



Defence Sub-Committee

Oral evidence: Foreign Involvement in the Defence Supply Chain, HC 699

Monday 14 December 2020

Ordered by the House of Commons to be published on 14 December 2020.

[Watch the meeting](#)

Members present: Richard Drax (Chair); Stuart Anderson; Mr Tobias Ellwood; John Spellar.

Questions 96-161

Witnesses

I: Nadhim Zahawi MP, Parliamentary Under-Secretary of State (Minister for Business and Industry) Department for Business, Energy and Industrial Strategy, and Dr Sarah Mackintosh, Deputy Director for National Security and Investment, Department for Business, Energy and Industrial Strategy.

II: Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence, Huw Walters, Director Economic Security and Prosperity, Ministry of Defence, Air Marshal Richard Knighton, Deputy Chief of the Defence Staff (Financial and Military Capability), Ministry of Defence, and Lieutenant General Jim Hockenhill, OBE, Chief of Defence Intelligence, Ministry of Defence.

Written evidence from witnesses:

Ministry of Defence: [FSC0001](#)



Examination of witnesses

Witnesses: Nadhim Zahawi MP and Dr Sarah Mackintosh.

Chair: This is the third session of the Defence Sub-Committee. Today we will examine the National Security and Investment Bill, in particular the powers within that Bill—particularly the shift from a wholly voluntary to a partially mandatory regime—and comparative international regimes and lessons learned from more established systems, plus other elements. We have two very distinguished panels. The first is made up of the Minister, Nadhim Zahawi, and Dr Sarah Mackintosh. I will just ask you both before we start the questions, to give 30 seconds on what you both do: I'd be grateful.

Nadhim Zahawi: Thank you very much, Mr Drax. It is great to be before your Committee. I am the Minister responsible for the National Security and Investment Bill in the Department for Business, Energy and Industrial Strategy.

Dr Mackintosh: I am Sarah Mackintosh. I am the deputy director leading on the National Security and Investment Bill. I am very happy to be here today supporting the Minister.

Chair: It is a pleasure to see you both. The first question comes from the Chairman of the Select Committee, Tobias Ellwood.

Q96 **Mr Ellwood:** Thank you very much indeed, Chair. It is good to see the panel here today. Minister, I am glad you have been able to step back from your duties at the moment in dealing with the vaccine. That is much appreciated. I wondered, just to set the scene, whether you could spell out, in just a couple of minutes, why this Bill is so important, and why now.

Nadhim Zahawi: Thank you very much, Mr Ellwood. It is great to be before a Sub-Committee of your Committee, the Defence Committee. Why now: this Bill has been a long time in the making, so really the origins go back to the October 2017 Green Paper, followed by the White Paper in July 2018 and then the consultation. Of course, we are not alone in making such changes, Mr Ellwood. Our new approach really just brings us into line with other open, free market economies, such as our Five Eyes partners. I know you are close to a number of them, including, of course, the United States of America and Australia. Like us, the US and Japan have recently introduced mandatory notification requirements. In July the Australian Government also released draft legislation requiring foreign investors to seek approval to acquire a direct interest in sensitive national security businesses. I think this is due to the long-term trends of what is happening with malign actors. By the way, the majority of investors are good, positive investors. We cherish our position of being in the premier league of destinations for foreign direct investment. There is a small minority who obviously wish us harm. There are malign actors. So there



has been a long-term trend of them becoming more creative, and I am sure we are going to delve into that in this session—how they attempt to do harm to our national security. Of course, the onset of covid has focused the mind in terms of, especially, some nascent technologies—young companies that may be struggling and could be targets for those malign actors.

- Q97 **Mr Ellwood:** Thank you, I appreciate that. You say it has been a long time coming, but some would say this should have come earlier. We are very pleased and congratulate the Minister on bringing this forward, but how come we haven't been a little quicker in recognising that this is now a commonplace theme: seeing other states and non-state actors wanting to take advantage of the distraction of covid and other things to buy access to companies that have a national security interest?

Nadhim Zahawi: You are quite right. I think we have worked as fast as we can. We moved towards a mandatory notification process of 17 sectors. We are currently consulting on the wording to make sure it is as tight as we can make it for those 17 sectors, so that businesses understand exactly where they stand, because, as I have said, we want to remain open to foreign direct investment of the right kind—one that brings positive outcomes to our country. To answer your question, this is a big year in many ways. I know you have been very focused on the issues around Brexit in your own public statements recently, but also on the challenge of covid. We haven't taken our eye off the ball. We have continued to pursue the laying of this legislation. We have just now gone through Second Reading and Committee stage.

- Q98 **Stuart Anderson:** Hello both. I just wanted to expand on your opening comments. You said that we want to remain the "premier league" for investment and that there is a "small minority" that would wish to do us harm. With the Bill, what sort of acquisitions are you attempting to prevent? Can you expand on that, please, Minister?

Nadhim Zahawi: Of course. Thank you very much for your question. We will be able to review a much broader range of transactions than under the Enterprise Act 2002. Obviously, the gap of 18 years has meant that there are many sectors that did not even exist back in 2002, things like AI and quantum computing. If the Secretary of State suspects that national security risks arise, he can intervene. The Bill will also allow us to intervene in acquisitions of control of entities and assets, looking not just at mergers or acquisitions in whole but the ability of a malignant actor to seize control in more imaginative ways than a straightforward acquisition.

Under the new regime, we will be able to scrutinise mergers and acquisitions of any size and not be limited by turnover. As I said earlier, there are many young companies that may not even be profitable yet that are sensitive and critical to our national security that we want to intervene in. And in any sector, of course. Along with the 17 mandatory sectors, the Secretary of State, if suspicious, can intervene outside those sectors. There are much more objective trigger events where we can decide, when those have occurred, that we can then intervene, such as acquisition of



HOUSE OF COMMONS

material influence over an entity. So we are not just going after those mandatory 17 sectors or straightforward acquisitions but actually that additional control.

It is a big, big step forward, I think, in terms of our ability to protect our national security. But it is also tempered by making sure that, unlike the Enterprise Act, where it's on a case-by-case basis and could take many months before an acquirer could complete a transaction, we limit ourselves to 30 working days to be able to go back, extendable to 45 working days beyond that. That should, as it has in our consultations, send a very strong message to the investment community that we want a slicker, more efficient regime, but one that is much more robust in its screening of national security.

Q99 Mr Ellwood: I just wanted to go back to some of the earlier drafts, and the White Paper as well. Can you take us through how this is going to work, from a voluntary scheme to actual law obliging action?

Nadhim Zahawi: Sure. We are currently consulting on the 17 sectors where it is mandatory to report. That consultation will close on 6 January, and then after the Bill's passage, we will bring that back in secondary legislation to get those sectors in. If you are a company in those sectors, you will know that no matter what the size of your business, if there is a trigger event for selling partial shares or a full transaction—whatever it happens to be—you can come and talk to the unit. Sarah can talk more about one of the other innovations we have introduced by learning from our allies, which is the ability for companies and acquirers to come early and have an informal conversation with us about their transaction.

Then, of course, there are those sectors that are outside the 17. If, through our work with the agencies, if they happen to be defence-related with the MoD—I know you are taking evidence from Minister Quin later—the Secretary of State thinks there is suspicion that there may be a cause for concern on national security grounds, then he can call in; he has a call-in power to do that. We deliberately brought that in on the date of laying the Bill, just in case those malign actors may choose to use the gap between the laying of the Bill and commencement to complete transactions that we will not be able to intervene in later. Sarah, I do not know if you want to add anything else on this point?

Dr Mackintosh: I would just add that we are already offering this service where people can come and talk to us, and get some informal guidance before the Bill comes into force on how that might affect the transaction.

Q100 Mr Ellwood: Further to that, you mentioned international trends. Are we Johnny-come-lately here, or are we setting the trend?

