austerity and public spending cuts, many have turned their attention to how governments can do more with less. Full and open competition is one tool for governments to help ensure best value for money, yet previous studies highlight that the defence sector is poor in this respect.¹

Single-source procurement is also vulnerable to corruption risk, particularly when secrecy requirements mean that the deal is not open to public scrutiny, or even scrutiny by other government organisations.

Transparency International UK's Defence and Security Programme (TI-DSP) has partnered with the International Defense Acquisition Resource Management (IDARM) Program of the U.S. Naval Postgraduate School to explore trends in the award of non-competitive or single-source contracts. We requested data from 45 countries around the world and from the European Defence Agency, and we have examined in some detail both the qualitative and quantitative defence procurement data from those countries that responded.

38 OUT OF 45 COUNTRIES DON'T HAVE—OR DON'T REVEAL—DATA

The first major finding of this study is just how many countries do not collect data on the extent of single-source defence procurement, or are unwilling to release this information to external sources.

Of the 45 countries that we contacted—usually multiple times—only three countries have the data publicly available: Slovakia, the UK and the USA. A further four countries did have the data, though not publicly available, and were willing to release it to us: Bulgaria, Latvia, Poland and Slovenia. We also received qualitative data from the Czech Republic, Saudi Arabia, Serbia and Turkey. Two countries, Colombia and Sweden, stated that the data is available on their respective MoD websites. However, after searching these, the data on non-competitive procurement was seemingly unavailable.

The following 32 countries, in alphabetical order, either declined to release data or failed to respond to our request: Bangladesh, Belarus, Brazil, China, Croatia, Cyprus, Democratic Republic of Congo (DRC), Egypt, France, Germany, Ghana, India, Israel, Jordan, Kazakhstan, Kenya, Kuwait, Malaysia, Nepal, Nigeria, Norway, Oman, Pakistan, Palestine, Peru, Russia, Rwanda, Singapore, Somalia, South Africa, South Korea, and Ukraine.

This finding is disconcerting because single-source defence statistics are an important tool of professional defence procurement management. They are needed to understand exactly where and why competitive procurement may not be possible, and as a significant and well-known risk area. As a matter of practice this data should be made transparent. It clearly is possible to release it—as the three countries where it is already public demonstrate. Perhaps the data is not collected, or maybe it is only bureaucratic convenience and inertia that is preventing its release. That the European Defence Agency (EDA), a body that publicly proclaims its commitment to transparency, refuses to release it is alarming.²

¹ M Pyman, R Wilson & D Scott, 'The Extent Of Single-sourcing In Defence Procurement And Its Relevance As A Corruption Risk: A First Look', *Defence and Peace Economics*, 2009, Vol. 20(3), June, pp. 215-232.

² The EDA were contacted on a number of occasions by TI-DSP. We were informed that data on the levels of non-competitive procurement in member states could not be made public.

PRINCIPAL RESULTS

Whilst we hoped and expected that a greater number of countries would participate in the study, the information received has nonetheless allowed us to examine the extent and nature of single-sourcing in defence procurement. We do expect, though, that this will not be a representative sample of countries, as it seems a reasonable expectation that countries without this data may have higher levels of single-source defence procurement.

The chart on page four depicts the extent to which non-competitive contracts were awarded in the seven countries included in the study in the period 2009-2011.

The larger countries—Poland, UK, USA—have the higher single-source percentages, averaging almost 50 per cent. The principal reasons for this are:

- **Poland:** Partially attributes its high level to the fact that the original producer of their equipment retains the copyrights of technical documentation. Therefore the Ministry may not have a choice but to retain the same supplier for follow-on operations and maintenance contracts.
- **UK:** According to the Currie report, a common reason for the UK Ministry of Defence (MoD) to contract single-source is that it requires a unique capability that only a single contractor can fulfil. Other reasons include award to the original design team or contractor for follow-on work due to copyrights or licensing reasons, and finally to have the ability to conduct combat operations independent of support from other

states or entities.³

- **USA:** Of the countries in this survey, the USA is undoubtedly the most transparent in its justification for single-sourcing or not making available certain contracts for full and open competition. The primary reason given by the US Department of Defense (DoD) is that often, due to the complex nature of the equipment in question, there is only one responsible source. Other reasons include, but are not limited to, the contracting behaviour being required by statute, an international agreement obligating that a contract be not competed, or urgent requirements.

The smaller countries have an average single-sourcing percentage of 25 per cent. The most notable was Bulgaria, which reported a single-source procurement percentage of just under 10 per cent. There has been substantial defence reform in this country, including anti-corruption reforms and a focus on eliminating single-source procurement, and this is the likely explanation for the low percentage. However, it has to be noted that the non-competitive procurement figure is an average of two years rather than the three for the other countries.

Three reasons for single-sourcing can be ascertained from the qualitative data that was provided by Latvia and Slovenia. First, the supply and security of information for defence procurements is a challenge. Therefore new contractors may not provide the same level of assurance to the MoD that they can meet the requirements according to tender requirements and proposed prices during crises. Second, detailed technical specifications

³ Lord Currie of Marylebone, *Review of single-sourcing pricing regulations*, October 2011, accessed December 2013, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/35913/review_single_source_pricing_regs.pdf

and requirements may limit the number of available contractors to just one. Finally, the equipment purchased by these countries must be interoperable with other forces, and this may in turn limit the number of contractors. However, due to the fact that countries, apart from the USA, did not provide detailed justification of why each contract was single-sourced, there is no firm evidence to suggest that these reasons contributed to their respective non-competitive procurement levels.

FOCUS ON ARMAMENT PROCUREMENT

For four of the countries in the study, data on non-competitive procurement is also available by armaments alone. This provides an interesting comparison against the general levels of non-competitive procurement within armed forces. It also allows assessing whether armament spending lends itself more to non-competitive procurement.

All four countries exhibit a significant decrease in their competition levels when buying armaments. The single-sourcing percentage reported by Poland and the USA (the UK did not break out their data for armaments only) rises from 49 per cent to 76 per cent and 40 per cent to 76 per cent respectively. The graph below illustrates this point.

Due to national differences, the exact definition of what would constitute ‘armaments’ vary. For instance, data for USA armament contract award, which is available from the website www.usaspending.gov, is an aggregation of total expenditure by the DoD on weapons; ammunition & explosives; and aircraft structure/components/launch pads. Contrastingly, for Slovakia, where the Open Public Procurement Initiative website was used, the authors considered weapons, ammunition and associated parts; military electronic systems; military aircrafts, missiles and spacecrafts; and military vehicles and associated parts as armaments.

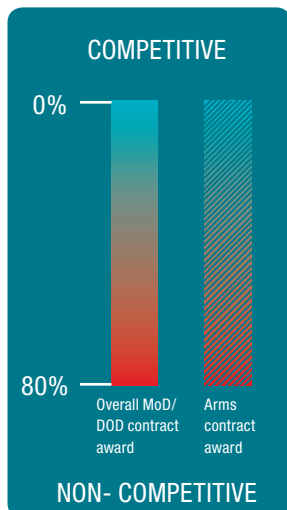
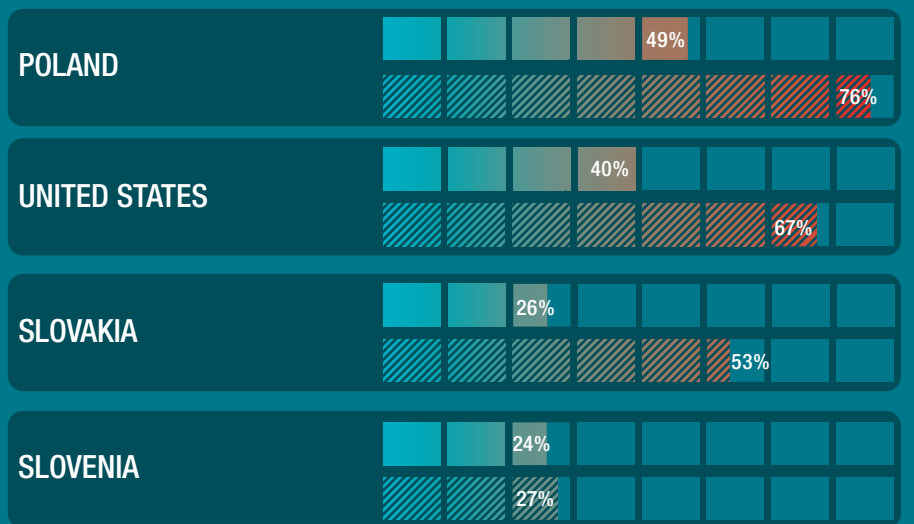


FIGURE 2 | NON-COMPETITIVE CONTRACT AWARD BY VALUE



The definition of what would constitute armaments in Poland and Slovenia is not available since the figures obtained were provided by Ministry of Defence officials in the survey instrument sent out by TI-DSP and IDARM. Nonetheless, when compared to the general difference between other countries, the numbers seem to correlate.

For the USA, the five largest contracts that were not competed under full and open competition were all for aircrafts or fixed wings. Given the unique and highly technological nature of the equipment in question, this does seem reasonable. Of the five contracts, however, one was modified because it was considered 'additional work' to an existing contract, and one was a 'change order', whilst the other three were 'funding only actions'.

COMPARISON WITH THE 2008 STUDY

The results for the 2008 study are reproduced opposite in Figure 3.

These 2009-2011 results and the 2008 results only have the UK, the USA, and Poland in common. Whilst the reason why the US number is substantially higher has been discussed above, the UK single-source percentage has also increased substantially since 2008. This is partly explained by the fact that in 2010/11 competitive contracts only accounted for a quarter of new contracts let by number. However, due to the fact that the UK does not make public the full details of individual single-sourced contracts, it is difficult to ascertain the multitude of reasons why this occurred.

In the case of Poland, there is significant change in the overall single-source percentage, down from 61 to 49 per cent. There has been a substantial defence procurement reform in Poland since 2008, including a greater focus on competition and e-procurement, and this may be the explanation.

The trend for lower single-source percentages from the smaller countries is similar—Ireland and Portugal both had single-source percentages of around 20 per

cent in the 2008 study, similar to Slovakia and Slovenia in this study.

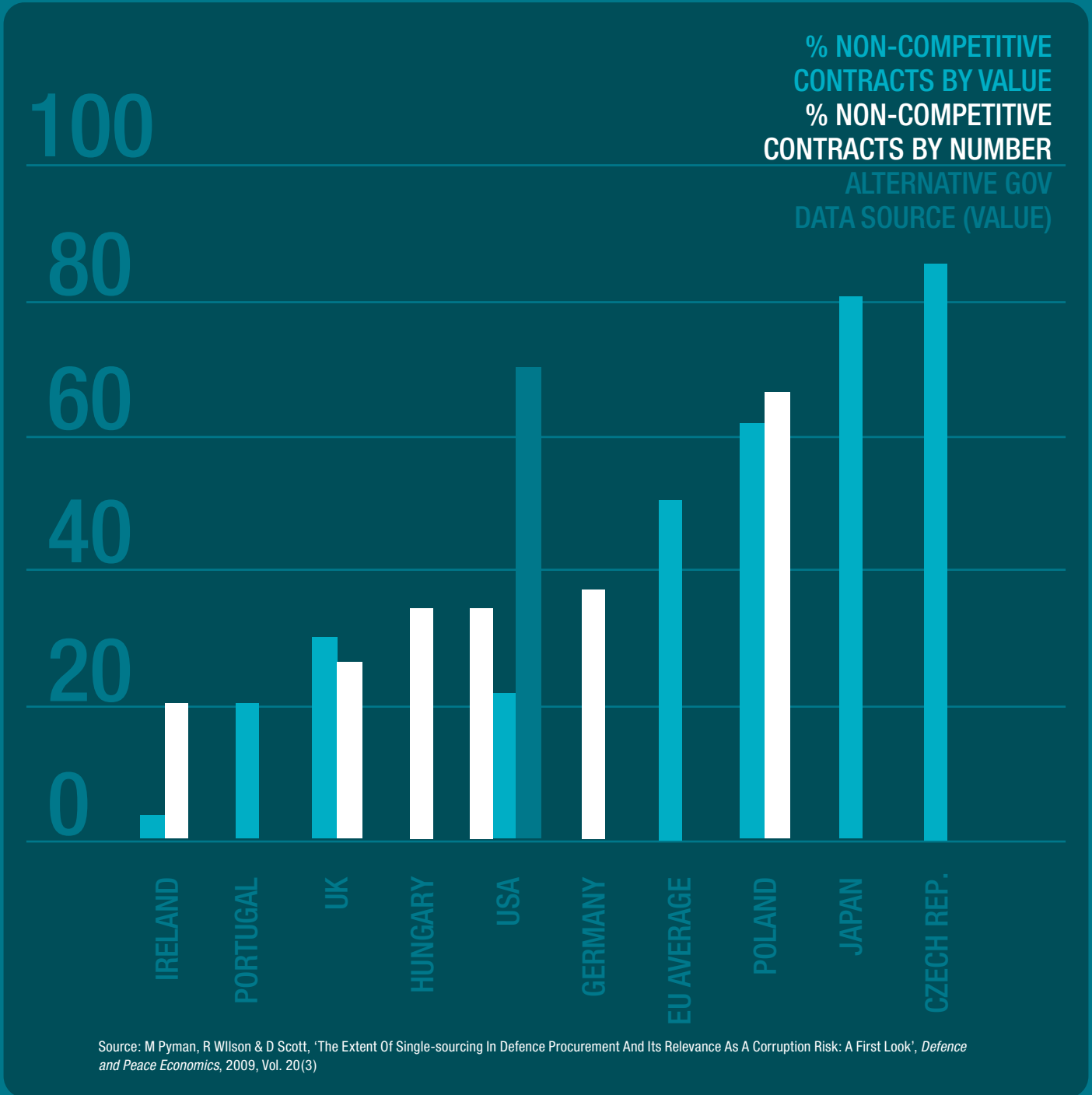
PUBLIC REPORTING AND QUALITY OF PUBLISHED DATA

The fact that three sizeable countries with large defence acquisition budgets—Poland, USA and UK—are able to publish fairly detailed procurement data, and detailed single-source information within that, is evidence that secrecy and classification rules should not be a barrier to good public reporting. In the case of both the USA and particularly the UK, the fact that they are actively examining the single-source data is strong evidence that scrutiny of single-source data is an important part of professional acquisition management.

Some of the sources of published data were easier to navigate than others. The two primary portals for US defence data, the Federal Procurement Data System and the more user-friendly www.usaspending.gov, offer information according to countless variables such as level of competition, contracting agency, and supplier. The UK is increasing its transparency in this regard and has also initiated a review in the recent past as to the extent of single-sourcing within the MoD and how the procurement process could be improved. The Slovakian Open Public Procurement Initiative is quite user-friendly, though it is limited by the number of ways that data on procurement can be displayed. The process by which countries refrain from utilising competition in defence procurement should be made transparent, and the percentage that is non-competitive should be publicly available.

On the negative side, the lack of data—or perhaps more appropriately the lack of willingness to publish it—is disconcerting. This is true not only for the 34 countries that declined to provide data but also for the European Defence Agency (EDA). Despite statements about their commitment to transparency and acknowledgement that they do have the data, the organisation does not publish the figures and declined to release it.

FIGURE 3 | SINGLE-SOURCE CONTRACTS BY VALUE AND NUMBER (2008)



ACTIONS

DEFENCE MINISTERS, MINISTRY HEADS AND DEFENCE PROCUREMENT CHIEFS

1. Keep up-to-date and consolidated records of the level of single-source or non-competitive contracts awarded. Routinely analyse the trends in this data.
2. Publish records of the level of single-source or non-competitive contracts awarded on your MoD website every year. Make public your justifications for using single-source contracts. This will help alleviate public concerns that contracting authorities are engaging in improper behaviour behind a veil of secrecy.
3. Make your procurement processes more transparent and open to public scrutiny. Include this in your policy and practice of single-source procurement.
4. Member States should grant organisations such as the European Defence Agency (EDA) permission to publish their competitive procurement levels.
5. Introduce clearly defined measures to reduce the risk of corruption in single-source procurement. These include multiple levels of oversight and approval, personal asset declarations, rotation of staff in key positions, rigorous internal and external audits focused on influence, benchmarking, and open-book pricing.

FOR THE EUROPEAN DEFENCE AGENCY

1. The European Defence Agency should embrace their commitment to transparency and press countries to be more transparent on their procurement data.

FOR NATIONAL LEGISLATORS AND LEGISLATIVE DEFENCE COMMITTEES

1. Demand more open reporting of procurement data and single-source information from the MoD. Consider the Polish, UK and US examples as models that your MoD could use.
2. Regularly request data on single-source percentages from the MoD and ask for explanation of the trends.

FOR CIVIL SOCIETY

1. Demand defence procurement information from the MoD. Propose an active role for civil society in monitoring and overseeing defence policies and practices in this area.

1. Introduction

For the purposes of this study, single-source procurement is defined as non-competitive purchase or procurement in support of military and defence institutions that takes place after soliciting or negotiating with only one supplier. It is a topic which until recently has not been thoroughly explored by procurement practitioners, academics and civil society.

Competition has been cited by many as the tool for governments to drive cost savings, improve quality of the product or service, and help ensure best value for money. The uptake of competition within defence procurement has been rather slow in many countries. Despite new legislation—particularly in Europe—encouraging greater competition in defence markets, many countries still exhibit a high rate of single-sourcing.

Due to the particular nature of the defence sector, contracts are often not available for open competition. Whilst there are some justifiable reasons why countries may choose to not open certain contracts for competition—such as national security considerations, the availability of only one supplier, or even due to the need to respond urgently to facts on the ground—the lack of transparency around the process exposes it to a high degree of corruption risk.

There are situations in which the procuring authority must determine whether or not competition is a reasonable strategy. Whilst there are many benefits to competition, there are also some disadvantages. In certain circumstances goods or services may need to be procured urgently to ensure success of the mission. Whilst this may at first glance seem like a reasonable justification, this reasoning has been questioned by many practitioners.