Nadhim Zahawi: I think we are in line with other Five Eyes countries. I mentioned the speed they are moving at, whether that is Australia or other countries, such as France and Germany. This is something that we have needed to do. As I explained earlier to Mr Anderson, the Enterprise Act 2002 is 18 years old. There are sectors that were not even around—were not invented—18 years ago, so it is right that we had the Green



HOUSE OF COMMONS

Paper in 2017, and then the White Paper and consultation. I think it is the right thing to do now, and to do at speed.

Q101 **Mr Ellwood:** What about those companies that you feel have already perhaps been exposed, and are now in the ownership of states or non-states that you believe may pose a threat to the UK?

Nadhim Zahawi: There are no retrospective powers in this Bill, if that is what you are asking, Mr Ellwood. If there are companies that are of concern to our national security apparatus, at the moment there are obviously other ways of dealing with that, but this Bill has deliberately not chosen to be retrospective in that sense, because I think that would send a very negative message and probably have a pretty chilling effect on the investment environment in the United Kingdom.

Q102 **Mr Ellwood:** But the negative message could be even greater than that, when we see threats to our security being increased simply because there has been access to share ownership and then influence on data, or influence over decision making. Could I invite the Minister to write to the Committee to indicate what those other powers are to deal with companies where there is a retrospective concern?

Nadhim Zahawi: I am happy to write. I would just remind the Committee that the Government moved speedily and robustly on the issue of Huawei, and there is obviously the Telecommunications (Security) Bill that Minister Warman is taking through Parliament as well.

Q103 **Mr Ellwood:** But that is a great example of the difficulties we had to go through to unpick Huawei and, therefore, if we are going to have to repeat that, it could be quite difficult.

Nadhim Zahawi: That is a point well made. I am very happy to write to the Committee, but as I said, as far as the Bill is concerned and our scrutiny here today, it is deliberate that it does not have retrospective powers.

Q104 **Chair:** Minister, you touched upon part of this question, but maybe you could just expand a bit. The UK was unique among western economies in not having stand-alone foreign investment legislation. What have you learned from the more established regimes in other countries?

Nadhim Zahawi: One of the things we have learned, and we are proposing to do the same thing here, is from the US regime and it is to have an online system—portal or platform—that will hopefully deal with the bulk of inquiries that come through, because we clearly anticipate an uplift from where we have been under the Enterprise Act and where we will be under the National Security and Investment Bill. Another innovation is the ability for acquirers and companies to come and talk to the team on an informal basis. Of course, we have taken the mandatory route; some of our allies have done similar things. The Secretary of State has a quasi-judicial role in the whole system, which, again, gives reassurance to acquirers and investors in the UK. One of our great advantages when we research this stuff is that our legal framework is robust and protects investors, which is why we are such an open and welcoming country for



HOUSE OF COMMONS

foreign direct investment. There is also their ability to legally challenge, to be able to judicially review if they feel that they have been treated unfairly. There are a lot of learnings. Do you want to add anything else to that, Sarah?

Dr Mackintosh: Just on ensuring that you are robust in the timings and making sure that we stick to our statutory timelines, which will provide greater assurance to businesses. That is something that we have taken away from looking at the other regimes.

Q105 **Chair:** You mentioned the US. Are there other systems that are comparable to ours? The reason I ask that question is because what started this Sub-Committee was a comment made at the Defence Committee about the French doing a root-and-branch reform of all their supply chain, which is what, in part, prompted this. For example, do you speak to the French and have you learned anything from what they are doing, which is looking, as I say, root and branch through their defence supply chain?

Nadhim Zahawi: Yes, and in some of the earlier consultation with colleagues in Parliament we mentioned the French and German examples, where they are doing similar things, to reassure colleagues who are concerned about the attractiveness of the United Kingdom for foreign direct investment that we are not an outlier and that we are very much doing exactly what other countries are doing. Therefore, the investment community will not see this as a strange system to operate within. They will be familiar with it because they have seen it in CFIUS in the United States, they have seen it in Australia, in France as you say, Germany, Japan, so a number of countries. We talked to all of them to make sure that we try to take the best ideas that we think will work sensibly in the United Kingdom.

Q106 **Chair:** China is mentioned a lot and, clearly, she is extending and all the other things we know. We are targeted on many occasions: IT and other attacks on this country. Did the rising of that sort of behaviour push this along to some degree? No one ever really talks about China. I know it is a huge trading partner as well, but they are doing what they are doing and we cannot just sit here and do nothing.

Nadhim Zahawi: Again, I would just stress that the Bill is not a country-specific Bill. Deliberately so, because we need primary legislation to be robust and stand the test of time. There are malign actors in many hostile states around the world, including individuals and criminal fraternities.

The Bill is deliberately not country-specific, because that is the right way for it to be able to serve this nation and protect our national security.

Q107 **Chair:** With your ministerial hat on, have you received any evidence that the Chinese are doing what the French are looking to make sure they do not do? The Chinese want to buy into the defence supply chain, even right down at the bottom—wheel nuts for lorries, for example. Have you looked into that, and are you convinced that they are not doing that?



HOUSE OF COMMONS

Nadhim Zahawi: We look across the board at all threats to national security. As I say, the Bill is not nation-specific in that sense. There are some nations or states that are clearly more active than others, and we read about all sorts of attempts at acquiring influence. The robustness of this legislation is that it will allow us to put in place a system that will pick up through the screening process what more creative behaviours, if I can describe them as such, some of these malign actors or hostile states may choose to use. I also think there is enough of a stick, if I could describe it like that, in the sense that there are both civil and criminal sanctions if someone is working or colluding in a role to acquire influence or assets that are important to our national security. Obviously, there are the fines and then the criminal offences, which could lead to a jail sentence.

Chair: Sarah, do you have anything to add?

Dr Mackintosh: I would just mention the voiding element of the Bill. If you do not notify and you are in a mandatory sector, your transaction will be considered void in law. That is a very encouraging power to comply if your transaction is considered void in law.

Q108 **Stuart Anderson:** Minister, you mentioned the stick approach. With the stick, we also want to see the carrot. Legislation is coming in, and there are a lot more rules around investment into the UK. How confident are you that we are not going to lose any investors with this Bill?

Nadhim Zahawi: Thank you, Mr Anderson. I think your question is around our attractiveness for foreign direct investment, or FDI. We have been really clear from the outset that this regime will be used exclusively to protect the UK's national security, rather than for wider political considerations. At one stage on Second Reading, the shadow Secretary of State for BEIS was suggesting that it should be used for what he described as the industrial strategy Bill. That would be a mistake, because I believe that would have a really chilling effect on investment into the United Kingdom. We are making the process of notifying and screening investment much simpler, quicker and slicker, so that we provide clearance and statutory timelines—not stuff that is left up to ministerial diaries.

We will also facilitate the engagement that I talked about earlier—early engagement with the system—and it will take 30 days or less to clear the bulk of the notifications. The overwhelming majority of transactions will be unaffected by these new powers. We think that less than 1% of all M and A and asset transactions will result in a notification to Government.

Of course, the recently announced Office for Investment will also likely play a big role in promoting the United Kingdom as a great place to invest. It will work seamlessly across Government to drive and co-ordinate the deal-enabling activities that are required to land high-impact, high-value investments.

I will give you a quick quote from the expert evidence that we took from Dominic Long, a partner at Allen & Overy. He agrees that there will not be



HOUSE OF COMMONS

a significant burden on deal timelines “for transactions in the mandatory notification sectors, but where there aren’t any obvious national security concerns, the Government’s position is that the review would be very quick”.

I think this strikes a balance. It is proportionate and the right thing to do to protect our national security. We are absolutely right to bring it forward—it is the first duty of Government to protect the nation’s security—but, as I say, it also allows us to send a very clear message to the world that we are open to good, positive inward investment.

Q109 Stuart Anderson: You talked about industrial strategy and gave your views about why that was not the best route, and I understand that. But let us drill down and look specifically at defence and security, which is what the Committee is concerned about. Are you 100% confident that the Bill will not cause us to lose any investment in the specific sector of defence and security?

Nadhim Zahawi: The only investment it will lose us is malign investment by hostile actors—that is business we probably would not want here anyway. Colleagues in the Ministry of Defence and Minister Quin are doing a brilliant job engaging with the industry, as we do in BEIS, by being incredibly open and welcoming. We want to understand better and get behind our industry. I do not see the Bill impacting in any way the wellbeing of what I think is an important sector for the UK economy.

Q110 Chair: Let me butt in before I bring Tobias back in. I was having a chat with Airbus, and one of the complaints or observations they made was that many contracts go abroad and that the Government should look at far more home-grown contracts for Defence. When we leave the EU, I would have thought that reliance on such special skills and expertise will be important to keep them in the UK. Will you as a Business Minister do all you can to ensure, with the Government, that more contracts are offered here rather than going off to France, Spain or anywhere else?

Nadhim Zahawi: I am grateful for your question, Mr Drax, which is a wider question outside of the National Security and Investment Bill, but I am happy to take it on as well. You are absolutely right that we have a real opportunity with Government procurement, because the Government buys about £292 billion of stuff a year across the board—that is above the threshold; I am not talking about the stuff below the threshold. I am providing input into Minister Agnew’s Green Paper and his excellent work looking at how we procure to ensure that, within WTO rules, our procurement strategy is flexed towards much greater UK content and much greater SME content.

I know that both in defence and in other sectors I look after at BEIS, it is those innovators who are so desperate for that first break and first contract—especially if it comes from Government—because they can then go out and say, “I am contracted with my own Government, so you should really look at my products, because I think I am best of breed.” I have been an entrepreneur—not in defence, but in data and information. It is



HOUSE OF COMMONS

going to be very important. I can assure you, even in the year of covid, that we have not taken our eye off that ball. Minister Agnew's work is well advanced.

Q111 Mr Ellwood: Minister, you touched on the ability of the MoD to move in quite quickly and say it has a concern with a company or organisation. Could you expand a little on how the operations will work across Whitehall, away from the MoD? Many Departments will have similar concerns. What are the mechanics of how it will work in feeding into you?

Nadhim Zahawi: Thank you very much, Mr Ellwood. The unit will sit in BEIS, and it is obviously up to the perm sec at BEIS, working with the Treasury, to make sure it is resourced adequately. It is able to pull in any expertise from across Government and the agencies. It is a sort of hub-and-spoke model, which I am sure you are familiar with, Mr Ellwood.

I believe that is the best way forward. Indeed, when I speak to some of my colleagues from other Departments, they say that BEIS is the right place for the unit to sit. If you take the MoD, for example, Minister Quin will want to maintain, drive forward and be incredibly positive about the relationships that he will have with the companies, whereas the Secretary of State at BEIS will have a quasi-judicial role in looking at a particular transaction. He will be able to pull in all the evidence from our national security apparatus and see where it leads in making that decision. That division of labour is the right one, because it will allow MoD Ministers to really lean into the industry, whereas the Secretary of State at BEIS will come into play only in that quasi-judicial role.

Q112 Mr Ellwood: Thank you for that. Moving to the scrutiny in Parliament and how Parliament fits into this, you will be aware that there is a register, which is updated annually, of terrorist organisations. It is presented to Parliament, and Parliament can confirm it. Will there be a presentation once a year so that we can understand what is happening here, what is changing, who is being added to the list and what BEIS is doing about it?

Nadhim Zahawi: The Bill proposes an annual review to Parliament, so the Secretary of State will be able to give us information about how many transactions there are and what particular sectors are of concern. It will contain some real detail and will allow Parliament to have that moment of scrutiny of how the system is operating. You mentioned the list of terrorist organisations. We see this as important input into the work of the unit, and lots of other information will come from other parts of Government. Sarah, I don't know whether you want to add anything else to that.

Dr Mackintosh: Just that we hope the report will be able to provide business with a lot of assurance about what we are looking at and why we are looking at it.

Q113 Chair: Under this regime, the UK will go from a limited system under the Enterprise Act to potentially over 1,000 notifications and up to 100 substantial reviews annually. Does BEIS have the institutional knowledge and capacity to run this system effectively straightaway?



Nadhim Zahawi: Yes, absolutely. The reason I say that is that, as I have just described—maybe I anticipated this question—we have the hub-and-spoke model, so the BEIS unit will be able to draw on expertise from across Government to be able to do its job, and the perm sec, working with the Treasury, will ensure that the unit has the wherewithal and the resources it needs to do its job properly. Of course, Parliament will have an opportunity to scrutinise that, through both the work of the BEIS Select Committee and the annual report.

Q114 **Chair:** Sarah, do you have anything to add to that?

Dr Mackintosh: I would simply add that under the Enterprise Act we truly have a cross-Government approach to those kinds of cases. We have learned an awful lot of lessons during that. In the set-up of the investment security unit, we will continue to learn those lessons. It truly is a cross-Government effort.

Q115 **Chair:** Will you have more staff, Minister, or will you just move people around and train them up to meet this new legislation? What will you do?

Nadhim Zahawi: The ultimate decision about how to staff the unit is for the perm secretary. The unit will be staffed to do this work, so it won't be people who are part time. It will obviously pull in additional resource or information from relevant Government Departments. If a transaction—this is one for your Committee—involves a defence contractor or supplier or a particular piece of innovation that could be either dual use or something that, in the future, could play a big part in our military capability, then the unit will be able to pull in that information from experts in the MoD, and therefore present the Secretary of State with that information. He can then make that quasi-judicial judgment that he needs to make in terms of what he will do vis-à-vis a particular transaction or someone seeking influence or control over a particular entity or asset.

Q116 **Stuart Anderson:** In a previous Committee meeting, concerns about venture capitalists and small start-ups became very clear. If somebody wants to invest in one of the major defence primes, all along, bells are going to go off if that is someone hostile. So we want to know—because this Bill, I believe, doesn't cover it—how you are going to guard against early-stage investments in start-ups from venture capitalists? They are not actually acquiring the businesses, but they are investing in them at a very early stage? Is this a gap that we can plug?

Nadhim Zahawi: This is actually covered by the Bill. Where early funding or venture capital amounts to a trigger event, that will be absolutely covered by the Bill. I believe very strongly that it is only right to ensure that we can scrutinise acquisitions of control over national security-sensitive entities, some of which may happen at a very early stage, to your very good point. Where equity is traded for investment in order to grow, which is what most young start-ups do—as I did with YouGov—we will be able to review a much broader range of transaction than under the Enterprise Act, if the Secretary of State then suspects national security risks could arise. Under the new regime, we will be able to scrutinise mergers and acquisitions involving any size of company, in any sector,



along with acquisitions in sensitive assets such as intellectual property, so that will be absolutely covered under the mandatory notification in the 17 sectors. I think the regime is pretty wide and far reaching, and will cover those early fundraisers that you quite rightly asked the question about.

Q117 Stuart Anderson: Let us say a few people have an idea around AI. They come together, they are going to form a company, and someone decides to put £1 million into that start-up even before it's established. Will you then know who every investor in that business is when it is launched?

Nadhim Zahawi: Yes. If that entity is in AI, which is one of the 17 sectors that are covered, the moment that company is looking to take in that million quid, the acquirer or the investor has to come and say, "Look, I'm thinking of putting a million quid in this company," have an informal discussion or fill in the forms, and then seek clearance.