Most recently, a government watchdog argued that such arguments may have been used to conceal a lack of planning for requirements that have been known for years on the part of the defence agencies.⁵

Other justifications that are often cited include existence of only one legitimate supplier, the highly technical nature of certain products and awarding follow-on contracts to the original equipment manufacturer. Running a competition requires an increase in both time and funding, and places a greater burden on the programme management office with regards to additional planning, monitoring, and quality assurance efforts.⁶

Yet single-sourcing defence contracts can lead to greater risk of corruption. From the buyer's perspective, the contracting officer has greater decision making authority and power over which companies ultimately will be awarded contracts. The loss of oversight which competition affords means that individual preference can easily play a significant role in the decision making process. Given such a circumstance, it is somewhat easier to envisage persons who substantially participate in the procurement processes looking for opportunities of personal enrichment.

From the perspective of the company looking to sell their product or service, the opportunity to win contracts without going through the bidding process is obviously desirable. To reach such a favourable outcome, the benefit of bribing officials to win contracts suddenly increases. This can also lead to contracting or personnel requirements and the company forming a longer-term corrupt relationship, which could lead to inefficiency for the government and potential fines for the company.

⁵ The Center for Public Integrity, 'Windfalls of war: Pentagon's no-bid contracts triple in 10 years of war', 29 August 2011, accessed December 2013, <http://www.publicintegrity.org/2011/08/29/5989/windfalls-war-pentagons-no-bid-contracts-triple-10-years-war>.

⁶ M Arena & J Birkler, 'Determining When Competition is a Reasonable Strategy for the Production Phase of Defense Acquisition', *Occasional Papers*, RAND Corporation, 2009, accessed December 2013, http://www.rand.org/pubs/occasional_papers/OP263.html.

THE STUDY

As most countries do not make data on single-source procurement publicly available, one of the reasons for undertaking this research was to analyse this information for defence ministries in various countries.

TI-DSP's Government Defence Anti-Corruption Index 2013 (GI), released in January 2013, found that only seven of the 82 ministries of defence it surveyed around the world exhibited strong mechanisms to address corruption risk associated to single-sourcing. On the other hand, 58 countries—over 70 per cent of the countries surveyed—scored poorly as they exhibited 'None' to 'Moderate' transparency on the issue, and demonstrated 'weak' or 'no' activity to address the corruption risk associated with single-sourcing.

To gather data on the level of non-competitive defence procurements, a survey instrument was designed to capture both quantitative and qualitative data related to the subject matter. The survey was divided into three parts: information regarding the person completing the instrument, background information on the country's procurement environment, and breakout of the value and actions of defence procurements between 2009 and 2011. The survey instrument is referenced in **Annex A**.

The survey instrument was initially sent to 29 countries in April 2012. A further 16 countries were contacted the following month with a request to fill in the survey form. By May 2012, a total of 45 countries were sent the survey instrument. Both TI-DSP and the IDARM Program sent follow-up letters and emails to those who did not respond in the first instance.

This study examines quantitative defence procurement data for seven countries: United States, United Kingdom, Slovakia, Bulgaria, Latvia, Poland, and Slovenia.

In addition to the aforementioned countries, Czech Republic, Saudi Arabia, Serbia and Turkey provided qualitative data. Annex B references the 45 countries that received the survey instrument.

For the countries that disclosed their procurement patterns, the quality of information as well as the ease of navigating the respective databases varied significantly. The two primary portals for US defence data, the Federal Procurement Data System and the www.usaspending.gov, offer data according to countless variables such as level of competition, contracting agency, and supplier. The UK is increasing its transparency in this regard and has recently also initiated a review as of the extent of single-sourcing within the MoD and how the procurement process could be improved. The Slovakian Open Public Procurement Initiative is quite user-friendly, though it is limited by the number of ways that data on procurement can be displayed. The process by which countries refrain from utilising competition in defence procurement should be made transparent, and the percentage that is non-competitive should be publicly available.

As a reference point, a previous study by Pyman, Wilson and Scott highlighted the levels of single-source procurement in nine Ministries of Defence around the world. This serves as an interesting comparator to this study. A graphical representation of their findings is shown opposite.

WHY A RENEWED EMPHASIS ON LEVEL OF SINGLE-SOURCING?

There are many reasons why ministries of defence must ensure that there is less reliance on single-source contracts to meet their needs. Situations in which suppliers know they are the sole provider may mean they are not incentivised to be efficient and provide best value for money. If proper measures to determine reasonable costs are not in place, suppliers can submit a

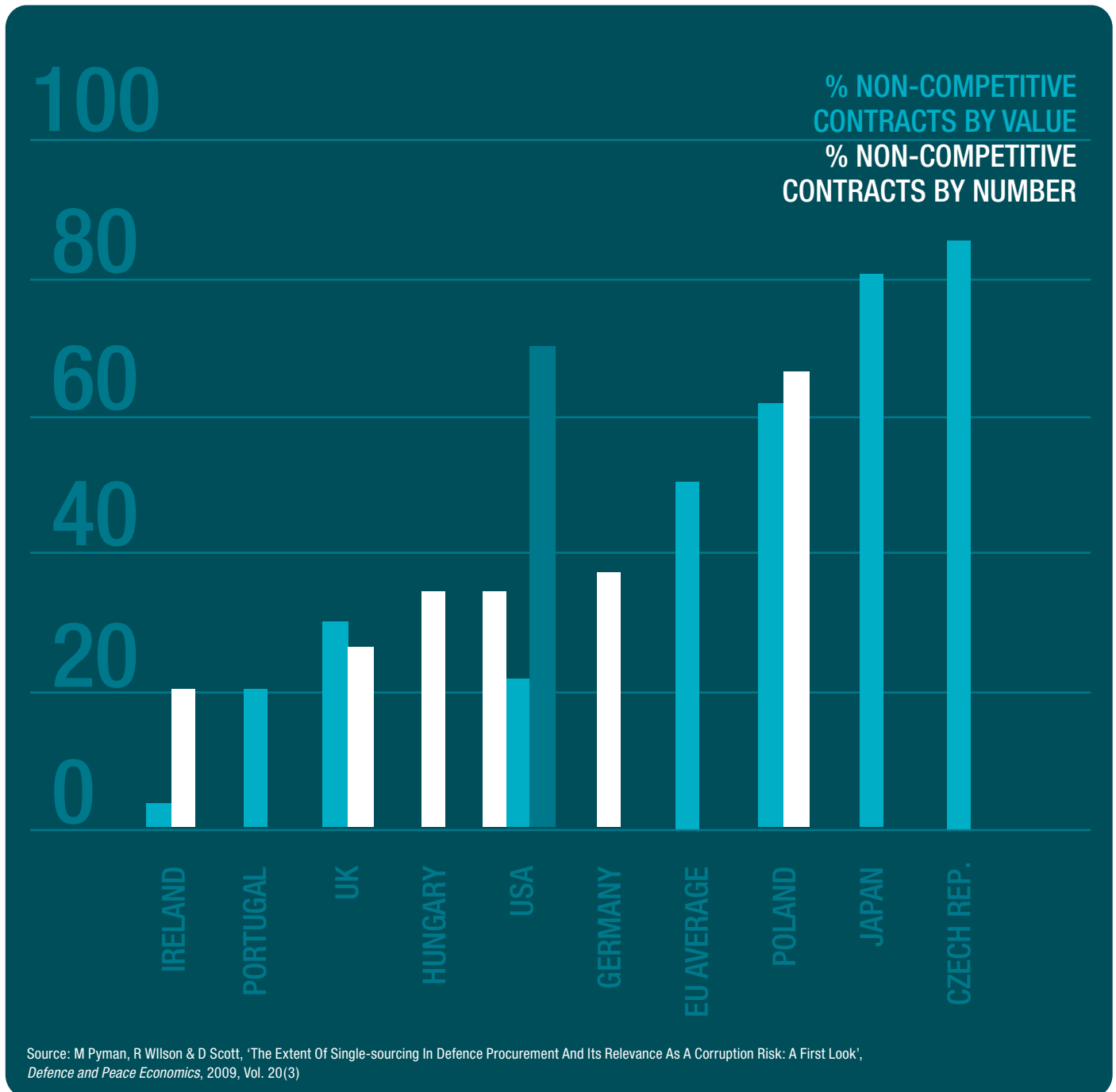
price without worrying about competitive market forces. Responsibility is thus on the MoD to act as an 'intelligent customer'. The risk, however, is that if contracts are being single-sourced and contracting officials granted exceeding responsibility and authority to choose a contractor, their decision making could be led by a desire for personal enrichment rather than any benefit being accrued to the ministry of defence.

In some instances the chance of an original equipment manufacturer being awarded follow-on work for the operations and support phase of a programme is quite high

regardless of past performance. Sufficient levels of oversight must be in place at the initial award through contract management and closeout.

Important characteristics to gauge trends in the award of single-source contracts include regulation governing competition in defence procurement, justification or the reason for excluding contracts from competition, and opportunities to overcome barriers limiting competition.

FIGURE 4 | SINGLE-SOURCE CONTRACTS BY VALUE AND NUMBER (2008)



Source: M Pyman, R Wilson & D Scott, 'The Extent Of Single-sourcing In Defence Procurement And Its Relevance As A Corruption Risk: A First Look', *Defence and Peace Economics*, 2009, Vol. 20(3)

BARRIERS TO OPEN COMPETITION

In the survey, procurement officials were encouraged to offer their opinions on what barriers to competition currently exist, how one might overcome these barriers, and how one might influence trends towards a more competitive contracting process. A number of countries shared similar experiences:

Protection of the national defence industry

In response to the survey sent to MoDs, many of the European countries cited the protection of the national defence sector as one of the greatest impediments to increased competition. Article 346 (1)(b) of the Treaty on the Functioning of the European Union (TFEU) provides a legal basis for EU countries to assume measures they 'consider necessary for the protection of the essential interests of its security'.⁷ Pertinently, the definition of what constitutes protection of essential interests lies with the Member States. However, according to case law in Europe, this does not give countries the authority to abandon the provisions of the Treaty by simply referring to national interests. The European Court of Justice has stated that derogation under Article 346 is confined to exceptional and clearly defined cases, and that 'the measures taken must not go beyond the limits of such cases'.⁸

Recognising that such derogation of EU law could lead to abuse by Member States, Article 346 (1) (b) states that this exception cannot be used to adversely affect competition for products not specifically related to military uses. In its document on

EU law and defence procurement the European Commission acknowledges that derogation under Article 346 is 'a serious political and legal issue'.⁹

It further goes on to state that the Treaty attempts to balance national interests with the wider desire to see greater competition within the EU. In that respect, derogation is limited to defined cases, and in the view of the European Commission is 'interpreted in a restrictive way'.¹⁰

EU countries are expected to assess each proposed requirement to determine whether it does fall within the scope of Article 346. The three major aspects that national procurement officials must assess are: 1) What is the national security interest that would allow the application of Article 346? 2) Is there a direct connection between the contract in question and the security interest that threatens to be impinged? 3) Why would EU rules undermine the country's essential security interests? It is pertinent to note that the Treaty does not cover arms trade with non-EU countries which is primarily governed by World Trade Organisation rules and the Government Procurement Agreement.

It has been suggested that one of the ways to limit the abuse of Article 346 is for Member States to be required to define what they consider to be 'essential security interests' and publish the same in a publicly accessible medium. Whilst countries will no doubt differ in their interpretation of essential security interests, this can nevertheless serve as a first step to a consolidated and transparent approach.

⁷ European Commission, 'EU law and defence procurement', December 2010, accessed December 2013, http://ec.europa.eu/internal_market/publicprocurement/docs/defence/more_on_defence_procurement_en.pdf

⁸ See judgment in Case C-414/97 Commission v Spain, paragraph 22 (<http://curia.europa.eu/juris/liste.jsf?language=en&jur=C,T,F&num=c-414/97&td=ALL>),

and judgments of 15 December 2009, for instance Case C-239/06, paragraph 68 (<http://curia.europa.eu/juris/liste.jsf?language=en&num=c-239/06>).

⁹ European Commission, op.cit.

¹⁰ European Commission, op.cit.

Restrictive requirements

The relevant agency is responsible for issuing the request for tender. If such requirements are too narrowly defined this can result in a lower number of qualified bidders and therefore inhibited competition.

For example, since the end of the Cold War, Russian defence companies have been supplying the UN and other international agencies with low-cost surplus aircraft, including Antonov transport planes and Mi-8 and Mi-26 helicopters. One of the U.N. requirements states a seating capacity for more than 20 passengers in certain aircrafts, which excludes most competitors. Many Western manufacturers have been unsuccessful in winning these tenders, given that these contracts must be awarded to the company which meets minimum requirements and has the lowest price.¹¹

Classification of information

Due to the nature of the defence sector, some of the information is inherently sensitive and thus lends itself to classification. Yet, some countries may be tempted to abuse this provision and overly classify non-sensitive defence related information in its entirety. According to EU regulation, information can be classified if it is 'in the interests of national security and in accordance with the laws, regulations or administrative provisions in force in the Member State concerned'.¹²

EU regulation also covers the classification of what are known as 'mixed contracts'. These are types of contracts in which certain goods or services may fall under the EU Directive on Defence Contracting, whilst others may not. Depending on the combination of items or services in the requirement, the contracting agency may be able to justify classifying the entire contract. To prevent contracting agencies from using this provision, EU guidance does stipulate that 'contracting authorities relying on this provision have to demonstrate that the various components of the mixed contract are objectively linked in a way that makes it necessary to award a single contract to a single partner'.¹³

According to one of the respondents of the survey, another way to prevent over-classification of information would be to adopt and apply the same international information classification rules and agree on mutual recognition of documents.

Limited license rights

In certain countries, when a contracting authority purchases non-readily available goods from a contractor, the Ministry of Defence signs a license agreement with the contractor. Usually a license agreement would stipulate that the government could only use, modify, reproduce, release or disclose data within the government.

¹¹ C Lynch, 'The Inside Story of Russia's Fight to Keep the U.N. Corrupt', *Foreign Policy*, 25 June 2013, accessed December 2013, http://www.foreignpolicy.com/articles/2013/06/25/the_inside_story_of_russias_fight_to_keep_the_un_corrupt

¹² European Commission, op.cit.

¹³ Judgment of 6 May 2010 in Joined Cases C-145/08 (<http://curia.europa.eu/juris/liste.jsf?language=en&num=C-145/08>) and C-149/08 (<http://curia.europa.eu/juris/liste.jsf?language=en&num=C-145/08>) Club Hotel Loutraki AE, paragraphs 45 to 64.

Further, the government would be prohibited from manufacturing additional quantities of the product.

Such stringent license agreements mean that in the eventuality that the government wishes to find a supplier for maintenance or repair, only one contractor may fulfil that requirement. The existence of limited rights in data, patent rights, copyrights, or secret processes, and the control of basic raw material amongst others, allow suppliers to retain the unique advantage in the market and can necessitate the government entering into an agreement with the same contractor.

It could be argued that such cases are the result of the company's innovation and investing significant money into research and development to come up with a product which is unique in the market. Further, with patents safeguarding the company's products, the options available to contracting agencies are limited.

Interoperability of equipment is particularly important for international organisations such as NATO. As the organisation is made up of many States that have their own requirements and would therefore purchase specific types of guns, armour, vehicles and so forth. However, during joint operations the equipment used needs to be operated by soldiers from different countries and therefore has to adhere to certain base requirements. A major drawback is that this may inhibit increased competition as the contracting agency may be under obligation to ensure the purchased equipment adheres to certain base requirements.

Unification of standards & interoperability of equipment

There are very few international standards that define the process of acquiring equipment between different countries. NATO's STANAG (Standardisation Agreement) is one of the few that attempts to define conditions for military and technical procedures between Member States. The main benefit of having such an agreement is that it provides for common operational logistics. This translates to one nation's military being capable of using the equipment of others. Moreover, STANAG attempts to form the basis for technical interoperability between systems and is deemed essential for NATO operations.

Country & regional analysis

- **United States**
- **European Union**
- **Bulgaria**
- **Latvia**
- **Poland**
- **Slovakia**
- **Slovenia**
- **United Kingdom**

United States

BACKGROUND TO COMPETITIVE DEFENCE PROCUREMENT IN THE UNITED STATES

In 1984 Congress passed the Competition in Contracting Act (CICA), which requires agencies to “obtain full and open competition through the use of competitive procedures” in all procurement activities unless otherwise authorised by a particular statute. CICA was enacted to foster competition with the goal of reducing economic burden on the government. CICA describes three levels of competition: (1) Full and open competition; (2) Full and open competition after exclusion of sources; and (3) Other than full and open competition. Whilst CICA remains the foundation for competition requirements, it has been supplemented by additional laws.

To further improve levels of competition, the ‘Better Buying Power Initiative’ aimed to promote effective competition and reduce waste in defense spending.¹⁴ This initiative was the result of a 2010 Memorandum for Acquisition Professionals, authored by Dr. Ashton B. Carter—then Undersecretary Secretary of Defense for Acquisition, Technology, and Logistics (AT&L)—who put forward the argument that real competition remained the single most powerful tool to drive productivity in defense spending. Specific initiatives include targeting affordability, incentivising productivity, promoting competition, improving tradecraft, and reducing bureaucracy.¹⁵

Later that year the Implementation Directive instructed “military departments and defense agencies to increase their overall competition and effective competition rates by two and ten per cent, respectively”.¹⁶

In two subsequent memorandums the Defence Procurement Acquisition Policy section of the Office of the Secretary of Defense (OSD) amplified guidance to promote effective competition in the Department of Defense (DoD). This was primarily done by further strengthening guidance on procurement procedures by re-soliciting tenders which were open for less than 30 days and where only one offer was received.¹⁷

EXCEPTIONS TO OTHER THAN FULL AND OPEN COMPETITION

Whilst contracts entered into without full and open competition—or with full and open competition but after exclusion of sources—are considered non-competitive, such contracts can nonetheless be in compliance with CICA when legally acceptable circumstances permit.¹⁸

Under CICA “full and open competition” results when “all responsible sources are permitted to submit sealed bids or competitive proposals.” “Full and Open Competition after Exclusion of Sources” occurs when agencies enact “dual sourcing” initiatives and set-asides for small businesses.” CICA recognises seven exceptions permitting other than full and open competition.¹⁹ These address situations in which competition is not possible, or where the government assesses other objectives to be more highly valued than full and open competition. The Federal Acquisition Regulation—the principal set of rules which govern the federal acquisition system—provides further guidance on the seven circumstances under which contracts may be awarded without full and open competition:

¹⁴ Memorandum for Acquisition Professionals, 14 Sept 2010

¹⁵ US Department of Defense, ‘Better Buying Power’, accessed December 2013, <https://acc.dau.mil/bbp>.