Q118 Stuart Anderson: I want to clarify this point for my own understanding. That is on a pre-set-up company. What happens if they want to form a company with several other people? Will that still be registered under this, because then it is not an established trading organisation? They set up with £1 million investment and they form a company. Because it's one of those—let us take AI—17 sectors, will you know who those investors are?

Nadhim Zahawi: The moment that entity becomes real, and a transaction is taking place, they have to notify. If they don't notify, it will be made void. So it captures that.

We have not found any gaps in that process when we have gone through a thorough consultation, and also looked at our allies and what they have done. It is captured by the mandatory notification of those sectors.

Chair: John Spellar has just joined us, and he will have the final say.

Q119 John Spellar: Apologies; I have been in the Commons Chamber.

Are you looking at taking a broad or narrow view of what is sensitive? For the last 30-odd years in our history of this, rather than techniques and innovations developed in the military seeping out to the civilian, very often now it is the other way round. So developments are taking place that could be of potential use or, most importantly, could shorten the development cycle in countries that might not have our interests at heart.

Are you saying, "Here is a clear military application" or are you looking a bit more carefully and saying, "This could easily be developed into areas that would have a security and development application—and also, by the way, apply to the economic security of the country—and this might enable people to catch up with us"?

Nadhim Zahawi: Our focus is very much on our national security; we discussed this a little earlier. Your colleague, the shadow Secretary of State for BEIS, wanted a broader industrial strategy, which I think would be wrong. It is very much focused on national security.



HOUSE OF COMMONS

To your very good point and your first question around the applications of some of these new sectors, as I described earlier the Enterprise Act 2002 is 18 years old and some of these sectors were not even around then—some of the advanced material stuff that I think you were referring to, or AI or quantum computing.

In many ways there is an elegance to the mandatory notification in the 17 sectors that are critical to national security, which we are consulting on at the moment, because we did not want to just put them into the legislation as a *fait accompli*. We want to get the wording right—consult with experts and with industry to get that right. The elegance of that is that it should throw up those nascent, young technologies that could in the future have that dual-purpose role for defence, for example. Hopefully, it will allow us to be able to make a judgment as to how important to national security that particular innovation or company asset is, in the way that the Secretary of State will have a quasi-judicial role.

Q120 John Spellar: In that same way, on the industries that we might be developing—indeed, industries that we could then maybe lose because of the extra money being thrown in in other countries—might we get into a dependency relationship that affects our security because countries then say, “We will cut off your supplies”? We are seeing a lot of that going on as part of not just trade wars but political battles as well.

All I am saying is that the danger will be that some officials will want to interpret this in a very narrow way—in other words, are we selling them something that will enable them to optimise ICBM or whatever—instead of looking at the broad spectrum of our security and saying, “On these technologies, which are pretty vital for our development, are we handing another country an ability to catch up and overtake?”

Nadhim Zahawi: You are absolutely right to say that we need flexibility. The Bill deliberately does not define national security; we heard many colleagues in the Chamber on Second Reading agreeing with that. We took evidence that suggested that that is the right way to go, because national security can shift.

Look at what has happened in 2020, where we have added to the Enterprise Act the whole issue around combating the pandemic and health considerations.

In terms of primary legislation, the Bill will stand the test of time and will allow us to look at national security, depending on the particular sector and the particular circumstances as well; but it is very much focused on national security.

Q121 John Spellar: That could include energy security.

Nadhim Zahawi: Of course, and that is very much our intention.

Q122 Chair: Thank you. That concludes our first panel. I offer my huge thanks to Minister Nadhim Zahawi and Dr Sarah Mackintosh, the Deputy Director for National Security and Investment, from BEIS. Thank you very much for your time. I also thank our Clerk, Mark, without whom everything



would go astray. Thank you very much indeed for coming.

Examination of witnesses

Witnesses: Jeremy Quin MP, Huw Walters, Air Marshal Richard Knighton and Lieutenant General Jim Hockenhull.

Q123 **Chair:** This is the second part of the evidence gathering on the Defence Sub-Committee. We have another very distinguished panel. We have the MoD team here; we had the BEIS team earlier. Welcome to you all. It is very nice to have you here.

This session will continue to examine the National Security and Investment Bill, in particular the powers within the Bill and the shift from wholly voluntary to a partially mandatory regime, looking at, among other things, comparative international regimes and lessons learned from more established systems.

Could the four of you, starting with the Minister, just each say a little bit about yourselves?

Jeremy Quin: Thank you. I am Jeremy Quin. I am Minister for Defence Procurement in the MoD.

Huw Walters: I am the Director Economic Security and Prosperity in the MoD.

Air Marshal Knighton: I am Air Marshal Rich Knighton. I am Deputy Chief of the Defence Staff for military capability and I look after our future capability planning for defence.

Lieutenant General Hockenhull: I am Lieutenant General Jim Hockenhull. I am the Chief of Defence Intelligence, responsible for running the defence intelligence enterprise within the Ministry of Defence and across the armed services.

Chair: Thank you, gentlemen. Welcome. It is very nice to see you all. Thank you very much for coming. Stuart, over to you.

Q124 **Stuart Anderson:** Thank you, Chair. Hello everyone. Minister, could you let me know whether you are confident that the Bill meets the needs of UK defence?

Jeremy Quin: Yes, we do. It is a simple and short answer.

It is important that we shouldn't view this as coming into a vacuum. The Enterprise Act has been there since 2002 and it has been strengthened by SIs, including in 2018, and by measures that we have put in place in defence over that period and particularly over the last few years. This is, in our view, a very welcome and very necessary bit of legislation. It broadens the scope in terms of the lower threshold for SMEs, so a larger number of SMEs will be caught by the threshold under the NS and I Bill.



HOUSE OF COMMONS

I very much welcome the introduction that the Chairman referred to of mandatory reporting, which makes us more confident that issues will not be missed. It broadens it to include asset sales, as well as the control of companies. All of these are welcome developments. Defence has had more protections than other sectors, but as I think the Committee was saying in its last session, things are so fluid and evolve.

We are glad to see this broader remit, the broader scope and the 17 sectors—I know they are still being consulted on—that will give it a greater breadth across the whole width of companies that could impact on defence. It is very welcome.

Q125 Stuart Anderson: Thank you, Minister. When we look at foreign ownership, it is very widespread in defence. How will this proposed regime impact on the ability of international defence suppliers to operate in the UK? It would be great if you could provide your views, Huw.

Huw Walters: Certainly. Generally, we very much welcome foreign investment. As BEIS said earlier, defence has benefited a lot from the investment of companies who operate here, who generate intellectual property in the UK and carry out activities here, but we recognise that there are some sorts of hostile foreign investment that come in. We have had a team in place since 2017 to look specifically at these sorts of issues and carry out investment screening.

Overall, the number of transactions that we would regard as hostile are a fairly small proportion of the total, so I do not think it is likely to have an overall significant impact on foreign investment and the ability of overseas companies to operate in the UK defence sector.

Jeremy Quin: I absolutely back up Huw. The UK is proud of the fact that we have some £1.5 trillion of FDI. Defence is part of that. Look at some of the partnerships we have with companies such as Leonardo, Boeing, Thales and many others, who invest very strongly in skills, research and development, apprenticeships and generate jobs here in the UK. There are a great number of defence companies that may have a parent overseas, or may be listed companies in overseas jurisdictions, but they are deeply entrenched here in the UK and we do valuable work with them. I would not want them to be in any way discouraged; in fact, I do not believe that they are because I think they probably welcome the legislation and the protection that it brings.

Q126 Stuart Anderson: How happy are you that BEIS is leading on this?

Jeremy Quin: I am perfectly relaxed about that. It led on the Enterprise Act 2002; Huw is the gentleman who has had to deal with that Act over the past few years and you are welcome to ask him questions about how the relationship works with BEIS. Huw may want to chip in. From a ministerial perspective, it is great that you can have Ministers who have day-to-day working relationships with companies within their Department's remit. I have strong relationships with defence suppliers and I help them with strategic export drives and in other cases as well. We have a good, strong relationship.