¹⁶ DoD Competition Report, p.9, FY11

¹⁷ DoD Competition Report, FY11

¹⁸ CRS Report- Competition in Federal Contracting: An Overview of Legal Requirements, Summary.

¹⁹ 10 U.S.C. § 2304(c) & 41 U.S.C. § 253(c).

1. One responsible source and no other supplies or services will satisfy agency requirements:

This exception covers two aspects. The first is when the contracting agency can only find a limited number of responsible sources to fulfil its requirements. The second would be instances when no other supplies or services will satisfy the agency's requirements. This can include unsolicited proposals that demonstrate or provide a unique capability that the government does not currently possess.

For the DoD, services may be deemed to be available only from the original source in the case of follow-on contracts for the continued provision of highly specialised services when it is likely that award to any other source would result in substantial duplication of cost to the government that is not expected to be recovered through competition; or unacceptable delays in fulfilling the agency's requirements. (FAR Part 6.302-1)

In most cases the agency is required to advertise the requirement. Guidance regarding publicising and response time are outlined in FAR Part 5.203.

2. Unusual and compelling urgency:

Need for a supply or service is of such urgency that the government would be caused serious injury, financial or other, by not limiting the number of sources from which it solicits. The period of performance may not exceed the time required to execute the requirement (initially limited to one year) and award a competitive contract for the required products and services (FAR Part 6.302-2)

3. Industrial mobilisation:

Maintain capability to provide supplies or services to achieve industrial mobilisation and respond to a national emergency. (FAR Part 6.302-3)

4. International agreements:

Agreements or treaties between the United States and foreign governments or international organisations. Also extends to foreign governments reimbursing the Agency for the contract. (FAR Part 6.302-4)

5. Authorised or required by statute:

Legal statute explicitly requires procurement be made through a specific agency or source. (FAR Part 6.302-5)

6. National security:

Disclosure of requirements would compromise or undermine national security. This exception cannot be used for classified acquisitions or because access to classified material is required to perform the work. (FAR Part 6.302-6)

7. Public interest:

Deemed that a non-competitive contract would be in the public interest. (FAR Part 6.302-7)

Awarding a contract citing one of these exceptions requires the contracting officer to “solicit offers from as many potential sources as is practicable,”²⁰ justify the action in writing, certify the accuracy and completeness of the justification, and obtain approval as required.²¹ The written justification requesting approval must include the following:

- description of the procuring agency’s required supply or service,
 - identification of the statutory authority permitting other than full and open competition,
 - demonstration that the proposed contractor’s unique qualification requires use of the authority cited,
 - description of efforts made to ensure offers are solicited from as many potential sources as is practicable (including whether the notice was or will be publicised as required),
 - determination by the contracting officer that the anticipated cost to the government will be fair and reasonable,
 - description of the market research conducted and the results,
 - any other facts supporting the use of other than full and open competition,
 - a listing of the companies that have expressed interest (in writing) in the acquisition,
 - a statement identifying actions to be taken in the future to remove barriers to unrestricted competition, and
- contracting officer certification that the justification is accurate and complete to the best of the contracting officer’s knowledge and belief.²²

Another procurement method which allows other than full and open competition is the Simplified Acquisition Procedure (SAP). This process gives the contracting officer the discretionary authority to limit the number of bidders, even to a single source. SAP aims to improve opportunities for small, small disadvantaged, women-owned, veteran-owned, Historically Underutilised Business Zones (HUBZones) and service-disabled veteran-owned small businesses. Simplified acquisition procedures have the benefits of reducing administrative costs and avoiding unnecessary burden on the agency. These procedures are applicable for relatively smaller contracts generally not exceeding USD 150,000, although the threshold may vary in situations such as procurement of commercial off-the-shelf products, or procurements in support of contingency operations.²³

In further efforts to enhance competition, the head of each executive agency is required to appoint a competition advocate for each procuring activity of the agency.²⁴ These advocates are responsible for promoting full and open competition and, when possible, the acquisition of commercial off-the-shelf items. Competition advocates are obliged to report annually on the competitive and non-competitive contracting operations of the agency and identify opportunities where the agency would be better served from further increasing competition levels.

20 FAR Part 6.301 (d)

21 FAR Part 6.303-1

22 FAR Part 6.303-2

23 FAR Part 13

24 Section 20 of the Office of Federal Procurement Policy Act

They are further mandated to outline barriers to competition, new initiatives that require increased competition and recommend ways in which the agency can improve competition levels. The latter can include recommendations to introduce award and recognition procedures to motivate programme managers and contracting officers to promote competition.²⁵

The legal framework governing contracting in the United States as explained above requires agencies to justify and obtain approval before limiting competition in contracting. Such provisions are designed to ensure that agencies receive fair value for money when prices are not driven by market competition.

SOURCE OF DATA

In accordance with the Federal Funding Accountability and Transparency Act of 2006, the government is required to maintain a single publicly accessible website detailing federal spending awards. The Federal Procurement Data System – Next Generation (FPDS–NG) serves as the primary source for government contract data. It includes, *inter alia*, agency data on non-competitive procurement actions within each fiscal year. The US fiscal year begins on 1 October of the previous calendar year and ends on 30 September of the following calendar year.²⁶

FPDS–NG, managed by the US General Services Administration, is the central repository for information on federal contract actions (contracts awarded) over USD 3,000.²⁷ FPDS–NG provides this data to the more easily navigable website, www.usaspending.gov, which is designed to enhance transparency and provide information about how tax dollars are spent.

The FPDS–NG database provides the option to initiate a competition report. This study utilised this feature to gather data on federal procurements. Examples of the type of data that can be reported to the FPDS–NG database includes: appropriated funds transferred from one executive agency to another, supplies and equipment, contract actions made with funds held in trust accounts for foreign governments, and procurement for foreign governments regardless of the nature of the funds.²⁸

This denotes that contract actions under Foreign Military Sales are included in the overall DoD section, as the Defense Security Cooperation Agency (DSCA) acts as the contracting agent.²⁹

The Government Accountability Office (GAO) reported that the DoD does not have a clear policy on reporting sensitive data to the system.³⁰ One of the limitations to data in FPDS–NG is that several agencies, notably the National Geospatial-Intelligence Agency, Defense Intelligence Agency, and the National Security Agency are exempt from reporting data.

25 FAR 6.502

26 Example: The year ending on 30 September 2011 is referred to as fiscal year 2011.

27 FPDS, 'What is FPDS-NG?', accessed December 2013, https://www.fpds.gov/wiki/index2.php/FPDS-NG_FAQ.

28 FPDS, *op cit*.

29 <http://www.dsca.mil/pressreleases/faq.htm>; <http://www.disam.dsca.mil/pubs/DR/15%20Chapter.pdf>; <http://www.dsca.mil/PressReleases/fmsadvantagev2.pdf>

30 *Ibid*, p.11

31 US Government Accountability Office, 'Defense contracting', Report to Congressional Committee, January 2012, accessed December 2013, <http://www.gao.gov/assets/590/587681.pdf>.

The pie charts opposite provide information on the level of competition in contracts awarded by the Department of Defense (DoD). It provides a comprehensive look at the trends driving more than 40 per cent of federal contract awards by both actions and value. Within this chapter we further investigate trends in non-competitive contracts. It is important to note only prime contractor award data was used for the purposes of this report.

DEPARTMENT OF DEFENSE (DOD) CONTRACT SPENDING, FISCAL YEARS 2009-2011

DoD contract spending accounts for nearly 70 per cent of all federal contract spending in the United States. Interestingly, whilst the value of contracts awarded has exceeded USD 360 billion in each of the past three fiscal years, the competition rate has remained fairly stable, fluctuating two percentage points over the last three years. In Fiscal Year (FY) 2009, 60 per cent of DoD contracts were procured competitively; the figure rose to 61 per cent in FY10 and hit a low of 59 per cent in FY11.³² The decreased competition rate in FY11 was likely caused by high-dollar contract awards and modifications for non-competed actions of major systems like the LPD-26 and DDG 1000 ships; the Virginia Class submarine; and the F-22, C-17, C-5, JSF aircraft programmes. Competitively awarded contracts for Littoral Combat Ships and the DDG 114-116 Arleigh Burke Class Destroyers are examples of major system contracts that have experienced increased competition levels in the DoD.³³

Within the Department of Defense agencies, the level of competition varies depending on the type equipment or service being procured. According to the 2010 DoD Competition Report, contracting

organisations that do not require specialist capabilities to execute the requirements will generally witness higher levels of competition than those whose primary function is to buy, service, or maintain major specialised systems.³⁵

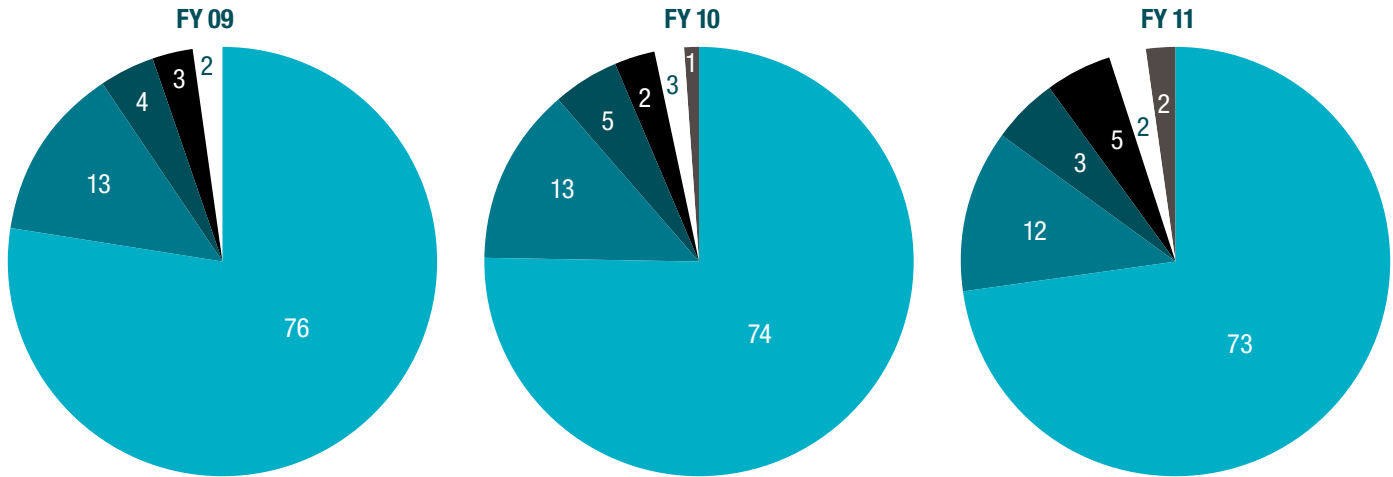
Whilst some organisations are able to openly compete for contracts upon their expiry, others must award the contract to the original supplier if they are the only source that has the technical capabilities to maintain or upgrade a particular product or service. With that in mind, it is perhaps unsurprising that the top five contractors on average have been awarded 20 per cent of total DoD contracts in terms of value. For the past three fiscal years this group has consisted of Lockheed Martin Corporation, The Boeing Company, Northrop Grumman Corporation, General Dynamics Corporation, and the Raytheon Company. The primary reason for this is the cost of license rights in technical data. When purchasing non-readily available commercial items, the DoD signs a license agreement with the contractor which allows it to use, modify, reproduce, release or disclose data only within the government. The data however cannot be used to manufacture additional quantities of the item, and except for emergency repair works, may not be disclosed to third-parties without the contractor's written permission.³⁶ The existence of limited rights in data, patent rights, copyrights, or secret processes, and the control of basic raw material amongst others allow suppliers to retain the unique advantage in the market and can necessitate the government entering into an agreement with the same contractor.

32 Analysis of FPDS-NG Data

33 DoD Competition Report, FY11

35 2010 DoD Competition Report, pp3-4.

FIGURE 5 | US DEPARTMENT OF DEFENSE (DOD) EXCEPTIONS OTHER THAN FULL & OPEN COMPETITION (IN PERCENTAGES)



The components

To further identify these trends, this report individually analyses the largest contracting agencies (Department of the Navy, Department of the Army, and Department of the Air Force), while the remainder are incorporated in the “Other DoD” component. The Army accounts for the largest portion of DOD contract award, followed by the Navy, the Other DoD components, and lastly the Air Force. It is important to bear in mind that the omission of classified procurement data, frequently Research and Development (R&D), may misconstrue contract spending data.

The three pie charts above demonstrate the exceptions most often used by the DoD. As can be seen, ‘only one responsible source’ was the most common, followed by the ‘authorised or required by statute’. As expected, there is a direct correlation between unique technical requirements (a barrier to competition) and the most often used justification limiting full and open competition.

Frequently the original supplier owns the patents and possesses the technical expertise to provide compatible spare parts.

The DoD Competition Reports from this period highlight certain barriers that inhibit the Department’s ability to offer contracts on a competitive basis. Whilst the below list is not exhaustive, it does offer some explanations for the data.³⁷

- aging weapon systems and non-competitive follow-on buys
- unique/critical mission or technical requirements
- proprietary rights on items developed at private expense
- lack of good technical data packages
- High-Dollar Foreign Military Sales (FMS) procurements
- classified requirements

36 For more information please see DFARS 227.7102-2. Available at: http://www.acq.osd.mil/dpap/dars/dfars/html/current/227_71.htm#227.7102-2.

37 DoD Competition Reports, FY09-FY11

Recipients of non-competitive contracts

In FY09 and FY10, non-competitive contracts accounted for approximately 65 per cent of total contract value awarded to the top five defence companies.³⁸ However, in FY11 the corresponding figure jumped to 73 per cent owing primarily to the fact that 93 per cent of United Technologies Corporation's DoD contract revenue was from non-competitive contracts. On average though, the revenue percentage of non-competitively awarded contracts remained fairly stable over the three year period.

Top non-competitive products and services

In the three years examined in the report the top two products purchased by the DoD through non-competitive contract award were aircraft-fixed wings and aircraft rotary wings. These two products accounted for approximately USD 69 billion over the three year period. Other notable products included guided missiles which constantly ranked in the top five and accounted for USD 12.5 billion of federal spending on non-competitive procurement. Other products and services receiving a high dollar value include wheeled trucks and truck tractors, combat assault and tactical vehicles, gas turbines and jet engines, submarines, and destroyers.

DEPARTMENT OF THE ARMY CONTRACT SPENDING, FISCAL YEARS 2009-2011

In terms of both actions and total funds obligated, the Army is the largest contracting agency within the DoD. Between FY09 and FY11 the Army awarded approximately USD 148 billion in contracts without providing for full and open competition. This value accounts for 37 per cent of Army contract award value. This translates to 29 per cent of contract actions awarded on a non-competitive basis. Between FY10 and FY11 there was a 48 per cent rise in the number of non-competitive contracts awarded. This corresponds with a seven per cent reduction in the dollar value of non-competitive contracts.

Justification for other than full and open competition

When looking at the justification used to obtain approval for other than full and open competition, the option 'only one responsible source' accounts for the justification of over 70 per cent, or USD 100 billion, of non-competitive contracts awarded. Whilst many may perceive national security considerations to be the justification used most often for other than full and open competition—as exhibited in many disparate countries including those in Europe and South America—this is not the case in the US. Procurement laws in the US are more developed and allow a nuanced categorisation of justifications.

³⁸ US Government, US Spending website, accessed December 2013, www.usaspending.gov.

In FY09, the Army spent nearly USD 20 billion on the five items³⁹ most frequently procured on a non-competitive basis. While the products remained the same in FY10 they accounted for USD 4 billion less than the previous year. In FY11 this figure further decreased, with the top five items accounting for only USD 12.5 billion. Between FY09 and FY11 the top non-competitively procured products accounted for less of the share of non-competitive DoD dollars, dropping an average of 5-6 per cent annually.

The Army competition reports from FY09 through to FY11 list several barriers to competition. These impediments include major hardware systems and spare parts, requirements designated for research and development or determined to be 'state of the art', and bridge contracts. Bridge or 'interim' contracts were often utilised as a gap measure to avoid programme disruption during the process of follow-on contract award and Continuing Resolutions.⁴⁰

DEPARTMENT OF THE NAVY CONTRACT SPENDING, FISCAL YEARS 2009-2011

Within the DoD, the Navy is second to the Army in total contractual spending. It accounts for the highest percentage—on average 34 per cent—of contract actions awarded by non-competitive means within the Armed Services. Between FY09 and FY11 the Navy awarded approximately USD

140 billion of contracts without providing for full and open competition. When analysing data by value versus the number of contracts awarded, it is worth noting that whilst the value of non-competitive awards varied, the value of competitively awarded actions has remained fairly consistent.

In FY09 the average value of a non-competitive contract was USD 385,206; in FY10 this figure decreased to USD 357,542; and finally in FY11 the number jumped to USD 429,266. In the final two years, an 11 per cent increase in the number of non-competitive contracts signed resulted in a significantly higher increase in the dollar value of these contracts: 33 per cent. In essence the additional 12,383 non-competitive contracts accounted for a USD 13.4 billion increase spend by the Navy on non-competitive procurement.

Of the USD 45 billion of non-competitive contracts awarded in FY09, approximately USD 38 billion, or 83 per cent, were awarded under the premise of only one responsible source. This exception continued to account for over 80 per cent of non-competitive contracts through FY11. This is likely due to unique requirements and the limited size of the industrial base.⁴¹

39 Wheeled Trucks and Truck Tractors, Rotary Wing Aircraft, Combat Assault & Tactical Vehicles, Opsry Dev R&D, and Guided Missiles.

40 Legislation in the form of a joint resolution enacted by Congress, when the new fiscal year is about to begin or has begun, to provide budget authority for Federal agencies and programs to continue in operation until the regular appropriations acts are enacted.

'Authorized or required by statute' was the second most frequently used exception for both FY09 and FY10. This authority may be used when statutes authorise or require that the acquisition be made through a specific source such as Federal Prison Industries (UNICOR); Qualified Nonprofit Agencies for the Blind or other Severely Disabled; Government Printing and Binding; Single-source awards under the 8(a) Programme; Single-source awards under the HUBZone Act of 1997; or single-source awards under the Veterans Benefits Act of 2003. Mobilisation and essential R&D experienced a significant rise to account for 10 per cent of non-competitive awards in FY11.⁴²

In both FY09 and FY10 the top five products or services purchased by the Navy through non-competitive contract award were Fixed-Wing Aircraft, Submarines, Rotary Wing Aircraft, Aircraft Carriers, Submarines, and Defence Aircraft (Operational). These products account for over USD 17 billion, or 37 per cent, of the non-competitive contracts awarded in FY09 and USD 14 billion, 35 per cent, in FY10. In FY11, the total value of the top products rose significantly, to USD 21 billion, yet the percentage compared to overall contract award showed only a slight increase to 39 per cent.

There were few noticeable changes in the companies taking the largest share of non-competitive DoD dollars. Only six companies have occupied the top five slots from FY09- FY11: Lockheed Martin Corporation, General Dynamics Corporation, Raytheon Company, Northrup Grumman Corporation, The Boeing Company, and the Bell Boeing Joint Project Office. This distribution is likely due to long term projects and the continued requirement for spare parts from the original manufacturers that few companies produce. Northrup Grumman may have descended from the top contracting companies in FY11 due to the divesting of its shipbuilding unit.⁴³ Many of the larger corporations listed above have managed to remain at the top partially due the acquisition of smaller firms that sell in specialty areas such as cyber security and unmanned aerial vehicles (UAVs) to the US government.⁴⁴

The official Navy competition reports from FY09 – FY11 list several barriers to competition. Amongst these are: unique/critical mission or technical requirements in which the designer or developer possesses the proprietary information; lack of technical data to develop the packages suitable for competition; remaining military specifications; industry's trend of large defence contractors consolidating the industrial base; congressional earmarks which often direct a source; emergency contracting in support of war operations; the immature stage of programmes; and the limited number of suppliers.

41 DoD Competition Report, FY11

42 41 U.S.C. 253(c)(5)

43 G Ratnam, 'Northrop's \$6.7 Billion Spinoff May Set Defense Trend', *Bloomberg*, 6 April 2011, accessed December 2013, <http://www.bloomberg.com/news/2011-03-31/northrop-s-6-7-billion-dramatic-ship-spinoff-may-set-trend.html>.

44 M Censer, 'Mergers and spinoffs shake up the defense industry', *Washington Post*, 7 February 2011, <http://www.washingtonpost.com/wp-dyn/content/article/2011/02/04/AR2011020406136.html>; D Cameron, 'Lockheed's Next CEO Says U.S. Cuts Will Spur Mergers', *Wall Street Journal*, 1 May 2012, <http://online.wsj.com/news/articles/SB10001424052702304868004577377952314325464>; L Adler, 'Pentagon open to mergers, but not at very top', *Reuters*, 9 February 2011, <http://www.reuters.com/article/2011/02/09/us-pentagon-mergers-idUSTRE7186L120110209>.

DEPARTMENT OF THE AIR FORCE CONTRACT SPENDING FISCAL YEARS 2009-2011

Of the three main agencies covered in this report, the US Air Force consistently awards the least number of contracts by both absolute number and dollar value. Yet while it spends approximately USD 65 billion a year on its various contracts, it accounts for the highest percentage of non-competitive contracts by dollar value. On average nearly 56 per cent of contract dollars were awarded on a non-competitive basis. When comparing the value versus the number of contracts awarded, there is significant disparity between the two.

Between FY09 and FY11 approximately USD 145 billion of non-competitive contract spending was attributed to 'only one responsible source'. Whilst 'authorized or required by statute' was the second most frequently used justification in FY09, its use declined in both FY10 and FY11. The most noticeable increase was in the number of justifications citing 'national security' and 'urgency'. Whilst it may be expected that government agencies use 'urgency' justifications towards the end of the fiscal year in order to use expiring funds, analysis of FPDS-NG Air Force data reveals that use of this justification did not exceed 55 per cent in Q3 and Q4 of fiscal years 2009 through to 2011. In fact the use of this justification in the final two quarters of the fiscal years declined from 55 per cent in fiscal year 2009, to just over 25 per cent in fiscal year 2011.⁴⁵

The majority of non-competitive procurements consisted of fixed wing aircrafts, while space vehicles were the second most frequently procured product. Between FY09 and FY11 these two items accounted for approximately USD 36.5 billion dollars, over 30 per cent, of non-competitive procurements. In FY11 the top five non-competitively procured products accounted for 51 per cent, the highest in the three years, of non-competitive contract spending.

Similar to the other Armed Services, only six defence contractors have occupied the top five slots over the previous three fiscal years. These companies are: Lockheed Martin, The Boeing Company, Northrup Grumman Company, Raytheon Company, Massachusetts Institute of Technology, and L-3 Communications Holdings Incorporated. Increasingly, the top five companies are taking a larger portion of Air Force non-competitive dollars. In FY09 these companies accounted for 61 per cent, growing to 63 per cent in FY10 and jumping to a record 74 per cent in FY11. Notably, Lockheed Martin, who has occupied the top slot in each of the past three years, has received 30 per cent more of the non-competitive dollars than their closest competitor.

The official Air Force competition reports from FY09 – FY11 list several barriers to competition. Amongst these are: increased reliance on follow-on buys for mature systems, bridge contracts, non-competitive unmanned aircraft for use in Iraq and Afghanistan, national security, and specialised products.⁴⁶

European Union

INTRODUCTION

The EU Defence and Security Procurement Directive (DSPD), 2009/81/EC, effective from 20 August 2009, provides a framework for cross-border defence procurement within the EU and represents the European Commission's efforts to increase competition. The Directive serves as the basis for EU Member States to conduct defence contracting in their respective jurisdictions. While Member States can cite Article 346 of the Lisbon Treaty to exclude certain procurements from open competition, the European Commission has clarified in an interpretive communication⁴⁷ that Article 346 should be treated as an exception rather than a standard. The Directive does not apply to arms trade with non-EU countries, which continues to be governed by WTO rules, and in particular the Government Procurement Agreement (GPA).⁴⁸ All EU Member States are required to abide by the mandatory provisions of the Procurement Directive, and to assimilate the requirements into national procurement laws no later than August 2011.

OVERVIEW OF REGULATION

The directive encompasses regulations covering defence and security procurements for military equipment and related works and services. This includes security equipment, works, and services involving access to classified equipment. The aim is

to implement fair and transparent procurement processes in EU Member States; ensure flexibility in negotiations of complex contracts; and require suppliers to safeguard classified information against unauthorised access and security of supply.⁴⁹

NON-COMPETITIVE PROCUREMENTS

Limited or non-competitive procurements may be carried out under the negotiated procedure without publication of a contract notice, only if it is justified for the following reasons:⁵⁰

- If irregular, unacceptable, unsuitable tenders or no applications are received in response to a call for competition during a restricted, competitive dialogue or negotiated procedure.
- Where for technical reasons or for reasons connected with protection of exclusive rights, the contract may only be awarded to a particular supplier. Artistic reasons are no longer a justification.
- Where the normal and accelerated time limits laid down for the competitive restricted and negotiated procedures cannot be met:

⁴⁷ Commission of the European Communities, 'Interpretative communication on the application of article 296 of the Treaty in the field of defence procurement', 7 December 2006, accessed December 2013, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2006:0779:FIN:EN:PDF>

⁴⁸ Article XXIII paragraph 1 of the GPA states that "nothing shall be construed to prevent any Party from taking any action or not disclosing any information which it considers necessary for the protection of its essential security interests related to the procurement of arms, ammunition or war material or to procurement indispensable for national security or for national defence purposes". In accordance with these provisions, Annex 1 Part 3 in Appendix 1 to the GPA contains a list of supplies and equipment

purchased by Ministries of Defence that are covered by the Agreement. This list covers only nonwarlike material.

⁴⁹ European Commission, 'Press Release: Internal Market: Commission acts to ensure implementation of EU rules in the area of defence procurement', 26 January 2012, accessed December 2013, <http://europa.eu/rapid/pressReleasesAction>.

1. for reasons of urgency resulting from a crisis; or
 2. due to the nature of the market for air and maritime transport services when deploying military or security forces abroad; or
 3. for extreme urgency brought about by events not foreseeable or attributable to the procurer.
- For additional deliveries by the original supplier when the length of contractual arrangements may not generally exceed five years.
 - Where goods are quoted and purchased on a commodity market.
 - To take advantage of particularly advantageous terms in a closing down sale or where a supplier is bankrupt, insolvent or being wound up.
 - For research and development services other than those services exempt under the research and development exemption.
 - Where goods are solely for the purpose of research, experiment or development, and not with a view to establishing commercial viability or recovering research and development costs.

BACKGROUND: ARTICLE 346

Article 346 (previously article 296 of TEC) of the Treaty of the Functioning of the European Union (TFEU) in European Union Defence Procurement, codifies the principle that Member States are entitled to take measures to protect their security in connection with the production of, or trade in, arms, munitions, and war material.

Article 346 of the TFEU states:⁵¹

1. *The provisions of the Treaties shall not preclude the application of the following rules:*
 - b. *No Member State shall be obliged to supply information, the disclosure of which it considers contrary to the essential interests of its security;*
 - c. *any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of, or trade in, arms, munitions, and war material; such measures shall not adversely affect the conditions of competition in the internal market regarding products which are not intended for specifically intended for military purposes.*

51 European Commission, 'EU law and defence procurement', December 2010, accessed December 2013, http://ec.europa.eu/internal_market/publicprocurement/docs/defence/more_on_defence_procurement_en.pdf.

2. *The Council may, acting unanimously on a proposal from the Commission, make changes to the list, which it drew up on 15 April 1958, of the products to which the provisions of paragraph 1(b) apply.⁵² In other words, items on this list can be exempted if the conditions for use of the Article are fulfilled.*

Other interests, in particular industrial and economic, although connected with the production of and trade in arms, munitions and war material, cannot by themselves justify an exemption. However, it appears that the Members' motivation for invoking Article 346 is often the economic benefit of reserving high-value contracts for domestic or favored suppliers. In short, Member States have often procured defence and security contracts contrary to the Commission's interpretation of the Treaty.⁵³ There are two disparate views on the subject of increasing competition within the EU. Whereas the European Commission urges more foreign access and competition in the Member States' defence contracting opportunities, the States themselves have traditionally been reluctant to compete defence contracts outside domestic markets.

To reconcile individual prerequisites in the field of defence and security procurement with treaty obligations, Member States must assess each contract and determine whether an exemption from Community rules is justified. Such case-by-case review must be particularly rigorous at the borderline of Article 346 TFEU, where the use of the exemption may be controversial. Contracting authorities should therefore evaluate:⁵⁴

- Which essential security interest is concerned?
- What is the connection between this security interest and the specific procurement decision?
- Why is the non-application of the Public Procurement Directive in this specific case necessary for the protection of essential security interests?

Ultimately, time will demonstrate the practical effect of the Defence Directive. Currently Article 346 of the TFEU remains available to contracting authorities. With the transposition of the Defence Directive into the national law of Member States, use of this exemption will be limited to exceptional cases only—where the exemption is 'necessary' for the protection of genuinely 'essential' security interests. This in theory should result in contracting authorities using more competitive tendering to award defence contracts. If, on the other hand, reliance on the exemption remains the rule rather than the exception, it is likely that the transposition of the Defence Directive and the Commission's renewed stance on defence procurement will give greater impetus to the Commission to bring proceedings against Member States before the European Court of Justice.

⁵² In 1958 the Council of the European Union listed the items that are subject to Article 296. That list is still in force, and obviously includes major weapons systems such as ships, aircraft, armor and artillery.

⁵³ O Graber-Soudy & A Labbet-Ainsworth, 'Defence procurement', *Global Competition Review*, accessed December 2013, <http://www.globalcompetitionreview.com/reviews/37/sections/131/chapters/1377/defence-procurement/>.

⁵⁴ Commission of the European Communities, 'Interpretative communication on the application of article 296 of the Treaty in the field of defence procurement', 7 December 2006, accessed December 2013, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2006:0779:FIN:EN:PDF>

Bulgaria

The Bulgarian Law on Public Procurement along with the Ordinance on the Award of Special Public Orders and the Ordinance on the Award of Small Public Orders, provide a legal framework which mandates that government contracts be openly competed where possible. Priority is given to open competition and companies are given the opportunity to take part in the competitive tendering process. Article 13, Paragraph 1 of the Law on Public Procurement becomes applicable when procurement involves deployment of forces into conflict environments through, for instance, participation in international missions and exercises.

By and large due to the legal structures in place, the Bulgarian MoD cannot bypass the competitive process and choose a specific company to fulfil their requirements. However, there are two exceptions to this rule. The first is when the company has certain technical or financial expertise, and the second exception is for maintenance contracts. This occurs when the MoD is obliged to sign a contract with the original supplier due to a unique patented design which only the company has the technical expertise to maintain. The conditions, which allow the contractor to negotiate a public order without opening it up for competition, are regulated by Article 90, paragraph 1, items 1 through 13, and Article 119c, paragraph 3, items 1 through 13 of the Law on Public Procurement.⁵⁵

Since the implementation of EU Directive 2009/81/EC, Bulgarian legislation has been brought in line with the rest of the European Union. The directive has been transposed into the Law on Public Procurement. Particular cases which allow for public officials to sign single-source contracts are governed by Part 2, Articles 1b and 1c.

Bulgaria is one of a number of countries that makes use of Integrity Pacts during their procurement process. Before entering into a contract, the MoD and the relevant participants in the public order sign an agreement declaring their desire to enter into a process underpinned by free, open and fair competition which excludes misuse or abuse of any nature. Three government agencies, the National Audit Office, the Commission on Protection of Competition and the Public Financial Inspection Agency are responsible for monitoring and surveying the performance of the public orders. Within the MoD, this function is also performed by the Internal Audit Directorate and the MoD Inspectorate.

The Defence Investments Directorate, the entity responsible for organising and implementing MoD procurement, monitors and updates information on available contractual opportunities on the Ministry's website. This is intended to provide all companies with a fair opportunity to compete for government contracts. For purposes of transparency, even in cases when contracts are awarded on a negotiated basis without a public notice, Article 90, paragraph 1, items 1 through 13, as well as Article 119c, paragraph 3, items 1 through 13 mandates the information to be publicly available.