HOUSE OF COMMONS

I think it is helpful that the final decisions on strategic issues of this nature are taken by a third party that can act in a quasi-judicial role and is slightly separate from the immediate debate in hand. It is a good protection and methodology. The one thing I would add is that you must not feel that Defence will be shy about making its views known. We have a good team, and it will be built up, as it needs to be, because we will have more notifications. We will be very strong in making our views heard, and I would be very surprised if those views were not taken very, very seriously by BEIS. I think we get protection both ways – through the quasi-judicial role and from the reassurance that we have a good team who will have an input on all the relevant decisions.

Q127 Stuart Anderson: It would be good to hear Huw's views on how that relationship works. We are keen to see that all the needs of Defence are considered during any assessment of acquisition. Huw, it would be excellent if you could expand on how that relationship works.

Huw Walters: Certainly. We have a very good working relationship with BEIS, and have been working closely with them on Enterprise Act cases for the past three or four years. The current arrangement gives us freedom to pull together a very robust national security assessment because we are advisers who do not have to balance all the other issues that BEIS must consider. We can give an unfettered national security perspective.

Although there are a number of cases where Defence leads, there are an awful lot of other cases where we have an interest but we are not the lead Department. The consistent approach that BEIS brings across the sectors is something that we welcome, and we can feed in to all those assessments as well where we need to. The relationship has been very good, and we have been involved with them in shaping the NSI legislation because we have been feeding in the lessons that we have had from Defence cases. In addition, we have fed into the amendments to the Enterprise Act over the past couple of years. I would say that we have a strong relationship.

Q128 Stuart Anderson: A strong relationship is great to see. Is there capacity between the Departments to deal with an increase in acquisitions or a review of them?

Huw Walters: As the business Minister mentioned, it will very much be a hub-and-spoke model. We have a team that pulls together resources from right across the MOD; we will be pulling in technical specialists and analysts as well as defence customers. We have quite a lot of resource to draw on, but we recognise that the number of cases will increase as we get a mandatory regime. We are looking at the resources in my team to carry out that co-ordination activity and I know that BEIS is also ramping up the resources in the Investment Security Unit. We recognise that need and are working quite hard to address it.

Q129 Chair: Given the geopolitical climate, will the MoD stick to its historical approach of encouraging inward investment in defence, almost regardless of the source of that investment? I aim that question at you, Minister, and at Huw.



HOUSE OF COMMONS

Jeremy Quin: I am trying to think whether there has been a defence-specific invitation to invest. I am not certain that there would have been, but please correct me if I am wrong on that. I think there has just been a general UK willingness to see foreign direct investment across our industries. That is something that we have obviously gained from as a country, and that is global Britain at work.

The £1.5 trillion of investment in 2018 is a vote of confidence in the country. It has created hubs, such as the City of London and the like, which are unrivalled globally. When it comes to defence, we have certainly been willing to develop relationships with overseas companies that have come and invested here, set up here and added capabilities. Indeed, when making acquisitions overseas when the capability does not exist in the UK and is needed, we have always encouraged those suppliers to create jobs, infrastructure and support here in the UK.

It is a positive working relationship. There are examples embedded in the skills and technology that British industry brought to bear. The F-35 has been a great example. It is an extremely strong American-led project with one tier 1 supplier—the UK, with something like 15% of the value—and it is creating jobs and opportunity here in the UK.

We will continue to be very open to working with other nations and overseas companies in partnership, but there is always a risk-based approach. The fact that we are prepared to work with companies that have added value, and that can help keep our people safe and provide them with the best capabilities, does not mean it is a free-for-all. We take a risk-based approach, and it really depends on who we are talking about and who the suppliers are. That comes through in the approach that we take at every level.

Huw Walters: I have a couple of things to add to that. We think it is a very positive thing to have overseas companies generating intellectual property, carrying out research and development in the UK, and developing their capabilities here. We also think it is positive for the UK supply chain—it gives them a route to market and easier access to some of the primes. Of course, it is something that works in both directions, because quite a lot of our companies will have a strong presence in other markets, such as the US.

Q130 **Chair:** It is a little bit off the track, but I raised this point with the previous panel. Do you agree that it is going to be important, particularly once we have left the EU, to nurture our defence talent? We are one of the leading defence manufacturers in the world. I should imagine that you both think that it is going to be extremely important to nurture that and to make sure, as much as one can, that contracts for shipbuilding and other things stay in this country.

Jeremy Quin: I enthusiastically endorse the broad point. I have no doubt that you will see this through the DSIS. In the defence and security industrial strategy, exactly what we are looking through is how we ensure that we retain those sovereign capabilities and build and maintain the skills base.



HOUSE OF COMMONS

You are quite right to say that we have a lot to be proud of. We are the second biggest exporter of defence products in the world, which speaks volumes about the capabilities that we have in the UK. It is critical that we retain the right capabilities within the UK. I think you will have seen from the Prime Minister's announcement a very strong endorsement of whole areas of future technology.

When it comes to our commitment to the Future Combat Air System, the development of future warships that will be critical to our nation's defence, our absolute determination to ensure that we have a flourishing shipbuilding industry, and, beyond that, areas such as cyber and space, where we really need to be at the cutting edge—in all those areas, we are going to be showing the way in terms of the direction of travel for these sectors, and we want to work closely with them in partnership. Part of that is being prepared to invest in research and development, and there is £6.6 billion coming over the next few years. All these are a very strong indicator of our determination to ensure that the British defence sector flourishes in the future.

Chair: You just mentioned space. Airbus uses the Skynet system, which I am sure you are aware of. They are very concerned that although we will be manufacturing the space bit, all the ground elements will go to the US. Can you comment on that? They think that it should be a UK package, as you would expect them to say, but they are concerned that much of the ground support for Skynet in the future will go to the US. Is that something you can comment on?

Jeremy Quin: I think it would be unwise of me to get into specific procurement decisions. It is certainly something that I am willing to have a think about and see if there is anything I can share with the Committee, but I would rather not speak ad hoc about ongoing procurements, if you will forgive me, Chair.

Q131 **Chair:** I quite understand. That is just an example of keeping high-tech work in the country and keeping that package together—made, produced and installed by one country.

Jeremy Quin: There is a series of quite exciting developments that we are making in the space area, as you will be aware. To talk about a specific project would probably be inappropriate now, but I am grateful, Chair.

Q132 **Chair:** May I move to you, General Jim and Air Marshal Richard, for this next question? How concerned are you both about hostile foreign investment in the defence supply chain, and what are the national security risks of hostile involvement in our defence and security industries? General Jim, do you want to start?

Lieutenant General Hockenhull: We are concerned about any threats to UK intellectual property and to anything that may undermine military capability for UK armed forces. These threats are not only in terms of foreign investment; they also range across espionage, cyber, broader intellectual property theft and, indeed, the engagement by companies of



HOUSE OF COMMONS

people from the UK with knowledge that they go on to share. We have made sure that we harness all available information and intelligence, not only within Defence but with our agency partners and, indeed, with international partners. That is both sensitive and highly classified information and information that is openly available. Our purpose then is to make sure that we understand the full panoply of those threats across the threat surface across Defence and to then provide advice to Rich and his team, as well as to Huw, as part of those overall assessments.

Air Marshal Knighton: If I might add, Chair, you and the Committee will obviously expect us to take the supply chain's health, resilience and security incredibly seriously. We recently launched the supply chain resilience and risk programme, which builds on work that we have been doing over the past few years to really understand and map our supply chain so that we have a better understanding of where those vulnerabilities and risks might lie and can take action to mitigate them. We use the information that Jim describes in order to inform those kinds of assessments. We will be happy later in the session to talk a bit more about that work and the mapping and the investigations that we have undertaken.