⁵⁵ For more information please see: http://rop3-app1.aop.bg:7778/portal/page?_pageid=173,1106253&_dad=portal&_schema=PORTAL

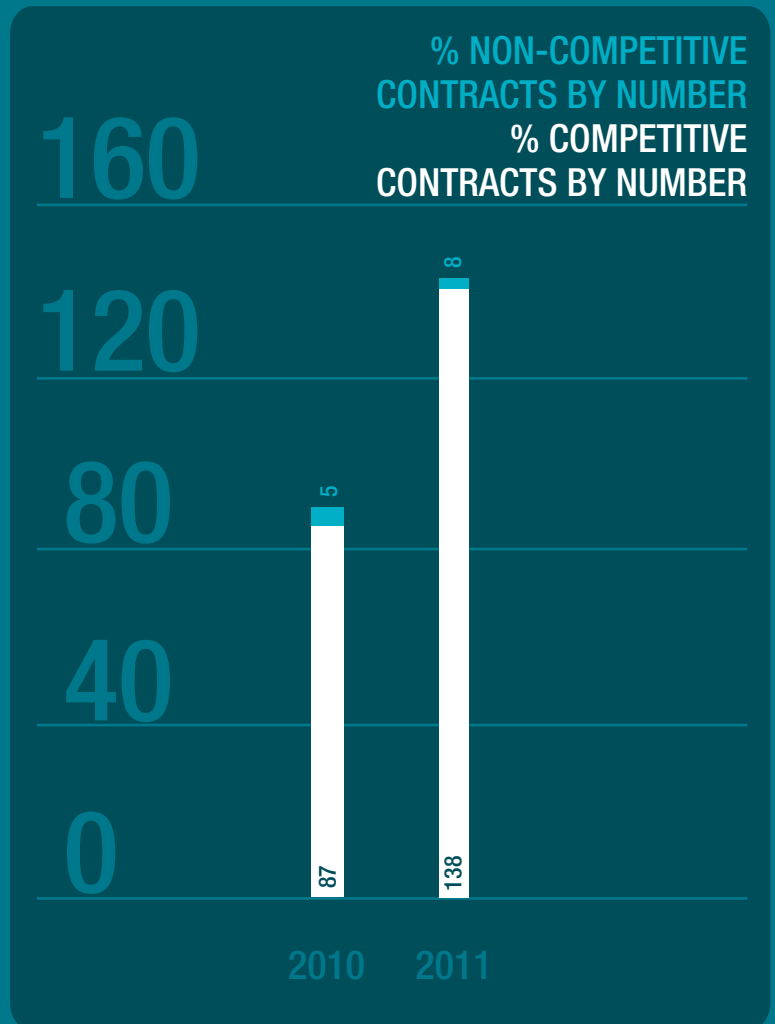
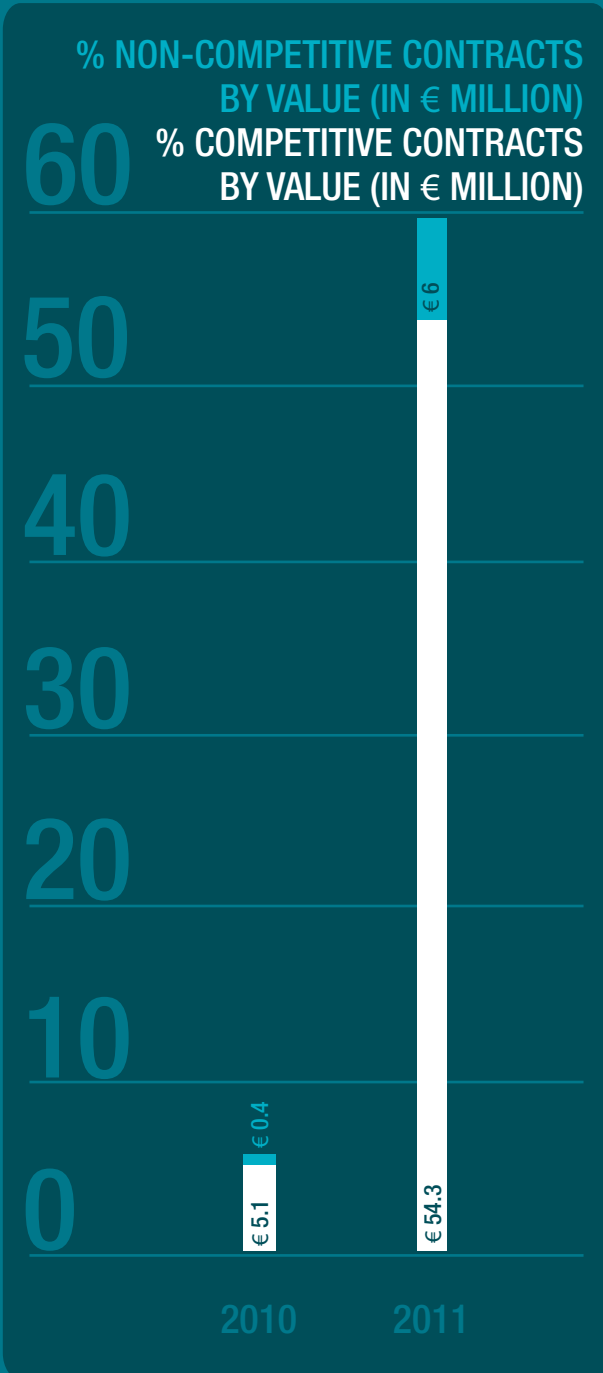
The activities and behaviour of the tender commissions are regulated by the Code of Good Administrative Behaviour. Their decisions are audited and these audits become a part of public records. Within the MoD, the Internal Audit Directorate fulfils this function. Information on the contracts signed by the MoD is sent to the Agency for Public Orders which maintains a register of all contracts signed by the government. In compliance with national legislation, this information is available online.⁵⁶ It is important to note that information is only passed on to the Agency for Public Orders after the conclusions of a contract or framework agreement.

Opposite is data on the level of single-source contracts signed by the Bulgarian MoD over a two year period covering calendar years 2010, and 2011.

Of the total procurement, there was roughly an equal split between armaments (accounting for approximately EUR 30.1 million) and other military supplies and equipment (accounting for EUR 30.4 million). In comparison to other countries, Bulgaria exhibits a significantly low percentage of single-source contracts. Whilst this is partially explained by their relatively low spend on defence and the procurement laws in place, the figures certainly merit further examination which is beyond the remit of this report.

⁵⁶ Please see: http://rop3-app1.aop.bg:7778/portal/page?_pageid=173,1&_dad=portal&_schema=PORTAL.

FIGURE 6 | LEVEL OF SINGLE-SOURCE CONTRACTS SIGNED BY BULGARIAN MOD, 2010-2011



Latvia

As with other European countries in this survey, competition is required by law in Latvia. Goods and services with a contract threshold over Ls10,000 (~EUR 14,000) are required to be openly declared unless they fall under one of the exemption categories (discussed below). Procurement announcements as well as the contracting agency's ultimate decision are available on the websites of both the Procurement Monitoring Bureau (www.iub.gov.lv) and the Ministry of Defence (www.mod.gov.lv). Procurement announcements above Ls 92,000 (~EUR 131,000) have to be published on the EU website and should be available in all EU official languages.

Single-sourcing is regulated by Latvian public procurement law. Contracting agencies can choose against certain procurement requirements being subject to competition as long as they meet the following rules:

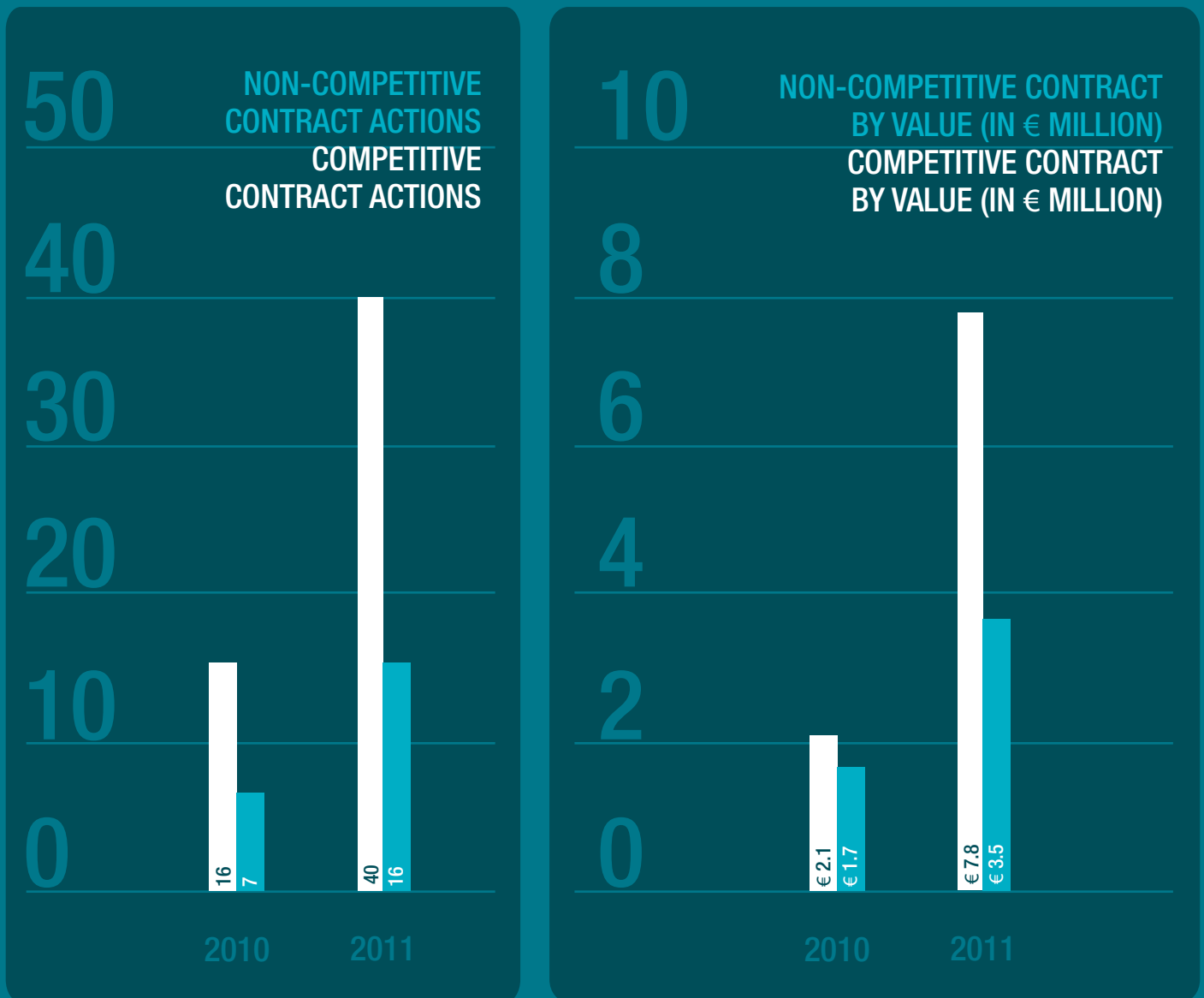
1. maintenance of specific equipment or technology for which there is only one supplier
2. statutory authorisation or acquisition of brand name items
3. national security considerations
4. contract extensions due to change in budget
5. urgency due to unforeseeable and extraordinary circumstances

SPENDING BY CONTRACT ACTIONS AND VALUE

Armed Forces data for Latvia is limited to 2010 and 2011 as statistics for 2009 were unavailable. Analysing the information provided by the number of actions, there is a decline in non-competitive procurement over the two years. Whilst in 2010 the percentage of non-competitive procurement stood at around 30 per cent, that number declined slightly in 2011 to approximately 28 per cent. The difference is more accentuated when analysing the same data by the value of the contracts signed. In 2010, EUR 3.7 million worth of contracts were signed by the Latvian Armed Forces, and of those, 44 per cent were tendered through non-competitive means. In 2011, the total value of contracts increased sharply to EUR 11.3 million, yet non-competitive procurement as a percentage decreased to 31 per cent.

The main agency responsible for this decline was the Army. Whilst in 2010 its non-competitive procurement percentage stood at 46 per cent of a total spend of EUR 3.1 million, this decreased to just over 25 per cent in 2011 out of a total spend of just over EUR 7.8 million. On the other hand, the Air Force, which over the two year period accounts for a very minor portion of total Armed Forces spend, witnessed a near 30 per cent increase in non-competitive procurement over the two year period.

FIGURE 7 | NON-COMPETITIVE PROCUREMENT CONTRACTS, LATVIA



Poland

Whilst Poland is bound by EU Directive 2009/81/EC, its national implementation of the rule is somewhat determined by local circumstances and history. The Polish Ministry of Defence has three methods by which it attempts to promote greater competition:

- **Use of public procurement calls:** This can be done on items or equipment for which there are established tactical and technical requirements. Further, such tenders are also distinguished by either the MoD or multiple companies holding the technical copyrights. This would allow the MoD to compete follow-up contracts since the copyrights are not the property of one supplier.
- **Negotiating with more than one supplier:** Certain equipment will need the joint effort of more than one company. When military equipment production needs to be unified, and there is more than one supplier, the MoD can enter into direct negotiations with more than one supplier. Such an avenue can also be used for long-term research and development projects which require the joint expertise of more than one contractor.
- **Electronic auctions:** When a piece of equipment or service which the MoD needs to procure has established quality standards, electronic auctions can be used to target as many potential contractors as possible.

Despite legal provisions requiring competition of defence-related tenders, there are a number of conditions which allow the MoD to award a contract without competition: the existence of one supplier, the contractor holding exclusive rights to the equipment in question, extraordinary procurements, and commercial contracts which are below the EUR 10,000 threshold.

In general, there has been an upward trend over the past three years in the number of single-source contracts in the country. The most common defence contract type awarded on a single-source basis is a fixed-price contract. This is where the purchaser pays a fixed price for a specific deliverable. Further, given the sophistication of the Polish defence industry it should come as no surprise that that local industry serves as the main supplier of goods and services for the MoD.

Interestingly, Poland does not have centralised statistics on competitive and non-competitive procurement. However, for each procurement the purchaser has to provide and demonstrate the reasons why non-competitive procurement procedures were chosen. This excludes those purchases made under the umbrella of national security. There are two main actors charged with gathering such information: the purchaser/agency in question and the director of strategy and security planning within the MoD.

DATA FOR SINGLE-SOURCE PROCUREMENT

In 2009, 28 per cent of contracts by the Polish MoD were single-sourced. This figure jumped to just over 50 per cent the following year, and then dropped slightly to around 40 per cent in 2011. Whilst this may indicate that single-sourcing is going down, a different picture is painted when the value of the contracts is analysed in conjunction. As the chart opposite shows, the value non-competitive procurement contracts has dramatically increased over the three years. Starting from a base of 35 per cent in 2009, the figure has increased to around 60 per cent in 2011.

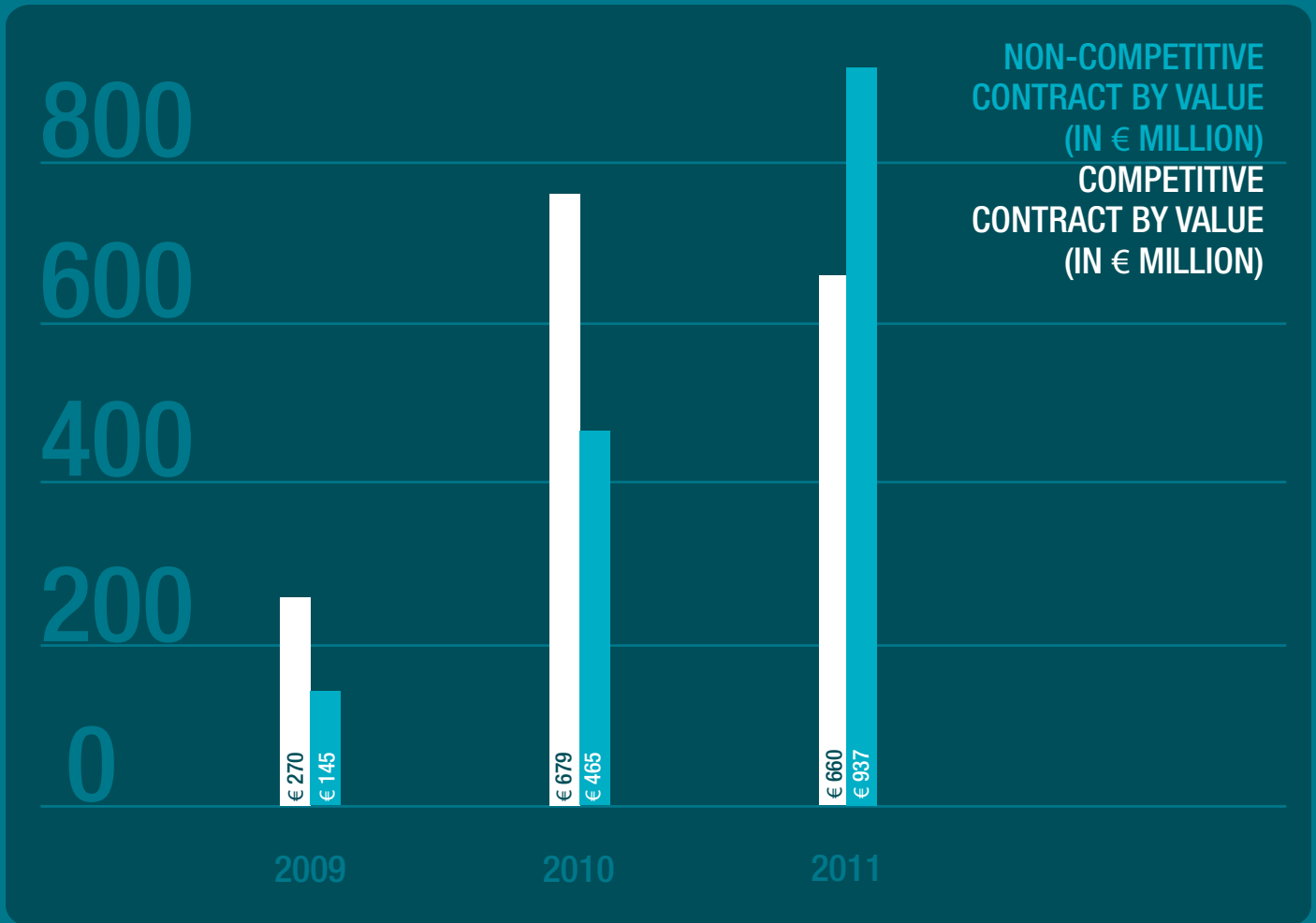
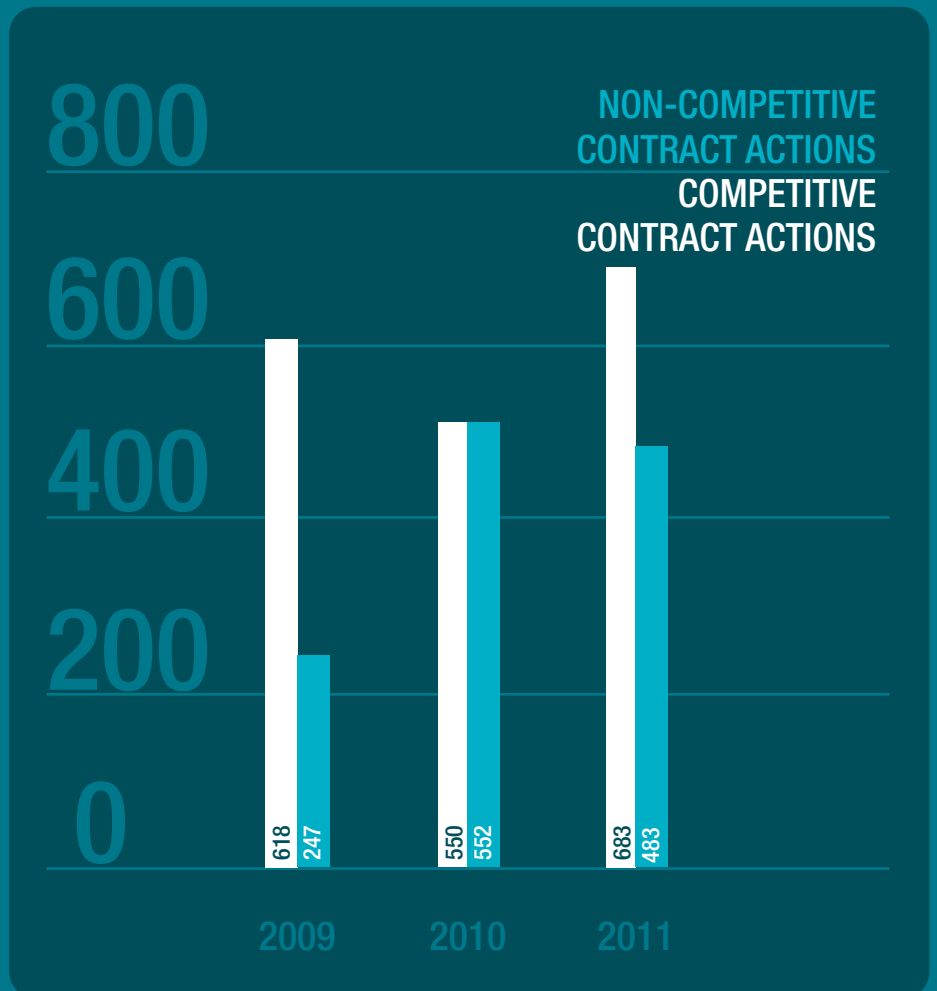


FIGURE 8 | NON-COMPETITIVE PROCUREMENT CONTRACTS, POLAND



Slovakia

The Slovak government publishes information on procurements through the Public Procurement Bulletin (Office for Public Procurement). However, this data is available only in Slovak and is provided on an individual basis. In order to address these limitations, Transparency International Slovakia has launched the Open Public Procurement Initiative. Its main purpose is to clean, aggregate, and process the available procurement data in order to allow users to compare this information over time and ascertain any trends. This study makes use of this resource to gather information regarding the level of non-competitive procurement in the country.

Procurement in Slovakia is governed by the Public Procurement Act. It applies to any entity which uses public funding. The Act dictates that the public procurement bodies announce open procedures in accordance with the law, make the conditions of the contract available so that tenderers know if they are eligible, publish an invitation to submit bids for an application (or for restricted tenders, select the applicants which meet the set criteria), and finally assess the bids. The Office for Public Procurement usually keeps a list of companies that have a track record of demonstrating that they are suitable for entering into public contracts.

There are five main types of tender procedures in the country:⁵⁷

- **Open tender:** The contracting authority invites an unlimited number of bidders to tender. Open tenders may be used without fulfilling other legal conditions. In essence, an open procedure is an *unrestricted selection procedure* whereby tenders may be submitted by anyone that wishes to participate in the process.
- **Restricted procedure:** An unrestricted number of suppliers are invited to submit an application to join a restricted public procurement procedure for a public contract. Usually, but not always, restricted procedures operate in two rounds. In the first instance, interested parties submit an application together with proof that they are qualified to compete for the contract. The contracting authority, which in this case would be the Ministry of Defence, has the authority to limit the circle of bidders based on specified criteria. Thus, a tender may be submitted only by those that have demonstrated their qualifications and have been invited by the contracting authority, on the basis and strength of their applications, to join the restricted procedure.

⁵⁷ For more information on public contracts in Slovakia, please see: http://europa.eu/youreurope/business/profitting-from-eu-market/benefiting-from-public-contracts/slovakia/index_en.htm.

- **Negotiated procedure with publication:** The contracting authority invites an unrestricted number of suppliers to apply. Notification is published to all suppliers and interested parties that submit an application together with a proof of qualification. Once more, for tenders related to defence and security, the contracting authority is entitled to restrict the number of bidders. The invited bidders submit bids that are then negotiated. The aim of this process is to achieve the performance of the contracts under the most advantageous conditions possible.
- **Negotiated procedure without publication:** The contracting authority directly invites one or more suppliers to negotiate for particular contracts. This type of procurement procedure is restricted in its use by law. Yet, the contracting authority has the power to invite only one supplier if it believes it to be the only one capable of fulfilling the requirements of the contract. Reasons can include—but are not limited to—exclusive rights, artistic reasons, supplementary performance, and action bids. The contracting authority may also invite a sole supplier to participate in the negotiations if the government requires the contract to be fulfilled as a matter of urgency or there has been a previous unsuccessful standard procurement procedure.

Despite such flexibility, the contracting authority must nonetheless demonstrate the financial advantages of following this procedure. Defence and security contracts, due to their unique sensitivities, have special authorisation. This is perhaps the least formal method of fulfilling a contract requirement.

- **Competitive Dialogue:** This procedure was introduced in the public sector procurement directive (2004/18/EC). It replaced the competitive negotiated procedure as the routine choice for complex contracts since the EU Commission felt that the competitive negotiated procedure was wrongly selected in many cases. Under this new procedure, the final tenders ‘contain all elements necessary for the performance of the project’. In theory, contracting authorities advertise their requirements, enter into dialogue with selected candidates (chosen on the same basis as in the restricted procedure), draw up the solutions needed, and then invite a number of the candidates to submit bids.

For the purposes of this study we have classified the last four types as non-competitive procurement.

Procurement

SPENDING BY CONTRACT ACTIONS AND VALUE

Information on defence procurement in Slovakia is available by both the number of actions (contracts) as well as the corresponding monetary value of the same. When analysing the levels of competition *vis-à-vis* in the number of contract actions, the level of non-competitive procurement fluctuates over the four year period. In 2009 it is approximately 35 per cent; it jumps to over 58 per cent the following year; drops down sharply to just over 7 per cent the year after; and climbs back up to over 20 per cent in 2012.

When comparing the same data by contract value, the percentages still fluctuate, but to a slightly lesser degree. In 2009 the percentage of non-competitive procurement, as defined by this study, was 23 per cent; in 2010 this shot to 53 per cent; decreased in 2011 to just over 6 per cent (in line with the decrease when analysed through the number of contracts); and finally increased to 21 per cent in 2012.

Unfortunately, the Open Public Procurement website does not provide justifications on why certain contracts were procured without open competition. It may be that the Public Procurement Bulletin has this information—however due to language barriers, this study was not able to access the website.

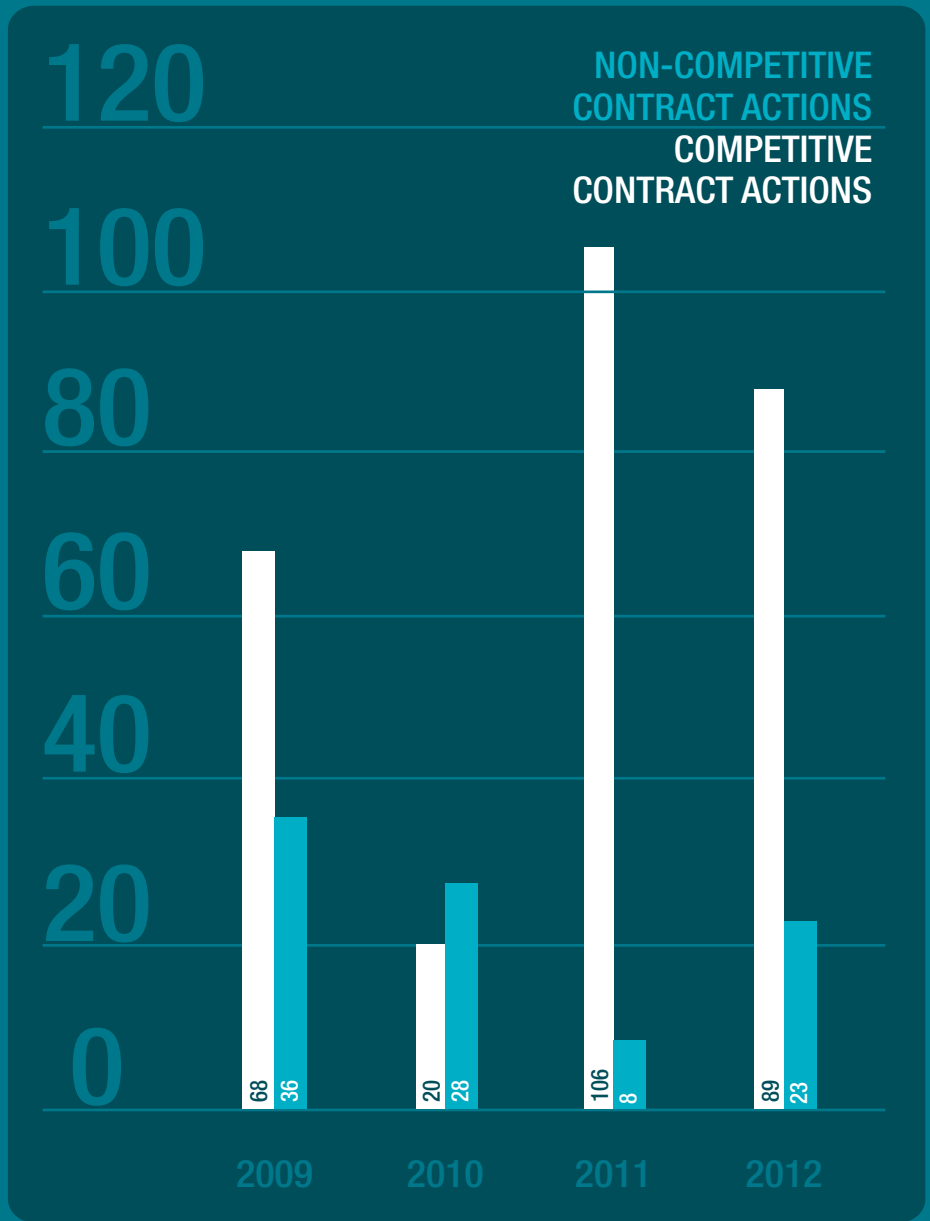
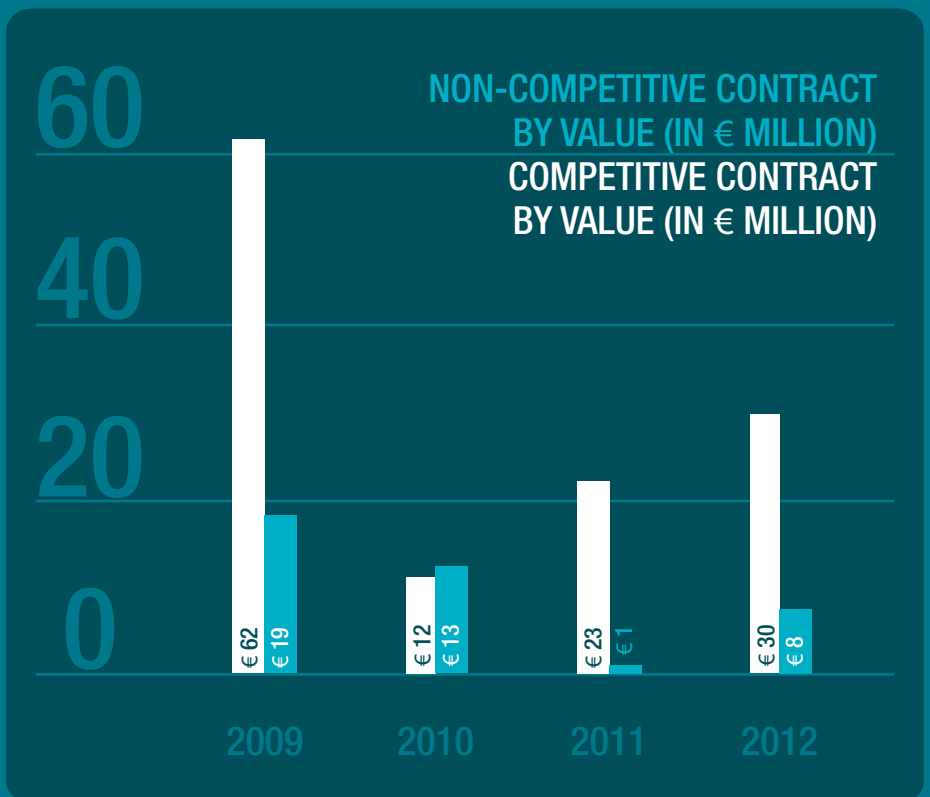


FIGURE 9 | NON-COMPETITIVE PROCUREMENT CONTRACTS, SLOVAKIA



Slovenia

BACKGROUND

Competition in Slovenia is required by law. Contracts should be awarded on the basis of objective criteria which ensure compliance with the principles of transparency, non-discrimination, and equal treatment. These principles are in place to guarantee tenders are assessed in conditions of effective competition. Where design contents are restricted to a limited number of participants, the contracting authorities are obliged to lay down clear and non-discriminatory selection criteria. The number of candidates invited to participate should be sufficient to ensure genuine competition.

There are a number of conditions which allow contract award without competition under Slovenian procurement law. These circumstances are outlined below.⁵⁸

1. exclusive technical requirements or protection of the company's protective rights
2. additional deliveries by the original supplier where a change of supplier would oblige the contracting authority to acquire assets that have different technical or tactical specification and would result in incompatibility and tactical or technical problems during performance
3. for additional services, already set in the original contract, if provided by the same contractor, within three years from original contract award
4. upgrade or maintenance of assets, which have specific technical or tactical specifications and would result in incompatibility, tactical or technical problems during performance
5. If the prerequisite for carrying out the contract, established by classified Information Law and Defence Law, is complying with only one provider.

Article 8 of the Public Procurement Act (ZJN-2) states that procurement procedures under this Act shall be made public. Further, provisions shall be put in place to ensure free publication of contract notices in respect of the values referred to in Article 12 of this Act—both in the Official Journal of the European Union and on the public procurement portal.⁵⁹ High level officials within the Slovenian MoD feel that publicising defence contract opportunities on the Electronic Bulletin Board increases competition, results in lower contract prices, and provides for greater transparency.⁶⁰

SLOVENIAN MINISTRY OF DEFENCE (MOD), CONTRACT SPENDING, 2009-2011

Corresponding with shrinking defence budgets in Europe, Slovenian MoD contract spending has declined approximately 25 per cent between 2009 to 2011. This has been mirrored in the decline of non-competitive procurements. In 2009 approximately 82 per cent of contracts were awarded on a competitive basis, this figure peaked at 86 per cent in 2010 before declining to 83 per cent in 2011.

58 Survey Instrument completed by a source within the Slovenian MoD. Note: Slovenia is in the process of implementing new defence and security procurement laws that cover all directives in 2009/81/EC.

59 <http://www.oecd.org/dataoecd/6/33/39647089.pdf>

60 <http://www.eda.europa.eu/EbbNewsLetter/Article.aspx?ArtId=c1847b30-fd07-4cf1-a5ce-bdf9eaf81895&lssld=84e2eae8-8437-4476-ba78-51f42a063f30>

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The process by which countries refrain from utilising competition in defence procurement should be made transparent, and the percentage that is non-competitive should be publicly available.

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When the competition rate is calculated by contract values, the trend reaches its lowest point at 72 per cent in 2011. Many of the non-competitive contracts have been attributed to maintenance of existing systems. It is worth noting that while armaments tend to count for a large portion of non-competitive contracts in most countries, on average they account for just over 23 per cent of non-competitive procurements by the Slovenian MoD.

The charts opposite display the data by value as well as by contracts awarded.

In our correspondence with the MoD, two significant barriers to competition were identified: Detailed technical requirements which limit the number of companies the MoD can negotiate with due to scant expertise and capability, and interoperability with NATO forces and standards. A further concern raised by the MoD was the amount of legislation governing competition requirements. Whilst recognising the importance of authoring robust requirements for the purchase of goods or services, the contracting chief must be careful not to impose unnecessary limits on competition.

Procurement data in the country is collected annually and categorised by both number and value of contracts. For public procurements, the MoD submits data to the Gazette of the Republic of Slovenia. The National Gazette in turn reports the data to the Ministry of Finance who subsequently pass it on to the central government. For confidentiality reasons, certain sensitive defence and security procurement information is directly passed on to the government.