Q133 **Chair:** Is the technology now getting so sophisticated that it is actually quite hard to keep track of where it comes from? That may sound a rather naive question, but I ask it as a complete ignorant of this topic. Is it hard to track where all this high-tech stuff comes from nowadays? Huawei is actually quite a good example, to a certain extent.

Air Marshal Knighton: I am not sure whether the technology necessarily makes it more difficult to track. We know that, as technology becomes mature and available and starts to be used in delivering military capability, we need to make sure that our capability assurance processes, testing and evaluation are able to keep up with that. One area that we know will become increasingly important to us is the use of automated systems and what is broadly described as artificial intelligence. We need to understand how those technologies actually work—not necessarily where they come from—so that we can provide assurance to our operators and to Ministers about how those things will work in a conflict situation. That will require us to continually modernise the test and evaluation capability and assurance capability that we have in the UK.

Jeremy Quin: I think you absolutely hit the nail on the head in terms of some of the practicalities we are now facing. Take a Type 26: there will be hundreds of thousands of components going into it. It is through having this risk-based approach that we can actually say those are areas where we really do need to understand, going down through tier 1, tier 2, tier 3 and, if need be, tiers 4 or 5, and get into the entire supply chain. There may be other areas that we are more relaxed about, for good reason, but when it comes to pieces of technology and kit, really getting to grips with all aspects of that supply chain is exactly the kind of question that needs to be posed to Huw and Air Marshal Knighton and the team, in terms of the risks associated with those components. We do that through the assured capability approach, the SALs that are issued and making certain



HOUSE OF COMMONS

that we understand the tiers. We are doing more and more work in that respect.

Q134 **John Spellar:** How well developed is that?

Jeremy Quin: The Air Marshal referred to the programme that has started. It is something that we take seriously, so it goes up to the defence board, in terms of the mapping exercise being done. It is a real work in progress and there is a lot more work to be done, in all candour. We started this over a year ago—it was pre-covid—as something we were aware we should be doing more work on. There are some 37 projects going through that supply chain mapping, some already in significant detail and others we are still working on, but we are leading projects that we really want to go through this in a very thorough way. We are taking it step by step. It is an evolving process, so we will not suddenly stop and say, “Everything’s fine”. We will continue to be evolving that process—and it needs to be a continuous process.

Q135 **Chair:** How would the MoD react to a Chinese company purchasing a company within the British defence sector?

Jeremy Quin: You heard the Minister say it in the last session. We are agnostic in terms of particular states, so if a particular company had critical defence applications, whoever was acquiring it—and from wherever—we would take a close interest in that and work through it wherever the origin was. Then it would go through the clearance process. But I think we have already shown—Huw can talk through it—how we have already tackled these issues through the Enterprise Act. There have been circumstances under which potential transactions have raised concerns. They have been investigated and, in some cases, they have not proceeded.

Huw Walters: I am very happy to talk through that. As the Minister says, the process that we follow will basically be the same regardless of the country of origin of the purchaser. So we will be doing a national security assessment and look at things like who the acquirer is and what their links are. We will look at the target company, what they do and what capabilities they have, and we will look at what programmes of ours they might be involved in. Then we will look at whether they could have an impact in providing insight to our potential adversaries about the capabilities we have and how those might be countered or whether they might give a capability uplift to our adversaries.

So we have got a process now that we have tested over quite few years and we will run through that. If we think there is a national security risk, we will put advice to the Business Secretary, who will then make a decision about whether to launch an intervention under the Enterprise Act. I think there have been 12 interventions so far under the Act, the majority of which have been Defence cases, and I think we have had six of those since 2017. Where necessary, we have sought statutory undertakings from companies or we have been prepared take further action if we have needed to.



HOUSE OF COMMONS

Q136 **John Spellar:** What is your definition or template for what national security is?

Huw Walters: We would look at what the end impact is likely to be from a transaction. It is quite hard to define in advance, but we would look at things like whether the outcome could disrupt some of our programmes and whether, as I said before, it would give insight into how our capabilities operate, allowing someone to counter some of those capabilities. If it was in an area where we thought our adversaries' own capabilities were quite weak, would it give them a capability uplift or give them the ability to do things they cannot do at the moment? It would take account of what the company does and what the transaction would lead to, but it would also have to look at the current state of capability among our potential adversaries. It is quite a dynamic assessment that we do.

Q137 **John Spellar:** You talk about getting undertakings from companies. We have recently had a case before this Committee where undertakings were secured—quite strong undertakings—and yet the Ministry of Defence declined to enforce them. It was only the pressure of publicity on the company, General Electric, that caused them to retain the capability in this country, rather than move it to a factory in France, where there had been considerable security breaches.

Huw Walters: That is not something that we would have looked at under the foreign investment screening, because it—

Q138 **John Spellar:** Well, we did originally when GE took over. In fact, undertakings were sought and given, and yet the Ministry of Defence declined to enforce them.

Huw Walters: That would have been something that would have been looked at as part of the assessment around that capability at the time. It was not something that my team would have looked at, but I think it would have taken into account the risks around whether that capability was sustainable in the UK versus any national security risk that might occur if it moved across to France.

Q139 **John Spellar:** If we can move on, we have looked a bit at the level of visibility that you think you have on the supply, so what about the assessment of the level of Chinese ownership within the Defence supply chain at the moment?

Jeremy Quin: Clearly, as Mr Spellar is very aware, Mr Chairman, there are a huge number of suppliers to the MoD and the supply chain, so there will be, without any doubt, a level of involvement from companies sourced outside of NATO and outside of our Five Eyes partnerships. Of that there is absolutely no doubt.

It comes down to that risk-based approach. If you are looking at companies inside the UK, there are clearly, as a result of the FDI we have spoken about, companies that have foreign parentage. You mentioned China; I think the actual number of Chinese companies is something like 0.3% of active companies in the UK. I think I am right in saying that a lot of the Chinese inward investment has been targeted understandably at

financial services, where London is the primary trader outside of China itself.

So, there is a lot of investment in the UK. There will be elements throughout our supply chain. I couldn't give you a figure on that, but I can assure the Committee that our approach is risk based. It is looking at where the technology is. It is not going through and saying, "We can't have that particular raw material: that raw material is completely inappropriate because it comes from the wrong place." That would be cutting off our nose to spite our face.

What we need to do is to look at the technology that is going into the capabilities. We do that on a case-by-case basis, and we are going through that process now, once again looking over our supply chain and double checking at every stage. That will be a continuous process that we will be doing with greater intensity in the future.

Q140 John Spellar: But, you see, a company called eXception PCB, which produced printed circuit boards that were going into the F-35s, was acquired by the Chinese, but it was only when an investigative journalist got on the case that the MoD seemed aware of that. That must be a matter of some concern, given the critical nature of that project.

Jeremy Quin: If that is true, Mr Chairman, and it may have been, I happily reassure the Committee that an approach was made to the MoD back in 2013—six years before it appeared on Sky—where this was flagged up. Again, to reassure the Committee, the components provided are bare plastic boards that are then supplied further up the supply chain, where stuff is added to them before they are then used as part of the process.

I am happy to confirm that an assessment was made at the time and it was reassuring. Notwithstanding our comfort, that was shared with the Joint Programme Board as well, and Lockheed Martin and other partners were comfortable with the decision that was taken. Happily, that was flagged. We need to be on top of our game. That is no cause for complacency, but I am happy to reassure you on that point.

Q141 John Spellar: The reason why there is particular concern about Chinese acquisitions and Chinese companies is that there is international concern about wholesale intellectual property acquisition, and theft in a number of cases, by Chinese entities. That is not just in the UK; it goes much wider. There is a big concern at the moment in the United States about those who are on university programmes that have a direct bearing on defence, as indeed there is in the UK. Surely we have to be particularly wary against that background.

Jeremy Quin: I agree.

Huw Walters: I absolutely agree. Intellectual property and the ability to access it is one of the drivers, I think, behind the new legislation, because it's an area where the Enterprise Act has struggled to pick up some of the small company transactions, particularly with start-up firms and emerging



HOUSE OF COMMONS

tech. We have been really keen that that gap gets addressed, and the new legislation does that. I think it drops the turnover threshold that is in the Enterprise Act at the moment and that makes it really quite hard for us to intervene.

Jeremy Quin: I will give specific reassurance, if I may. There are tens of thousands of non-UK students in higher education in the UK, and that is probably to our benefit. To have people doing degree-level courses here is global Britain again. It's people going off around the world, having understood more about our culture, speaking our language and having made firm bonds and firm friendships here, and that is a good thing.

When it comes to PhD-level research, where you are getting into a lot of rather more interesting stuff, particularly in areas that could be sensitive, there is a process that the Foreign Office run, ATAS, which does look at, from a visa perspective, applications to do that work and research. They publish their findings, I believe, to the House of Commons, and there are people every year who are rejected on security grounds, in that their presence doing that kind of research, on that kind of project, would not be appropriate. So there is a process in place, and the remit that they are looking at has broadened to cover advanced conventional military research. It has been broadened, it is looked at regularly and there is a process, so they do go through it.

Q142 **Stuart Anderson:** Minister, I would like to go on to onshoring supply chains. This year has exposed vulnerabilities in a global supply chain. Do you consider shortened, more domestic and sometimes more costly supply chains over the global supply chain?

Jeremy Quin: Thank you—good question. This is certainly something that we are acutely aware of. I think it has to be looked at on a case-by-case basis. We have broadened the intensity of the screening of our suppliers, so we have some 600 suppliers that we keep an eye on for their resilience during the course of covid. We have had very active dialogue through the Defence Suppliers Forum and other forums, to ensure that we understand what is happening within our supply chain, and we have continued to support it.

The Committee has to be aware that choices have to be made in this area. You can say, as regards suppliers, "We are going to source 100% in the UK," but that will rack up enormous costs, and our ability to provide all the capabilities that we wished to would be compromised by spending money perhaps unnecessarily on getting something from a particular source when what we really want to be focusing on is the high end, the real value added—the high technology and the innovation end of the supply chain. So there is a balance to be struck here. We are aware of this, and it really does depend on the specific capability that we are addressing. It is something we are conscious of, as are our allies, particularly when it comes to things like rare earths.

Q143 **John Spellar:** Didn't the Department of Health find out that that became immensely expensive?



HOUSE OF COMMONS

Jeremy Quin: In which respect, Mr Spellar? I can probably guess.

Q144 **John Spellar:** The answer is: on PPE. They had 1% being provided from the UK and they have perhaps spent tens of billions, with massive embarrassment, which will go on for many years as inquiries take place. There was also a lack of capability. Fortunately, there was some industry in the UK. It was then able to ratchet up and got to 70%.

That is quite apart from the fact that we are actually losing employment in the UK, let alone the tax base that provides. Rather than just saying that we are only interested in the real top end stuff, we actually need to have that pool of a skilled workforce and the industrial capability to enable us to have resilience. Running so close to the wire all the time, which is what the Treasury loves to do, ends up in the end costing us very dearly.

Jeremy Quin: It is a point well made. We are all aware of how quickly supplies of PPE were ramped up when they needed to be. There was a huge amount of effort put into providing PPE when it was required, as well as ventilators. The defence suppliers were all very active and adept in changing their modes of operation and producing the ventilators that were required at the early stages of the pandemic. We will have a lot to learn from what went on during the course of the pandemic. I have got no doubt that colleagues in the Department of Health and Social Care are very focused on the point that is being made. There are a number of ways of addressing that, including the size of one's stockpile and domestic production. It is not that the Committee would expect me to be commenting on PPE in particular, but I understand the more general point being made.

John Spellar: You can maintain stockpiles, or you can retain capacity and resilience, which then enables you to ramp up production. But if you have not been purchasing from those domestic suppliers, they are not there to do it. We found that in the Falklands with ammunitions, for example, that political decisions can also intervene. You can be penny-wise and pound-foolish in this.

Q145 **John Spellar:** It comes down to urging your main suppliers to actively look at domestic suppliers. Quite often it is a fairly, one might say, indolent, easy approach of buying from offshore when there might be capability in the UK. Does the Ministry of Defence seek to encourage that behaviour, to strengthen in depth the industry?

Jeremy Quin: Yes. It is a point very well made. I hope this has come through from witnesses to this Committee. I hope it is not just switching a switch because it is me they are seeing, but when they see me, they are very keen to talk to me about how they are contributing to jobs in the UK, to R&D, the levelling up agenda and how they are making certain that their jobs are spread right across the UK. Those are messages I consistently hear from our prime suppliers. I am constantly urging them, as you would expect, to focus on the amount of business they are putting in the way of SMEs. There is a reason we are seeing that increase in the amount of work going through to SMEs. It is now up to 19.3% of our



HOUSE OF COMMONS

spend, we estimate. With the increase in defence spending anticipated over the next few years, I want to see that grow still further as a proportion.

Mr Spellar is absolutely right, it is core to what we do. Looking at the work Boeing has done, for example, I joined a virtual meeting of something like 1,000 smaller companies who were basically pitching themselves to Boeing and Boeing were listening. A smaller number visited them in Seattle last year. It is in the interest of these large corporates to have a wide and diversified supply chain for the reasons Mr Spellar was setting out earlier. You want to have a large number of reliable suppliers to broaden your opportunity to drive down cost. And this works for them as well as for the SMEs concerned, providing they are quality SMEs, and there is a lot of quality in the UK supply chain. It is in the interest of the primes to make certain that that works. We encourage it forcefully.

John Spellar: It is also about sustaining the skilled workforce, which is one of the main attractions for companies to base themselves here. That is because, although a number of them do, many do not just stay in one company, they do move around between companies. That provides you with the skills base that is so crucial to it.

Jeremy Quin: It is so good when we have an outbreak of complete agreement around the Committee table. I totally agree that that STEM emphasis is critical. There is a lot of emphasis on that inside the MoD, and we actively work with BEIS on apprenticeship schemes. I always like to see and hear from our suppliers how they are creating apprenticeships and how they are leaning into attempts to create STEM interest from a very early stage in schools. Things like careers in engineering are absolutely critical to our future as a major defence supplier around the world, as is the vision— If you are a young person looking at your future and you see the Government doing the work we are doing on the future combat air system, that is the kind of project that you can really see stretching out over 10, 15 or 20 years and that will add a lot of excitement to the industry. Getting behind projects like that is critical.

Q146 **John Spellar:** But your primes can also play a role, because they will get far more applications for apprenticeships than they are able to use. They could say to their suppliers, “Here are some apprentices”, and they could also use their apprentice training capacity in order to do some of the work while a lot of the practical work is being done in the companies themselves. That is not unique; Rolls-Royce has been doing that for quite a while. There should be a real proactive role in increasing our rather limited number—compared with, say, Germany—of active craft apprenticeships.

Jeremy Quin: It is growing, but it needs to grow faster, and that is one way of doing that, absolutely.

Chair: Tobias Ellwood has rejoined us from the Chamber. Welcome back, Tobias. You have a question that you would like to raise.

Q147 **Mr Ellwood:** Minister, thank you for that. I just want to quickly—or



HOUSE OF COMMONS

cheekily—ask if you could just update us on the E-3 Sentry retirement and its replacement by the Wedgetail E-7.

Jeremy Quin: That is happening, as you know. E-7 is coming into service. There is a debate about exactly how many planes we will acquire, but that is an ongoing process.