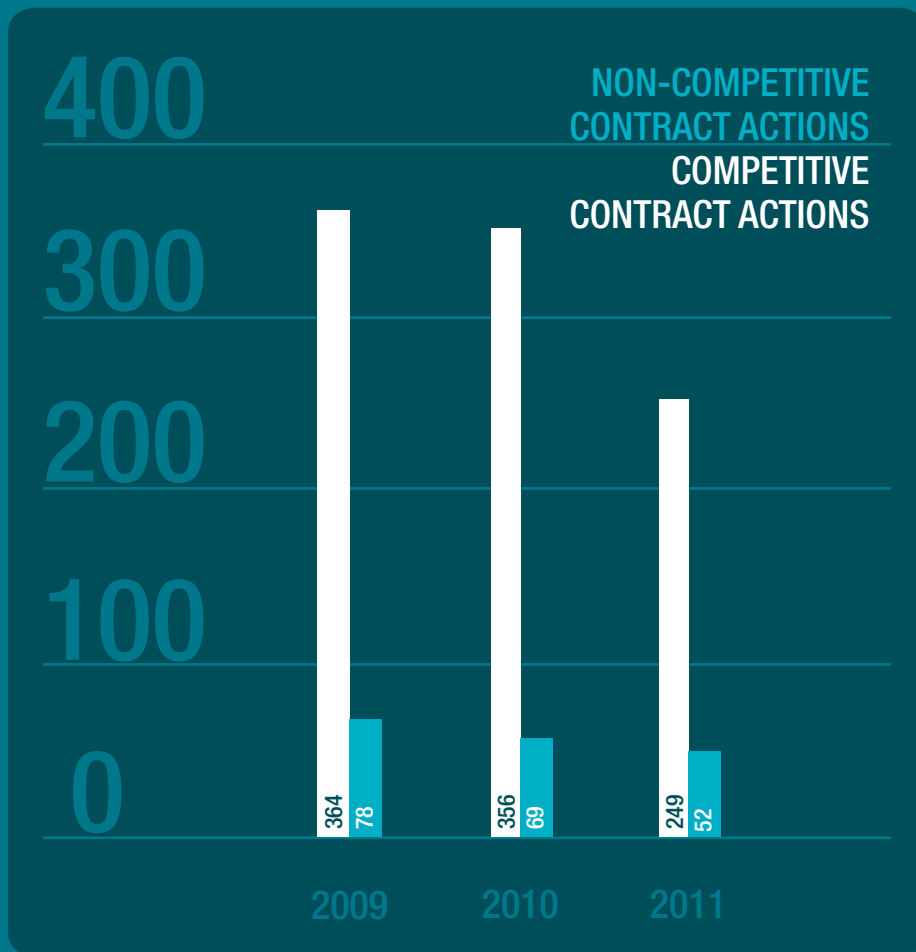
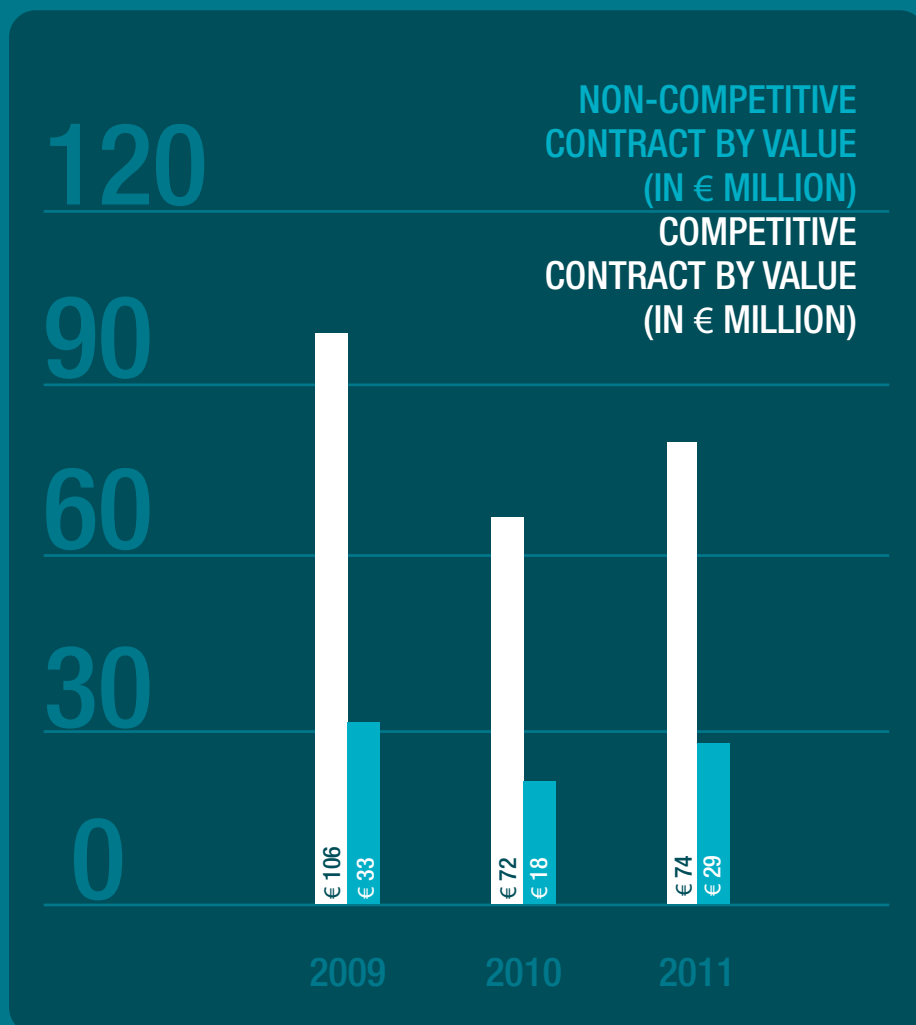


FIGURE 10 | NON-COMPETITIVE PROCUREMENT CONTRACTS, SLOVENIA



United Kingdom

The United Kingdom (UK) spent a total of £34.9 billion on new MoD contracts between the financial years 2008/09 and 2010/11. Of this total, £19.5 billion was awarded on a non-competitive basis. Such an alarmingly high proportion of single-source contracts impelled the government to undertake a review of the regulations applicable to military procurement on a single-source basis. The review, conducted by Lord David Currie, analysed in great detail the evolution—or lack thereof—of procurement regulations over the last forty years, and how the Ministry of Defence could go about the arduous task of ensuring that single-source contracts are fit for purpose and provide value-for-money. It is important to note that although the government has started this consultation process, commitments under the current regulations will bind the UK over the next twenty years or so, highlighting the long-term nature of the problem and the potential barriers to reform.⁶¹

In the United Kingdom, single-source contracts are governed by the ‘Yellow Book’.⁶² This government profit formula dates back to 1968 and it is the result of an agreement between the government and the Confederation of British Industry (CBI). Its underlying principle is that of comparability: Profits earned on government single-source contracts should be comparable with returns on other contracts.⁶³ Whilst some of the provisions in the Yellow Book have been revised, they have been ‘incremental and very slow’ according to the review conducted by Lord Currie.⁶⁴ This is partially explained by the fact that, according to the current regulations, any amendments have to be approved by both the government and the contractor.

YELLOW BOOK

The Yellow Book is underpinned by three pillars: the framework itself, contractor recovery rates, and individual contracts. The first pillar deals with the government’s accounting conventions, the profit formula that it uses, and the oversight mechanisms it has in place to ensure that the contract adheres to the agreed principles. The profit formula was originally conceived to provide contracts with a fair return given the absence of a market price. The second pillar covers the current procedures by which governments and contractors agree on costs, recovery and other such financial considerations. The third and final pillar deals with the intricacies of the individual contract. The information gleaned from the first two pillars helps inform this.

According to the Currie report, a weakness of the current system is its over-emphasis on profit rates rather than efficiency. According to Lord Currie, the emphasis is on ‘the 10 per cent profit elements of the contract value and not on the 90 per cent or so of cost’.⁶⁵ Incentivising greater efficiency and ensuring value for money should benefit both the government and the contractor. In his discussions with the relevant parties Lord Currie observed that whilst all were in favour of improving efficiency, some in the Ministry of Defence were uncomfortable with the idea of companies making huge profits, even when the major proportion of that would be delivered by efficiency gains.

Further, the current reporting system is not standardised and therefore does not allow the MoD to conduct cost benchmarking exercises. This has a direct adverse impact on its ability to ensure that taxpayer money is being used as efficiently as possible.

61 Lord Currie of Marylebone, *Review of single-sourcing pricing regulations*, October 2011, accessed December 2013, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/35913/review_single_source_pricing_regs.pdf, p.6

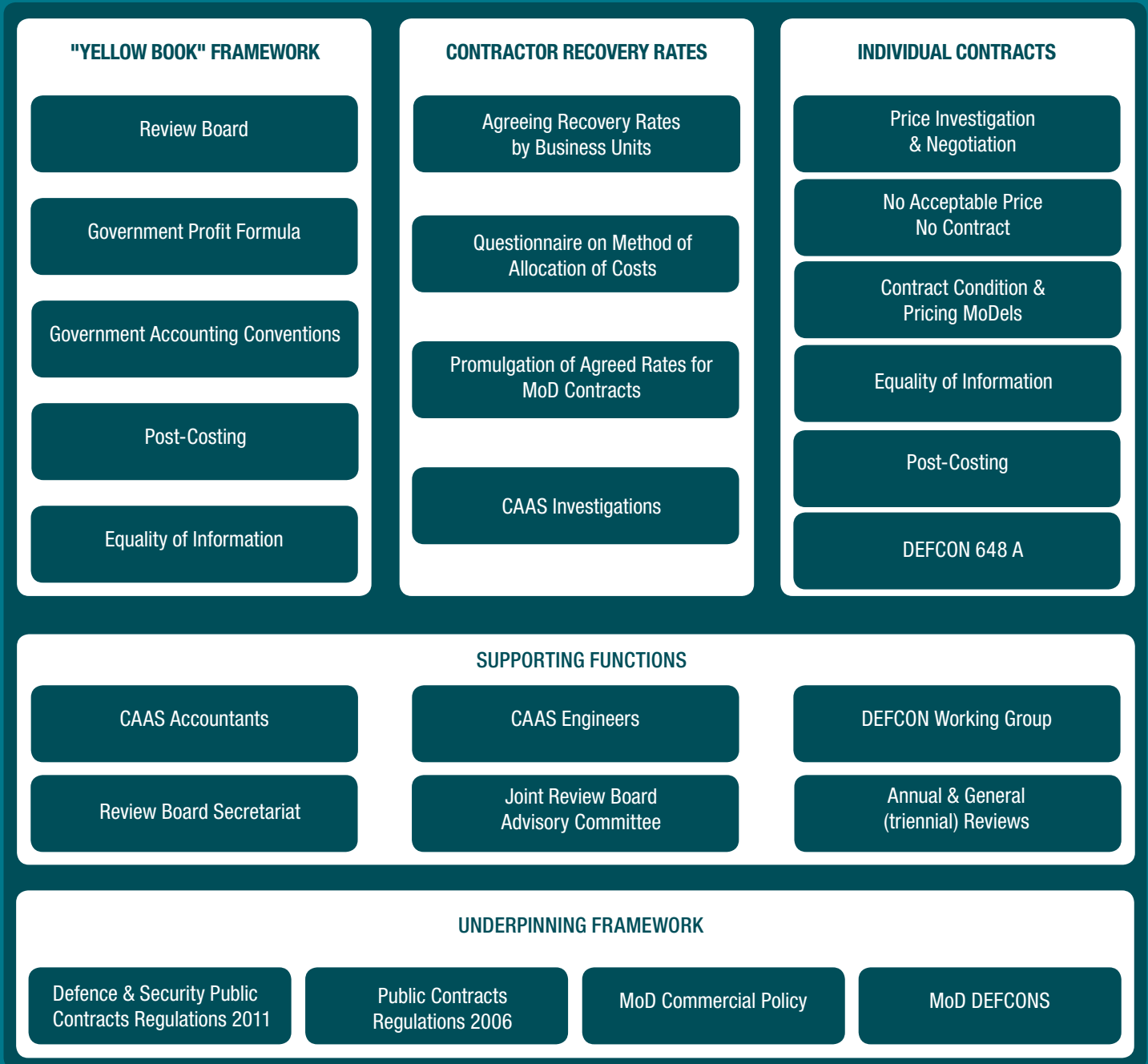
62 Ibid, p.6.

63 Ibid, p.82.

64 Ibid., p.67

65 Ibid., p.67.

FIGURE 11 | EXTERNAL REPORTING: HMT, NAO, DEFENCE SELECT COMMITTEE, PUBLIC ACCOUNTS COMMITTEE (PAC)



For all intents and purposes the Yellow Book's effectiveness has diminished since its inception in 1968. One of the main reasons for this has been the increasing consolidation of defence companies within the country. This has resulted in seven contractors accounting for approximately 80 per cent of the value of single-source contracts. This also means that companies have gained the advantage of understanding costs much better. Furthermore, major contractors are no longer reliant on the UK MoD for contracting opportunities to the extent they were in previous years. The diversification of their customer base and the internationalisation of their operations have placed companies in a stronger negotiating position.

The UK suffers from not having an adequate framework to govern single-source contracts. This is something that needs to be addressed as a matter of urgency since they are likely to remain a significant part of the MoD. This is primarily due to three causes: the MoD may from time to time require unique products which only one supplier has the capability and or capacity to provide; the contracting agency is locked in to a contract with the original supplier (this is most often the case for maintenance contracts for heavily specialised equipment); and finally because the Ministry will want to maintain a degree of self-sufficiency and not heavily rely on the support of other countries or entities. Within the current provisions, reporting standards do not allow the government to conduct benchmarking exercises, there is little transparency and few if any incentives for companies to improve efficiency.

The UK MoD is bound by EU procurement regulations and procedures. The requirement mandates that governments advertise and open for competition all contracts except in certain extraordinary cases. Regulation 14 governs how countries can single-source using the 'negotiated procedures without prior publication of a contract notice'.⁶⁶

WHY SINGLE-SOURCING IS OF PARTICULAR CONCERN TO THE UK

Utilising the National Audit Office's (NAO) report on major MoD projects, Lord Currie and his team concluded that projects with the 'greatest time and cost overruns are predominantly single-source'.⁶⁷ In total, 70 per cent of projects with major delays and cost overruns were single-source. The 2009 Gray report uncovered that the average delay for an equipment acquisition project was 2 ½ months.⁶⁸ Further, the report estimated that the associated costs of these delays were between £0.9 billion to £2.1 billion per annum.⁶⁹

The Strategic Defence and Security Review of 2010 aimed to correct the imbalance in the MoD budget given the overstretch it experienced in the last few years due primarily to the conflicts in Iraq and Afghanistan. Analysis of the report has shown that over 90 per cent of the contracts affected by the review were single-source. In most instances, these translated to delays, cost overruns, and greater inefficiency.

The recent trend within the MoD to outsource maintenance activities and terminate in-house manufacturing has a significant bearing on single-sourcing.

⁶⁶ For a fuller explanation please see the Central Procurement Directorate Guidance Note 02/10 authored by the UK Department of Finance and Personnel

⁶⁷ Lord Currie of Marylebone, *Review of single-sourcing pricing regulations*, October 2011, accessed December 2013, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/35913/review_

[single_source_pricing_regs.pdf](#), p.16

⁶⁸ Bernard Gray, *Review of Acquisition for the Secretary of State for Defence*, October 2009, p.286

⁶⁹ *Ibid.*, p.286

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In the UK, seven contractors account for approximately 80 per cent of the value of single-source contracts.

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Whereas previously, the MoD had engineering expertise which allowed it to be an intelligent customer, this is no longer the case. The fact that the government is negotiating single-source contracts whilst suffering from asymmetry of information should be a cause of concern for both the government and the taxpayer.

SINGLE-SOURCE PROCUREMENT ANALYSIS

The UK MoD spends around £8.7 billion per year of taxpayer money on single-source procurement. These contracts, by their very nature, tend to be the most complex. Further, they tend to be amongst the long-term projects undertaken by the MoD due to the significant research and development lead times attached to most. Recent examples of such contracts include the Astute and Successor nuclear submarines, the Queen Elizabeth class aircraft carriers, and the production as well as maintenance of the numerous air, land and sea equipment maintained by the Ministry of Defence.

The tables opposite provide information on new MoD contracts by value. They are broken down by contract type. Contracts have been placed into the relevant year based on the actual start date of the contract.⁷⁰

The 2011 UK Defence Statistics report defines competitive procurement as either 'contracts priced by competition' or those 'priced by reference to market forces'. Conversely, non-competitive contracts equate to those 'contracts priced on estimates at outset', 'contracts priced on actual costs with incentive to minimise cost', and 'contracts priced on actual costs plus a percentage fee'.⁷¹ The 'other' category

relates to contracts where the majority of contracts are let as a Terms of Business Agreement since the competition market is not known.⁷² It is worth noting that the total value of contracts in 2008/09 is slightly inflated due to the placement of a number of high-value contracts during that period. Two non-competitive contracts valued at £6.1 billion, half of which were earmarked for the Future Aircraft Carrier, were placed in that year.

The tables opposite show the non-competitive percentages are even higher when analysing the total new MoD contracts by number.⁷³

With the exception of 2009/10, there is little correlation between the non-competitive number of contracts and the value of these contracts. However, the corresponding percentages are much higher for the former. In 2010/11, whilst competitive contracts account for just over a quarter of new contracts, they represent just under a half by value.

COMPETITION ANALYSIS BY CONTRACTOR

In the recent past, the top 10 suppliers to the MoD have remained the same. However, their individual ranking fluctuates depending on the particular set of contracts held by the supplier in a given year. The top 10 suppliers for 2010/11 can be found in the next page.

Unfortunately, the UK Defence Statistics report does not release data on how much money was awarded to each of the contractors. Rather, it simply presents the percentages of overall MoD procurement spend. That being said, the report does provide a banding of companies according to the amount of money they have received.

70 UK Defence Statistics 2011 (Table 1.15)

71 These are priced according to the government's profit formula discussed earlier. For more detailed information please see: http://www.MoD.uk/NR/rdonlyres/A3A5959A-EDC4-49AF-BE03-1C2FBE6EF276/0/2011_annual_profitformula_noncompetitive_contracts.pdf.

72 For more information on this category please see Def Form 57.

73 UKDS 2011, Table 1.15

FIGURE 12 | NON COMPETITIVE PROCUREMENT BY VALUE AND NUMBER OF CONTRACTS, UK

Prices in £ billion	2008/09	2009/10	2010/11
Total value of new MoD contracts placed	£18.3	£9.4	£7.2
Competitive	£7.9 (43%)	£2.3 (25%)	£3.4 (48%)
Non-Competitive	£10 (55%)	£6.9 (73%)	£2.6 (36%)
Other	£0.4 (2%)	£0.3 (3%)	£1.1 (16%)

Prices in £ billion	2008/09	2009/10	2010/11
Total number of new MoD contracts placed	8083	8012	6424
Competitive	2020 (25%)	1843 (23%)	1670 (26%)
Non-Competitive	5496 (68%)	5769 (72%)	4368 (68%)
Other	566 (7%)	481 (6%)	450 (7%)

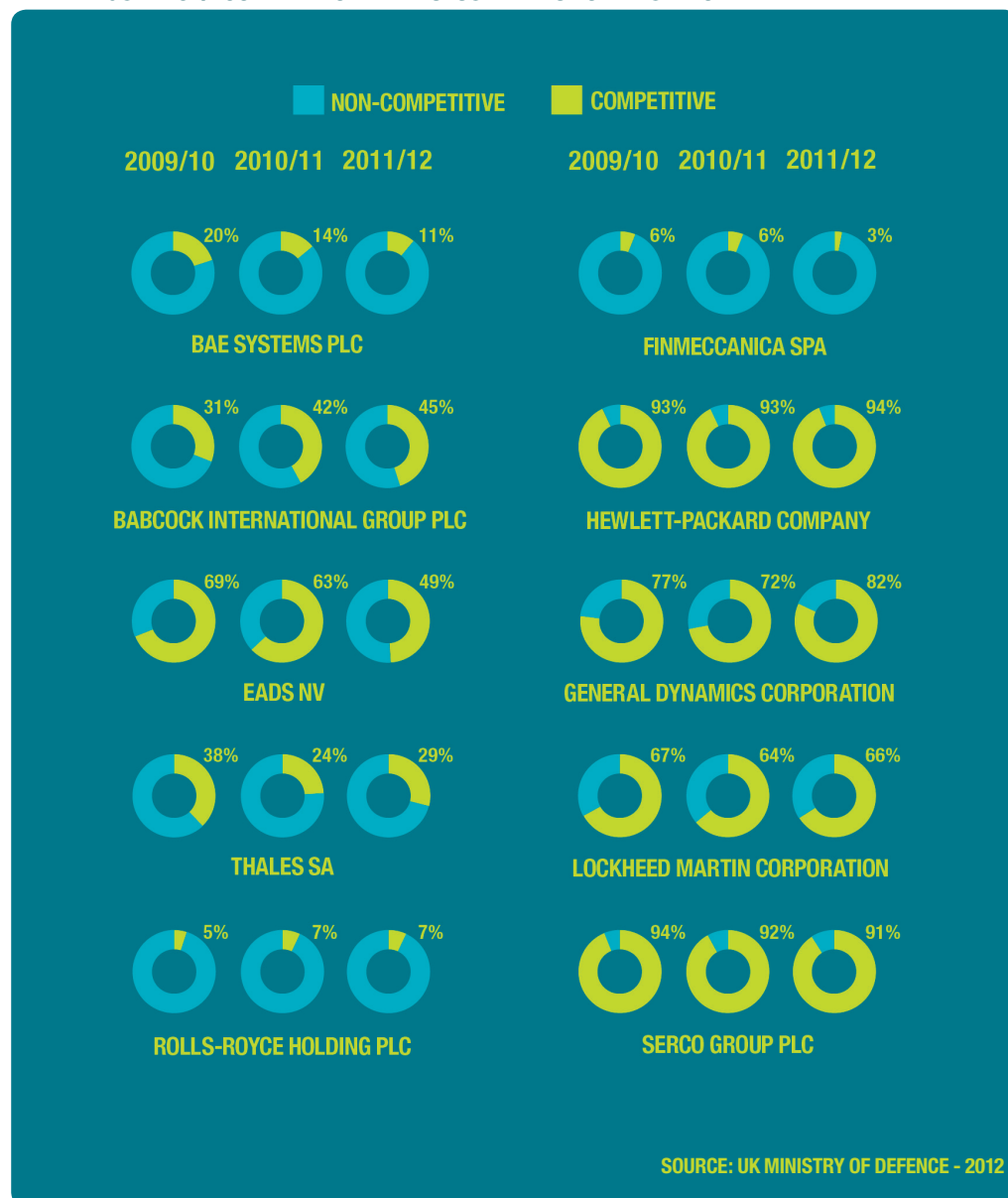
For 2010/11, eight private sector companies were paid upwards of £500 million. In no particular order these were: Babcock International Group PLC, BAE Systems PLC, EADS NV, Finmeccanica SpA, Hewlett-Packard Company, Lockheed Martin Corporation, Rolls-Royce Group PLC and Serco Group PLC, QinetiQ, and Thales. The two companies not in this band yet are in the top 10 list of MoD contractors for 2010/11, in the £250-£500 million band.

In 2010/11 approximately 40 per cent of MoD procurements were awarded to 10 suppliers, the largest of which was BAE Systems. Unsurprisingly perhaps, companies providing services tendered a higher proportion of competitive contracts than

those providing specialised products. The picture below provides a graphical representation of competition levels between traditional weapons manufacturing companies and the services companies.

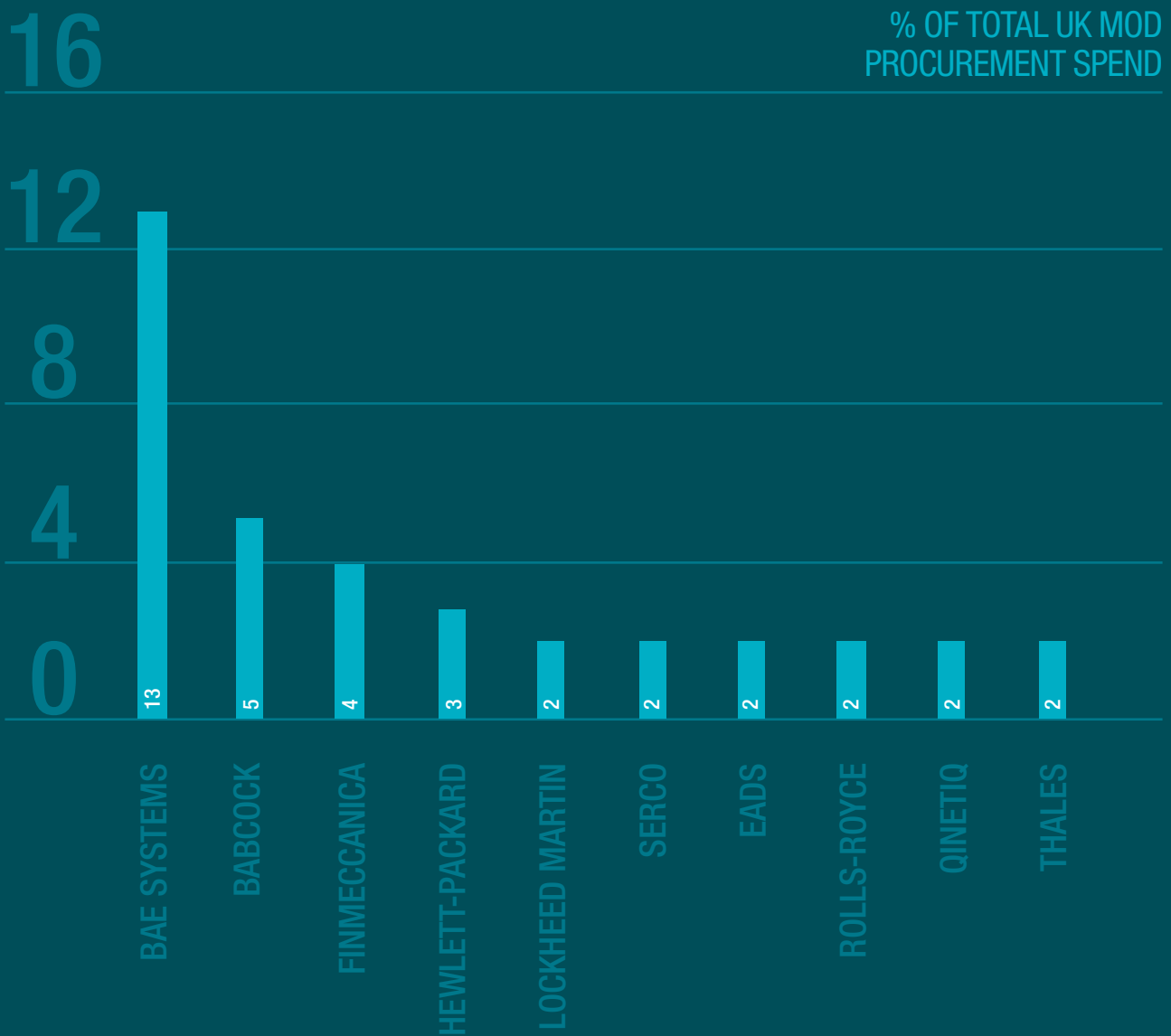
BAE Systems and Finmeccanica were awarded a significantly high number of single-source contracts. This is somewhat to be expected considering the products that these companies may provide the MoD. However, it should be noted that such an analysis cannot be undertaken despite the MoD committing to publish information on contracts over £250,000 or more under the Government's Transparency Agenda, because the MoD is exempt from reporting on:⁷⁴

FIGURE 13 | COMPETITION LEVELS: SUPPLIERS TO THE UK MOD



1. portable and automatic firearms
 2. artillery and smoke, gas and flame-throwing weapons
 3. ammunition for the weapons at 1 and 2 above
 4. bombs, torpedoes, rockets and guided missiles
 5. military fire control equipment
 6. tanks and specialist fighting vehicles
 7. toxic or radioactive agents
 8. powders, explosives and liquid or solid propellants
 9. warships and their specialist equipment
 10. aircraft and equipment for military use
 11. military electronic equipment
- It is assumed that the above list would constitute the majority of contracts signed by the MoD, at least in terms of value. Therefore, even though the MoD publishes a list of contracts that it signs, it is not replicated in this report.

FIGURE 14 | PERCENTAGE OF TOTAL PROCUREMENT SPEND, UK MOD



74 UK Ministry of Defence, *Ministry of Defence and MoD family spend*, May 2010, accessed December 2013, <http://www.MoD.uk/DefenceInternet/AboutDefence/CorporatePublications/FinancialReports/>

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Apart from graphically presenting the high number of non-competitive contracts that certain companies are awarded, the graph on page 52 is also helpful in representing trends over time. For instance, there seems to be little variance in the percentage of competitive and non-competitive contracts awarded to each company over the three year period.

CURRENT TRENDS AND RECENT RECOMMENDATIONS TO IMPROVE THE SYSTEM

One of the key recommendations of the Currie report was the move to an open book accounting system. This would allow the government access to a potential contractor's financial, management and operational data with the ultimate aim of being able to make a more informed decision. Such information is unavailable under the current contractual relationship. Such a system would help address the information asymmetry issues discussed earlier, and help the MoD deal with the loss of expertise it has suffered in the last few years.

Greater emphasis on efficiency is another key factor which must be addressed.

Under the current Government Profit Formula, only two references are made to efficiency. Concern about excess profit being made not through efficacy but faulty pricing has in fact led to the introduction of a new contract condition, DEFCON 648A. This provision nullifies many of the incentivising benefits in negotiating a firm or fixed-price contract, since when profits go beyond that agreed by the price (currently 5 per cent), it is the MoD which receives much of the excess via the price reduction of the contract. Therefore an efficient contractor would actually be faced with a situation in which his improved efficiency could result in higher returns for the contracting agency rather than the company. In his report, Lord Currie recommended not only for the 5 per cent threshold to be increased, but for greater incentives for contractors to become more efficient. He suggests doing this by allowing for a fairer distribution of profits resulting from greater efficiency.

Ultimately however, it may not be the function of the MoD to incentivise efficiency. It is a monopoly customer and as such would financially benefit from it. A separate, independent committee or agency should be made responsible for ensuring that the appropriate checks and balances exist to make sure that any changes made to the current incentivisation system are above board and not favour one party over others.

Note: At the time of publication the United Kingdom is proposing to create a framework to ensure greater transparency and efficiency in the award and management of single-source contracts. This new framework is based on the recommendations of the Currie report and emphasizes standardised reporting, stronger supplier efficiency incentives and stronger governance arrangements. A new organisation, the Single-Source Regulations Office (SSRO) will be created to monitor the regulations and serve as an independent expert in single-source procurement.⁷⁵

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⁷⁵ <http://www.contracts.mod.uk/changes-to-the-procurement-regulations-a-decision-that-will-keep-britain-secure/>

Focus on armament procurement

For four of the countries in the study, data on non-competitive procurement is also available by armaments alone. This provides an interesting comparison against the general levels of non-competitive procurement within armed forces. It also allows assessing whether armament spend lends itself more to non-competitive procurement.

Interestingly, all four countries exhibit a decrease in their competition levels when buying armaments. The chart below illustrates this point.

Due to national differences the exact definition of what would constitute 'armaments' vary. For instance data for US armament contract award, which is available from the website www.usaspending.gov is an aggregation of total expenditure by the DoD on weapons; ammunition & explosives; and aircraft structure/components/launch pads. Contrastingly, for Slovakia, where the Open Public Procurement initiative website was used, the authors considered weapons, ammunition and associated parts; military

electronic systems; military aircrafts, missiles and spacecrafts; and military vehicles and associated parts as armaments.

The definition of what would constitute armaments in Poland and Slovenia is not available since the figures obtained were provided by Ministry of Defence officials in the survey instrument sent out by TI-DSP and IDARM. Nonetheless, when compared to the general difference between other countries, the numbers seem to correlate.

For the USA, the five largest contracts that were not fully and openly competed were all for aircrafts or fixed wings. Given the unique and highly technological nature of the equipment in question, this does seem reasonable. Of the five contracts however one was modified because it was considered 'additional work' to an existing contract, one was a 'change order', whilst the other three were 'funding only actions'.

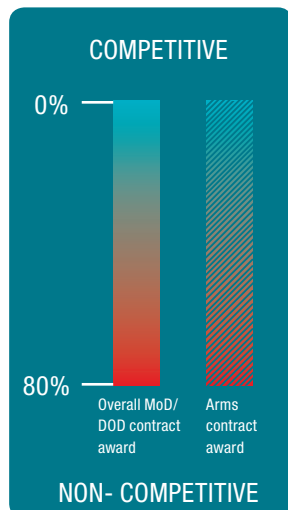
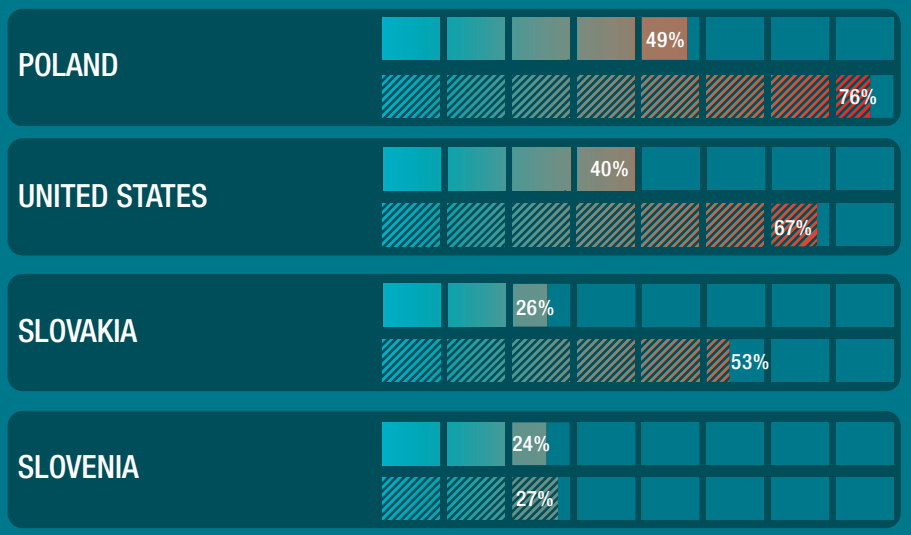


FIGURE 15 | NON-COMPETITIVE CONTRACT AWARD BY VALUE



Actions

DEFENCE MINISTERS, MINISTRY HEADS AND DEFENCE PROCUREMENT CHIEFS

- 1.** Keep up-to-date and consolidated records of the level of single-source or non-competitive contracts awarded. Routinely analyse the trends in this data.
- 2.** Publish records of the level of single-source or non-competitive contracts awarded on your MoD website every year. Make public your justifications for using single-source contracts. This will help alleviate public concerns that contracting authorities are engaging improper behaviour behind a veil of secrecy.
- 3.** Make your procurement processes more transparent and open to public scrutiny. Include in this your policy and practice of single-source procurement.
- 4.** Member States should grant organisations such as the European Defence Agency (EDA) permission to publish their competitive procurement levels.
- 5.** Introduce clearly defined measures to reduce the risk of corruption in single-source procurement. These include multiple levels of oversight and approval, personal asset declarations, rotation of staff in key positions, rigorous internal and external audits focused on influence, benchmarking, and open-book pricing.

FOR THE EUROPEAN DEFENCE AGENCY

1. The European Defence Agency should embrace their commitment to transparency and press countries to be more transparent on their procurement data.

FOR NATIONAL LEGISLATORS AND LEGISLATIVE DEFENCE COMMITTEES

1. Demand more open reporting of procurement data and single-source information from the MoD. Consider the Polish, UK and US examples as models that your MoD could use.

2. Regularly request data on single-source percentages from the MoD and ask for explanation of the trends.

FOR CIVIL SOCIETY

1. Demand defence procurement information from the MoD. Propose an active role for civil society in monitoring and overseeing defence policies and practices in this area.

Single Sourcing

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Design: SVIDesign, Maria Gili, Paolo Ganino

This report has been printed on FSC certified paper.

ISBN number: 978-0-9574970-2-3

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First published in April 2014.

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Thanks

TI-DSP would like to thank the UK Department for International Development (DfID) for their generous support, and the countries which collaborated with data for this research.

Effort has been made to verify the accuracy of the information contained in this report. Nevertheless, Transparency International UK cannot accept responsibility for the consequences of its use for other purposes or in other contexts.

ABOUT THE INTERNATIONAL DEFENSE ACQUISITION RESOURCE MANAGEMENT (IDARM) PROGRAM

The International Defense Acquisition Resource Management (IDARM) Program is a division of the Naval Postgraduate School's Center for Civil Military Relations. Established in 1997, the IDARM Program is intended to strengthen democratic relationships and international security cooperation through acquisition education, research, and professional service. The Program is internationally recognized as a premier source of education and training for defense acquisition, logistics, contracting, project management and negotiations. The aim is to provide the framework within which countries can develop and sustain efficient and effective defense acquisition systems. To this matter the program conducts research in related areas, in particular regarding the field of defense acquisition decision-making.

The views represented in this report are those of the author(s) and do not reflect the official position of the United States or any other government.

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