Q148 **Mr Ellwood:** Okay. I was hoping for a bit more than, “That is happening”. Can you confirm that there will not be a gap between the two? There is much talk about extra presence in the English channel, for different reasons, and concern that we have the ISTAR capability.

Jeremy Quin: From recollection, there will be no gap; the E-3 will retire as E-7 comes into service. The IR will be published in due course. There is always a debate about exactly the right numbers that one needs to fulfil that capability. I do not think there is a huge amount I can add, unless Air Marshal Knighton wanted to say anything to either correct me, if I have got any of that wrong, or to add to the Committee’s deliberations if there is anything he could do to help.

Air Marshal Knighton: I add only that the in-service date for E-7 is planned to be 2023.

Q149 **Mr Ellwood:** I understood that the E-3 would be retired before then, and also that you were going to cut the order for the E-7.

Air Marshal Knighton: We have already retired some of the E-3 aircraft. As the Minister described, part of a broader thinking—as we spoke to the Committee about last week, when we looked at the annual report and accounts—is looking right across all the programmes to make that sure we have exactly the right balance of risk and exactly the right profile, in terms of matching the ambition and the funding and the profile of the projects that we have got running.

Q150 **Mr Ellwood:** So there are five E-7s on their way, in time, so there will be no gap after the E-3s. Is that a nice summary?

Air Marshal Knighton: As I said, 2023 is the current in-service date for the E-7. I am afraid I cannot remember the dates when each aircraft will be delivered, but there is a viable capability by 2023. We have already retired some of the E-3 aircraft because they are getting older and more difficult to retain. The exact profile of the retirements of the E-3 is something we have yet to agree with Ministers.

Q151 **Stuart Anderson:** General, I wonder if you could let me know if you believe there is a national security risk in having a global supply chain for defence?

Lieutenant General Hockenhill: Sourcing anything from outside of the national chain of course brings some degree of risk, because it is always possible that there will be actors that wish to act with malign intent. However, it is my belief that the risk-based process that the Minister spoke to earlier gives us the ability to provide assurance over the supply chain that we use, together with the sorts of measures that Rick spoke to



HOUSE OF COMMONS

earlier around the assurance of our supply chain and the illumination we are doing with the supply chain at various levels. I think that gives us the best insight. When combined with our own intelligence capability, understanding the intent and capabilities of those malign actors, as well as seeing the actions that they take both in access that we provide through classified sources and what we see of their open activity, yes, I believe there is a risk, but I believe the process that we adopt is a way of actively managing that risk.

Air Marshal Knighton: May I add something, Mr Anderson? The other side of the coin, of course, is access to capability that the UK either does not produce or that we collaborate with allies on producing, which can generate both better capability and better value for money. What we have to balance is the demand to deliver the right capability for the UK, and to deliver it in a cost-effective way so that we spend taxpayers' money wisely, which I know is something the Committee is always keen to ensure that we do, against the inevitable risk that comes with a supply chain where we do not own all of it within the borders of the UK. The way to deal with this is, as Jim described, to make sure we put in place the scrutiny, the checks, the test and evaluation, and the assurance that allows us to secure the benefits of a global supply chain while mitigating the risks that come with that kind of global supply chain.

Q152 **Stuart Anderson:** Thank you. So we have this balancing act, as we have heard, and there will be some capabilities that we do not have here. Do you know how reliant the defence industry is on imports from China?

Air Marshal Knighton: In terms of rare earth elements as a specific example, as the Minister describes, about a third of the world's reserves are in China and about two thirds of the production capability are in China. Of those that are imported to the UK, only about 5% of that is relevant to defence, so that gives you an idea of the kind of specific example. For example, the phone that I am issued by work so that I can keep in touch is manufactured in China, so there is an inevitability that elements within our supply chain and the capability that we use is going to be sourced from China.

Jeremy Quin: There will be global supply chains coming in literally globally, and that is how the country has operated very successfully for decades. There are benefits in being able to source items very cheaply from around the world. That is what drives British industry and helps create a competitive advantage and drive down cost. That is what you would expect for the vast majority of companies and for industry, but the Committee is absolutely right that we are not like every other company or industry. We have a particular requirement in defence to look closely at where items that are supplied to us are being sourced from, and we need to be aware of those vulnerabilities. That is work that we are definitely doing, and that we have always been conscious of, but it has had greater intensity over the last few years, and I think that that will continue into the future.



HOUSE OF COMMONS

It is something our allies are very conscious of as well. Air Marshal Knighton mentioned rare earths, but that will be an issue for other allies—for America, for Australia. In many cases, there are items that can be found elsewhere if you choose to source them from elsewhere, not least in Cornwall, where there is lithium, I gather, and there are other rare earths that can be found elsewhere around the world if you so choose at perhaps an extra cost. It is simply a matter of taking a balanced, risk-based approach.

In many cases, while not being complacent, it is not something one should get overly concerned about, but one should be conscious of the issue and be prepared and have that risk-based approach to how you are looking at every single circumstance as they come up.

Q153 John Spellar: Would you say that the MoD has done enough to support the UK's defence industry during the coronavirus pandemic and the consequent economic depression?

Jeremy Quin: Let us see where the economy goes, on the second point that you have raised. Without doubt, the economy has taken a dreadful hit during the course of the covid pandemic—of course it has—and that is why the Government have quite rightly produced extraordinary amounts of support right across the board, but in particular aimed at industry, to support them and support jobs so that we can hopefully—touching lots of wood here—after a successful vaccine programme, get back closer to normality, as soon as possible.

In terms of defence in particular, I sincerely hope we have supported industry well. We have had a good relationship with them. They really rose to the challenge. There was that real moment of a sort of team UK and leaning in, at every part of the industry, with people recognising how important their role is to support essential defence tasks. We were deeply impressed by how industry at every level leant into the challenge, and I hope that was mutual. I certainly believe it was. I think something like £139 million of prior cash has gone through the defence supply chain during the course of the year. We have continued to provide the drumbeat of orders right the way through the year.

I think the Prime Minister's announcement, although it is clearly for the future, provides huge reassurance to companies that are perhaps looking to invest in defence and invest in R&D that there is going to be a winning supporter and buyer for their products and a real focus on the future in the MoD. I think in combination that has worked well, and it has not just been the primes. We have been very conscious that there is an entire defence supply chain out there and we have needed to also lean into the SMEs.

Q154 John Spellar: Given that you have now got some additional money, particularly for capital spend, are you in any way looking at pulling through orders for kit that you already know you need and in many cases are already pre-ordered, and bringing that forward where possible, in order to put some more money through the economy?



Jeremy Quin: I can certainly assure the Committee that we are now in a position, with that multi-year settlement, which is incredibly valuable and necessary for defence, to look with confidence at the orders that are going to come through.

I wouldn't want to pretend that it suddenly means that we bring forward huge amounts of orders and shove them through very quickly, and say, "You have got to do this and that." That won't necessarily play to the strengths of industry, who sometimes need time to complete one task and build up and then complete another task. As the Chairman and Mr Spellar said earlier, skilled labour is an incredibly important part of this, and we need to do things in a way that constantly builds. It does mean that we can give industry the reassurance that we will be investing alongside them in research and development, and that we will have programmes, for example, on the shipbuilding side—close to the heart of Mr Spellar—and that we will be able to be placing those orders. The commitments we have made in relation to Type 26 and Type 31 and the beginnings of the work on the Type 32 and, of course, on FSS are areas that people can have reassurance about.

Q155 **Chair:** We heard in evidence that France was looking into her defence supply chain very early on in the pandemic. Did we do that? As we understand it, we did not. Why did it take so long to do what you are now talking about? Perhaps General Jim could make a contribution too, as he is in charge of intelligence.

Jeremy Quin: May I start, Mr Chairman? Then if the General wishes to chip in, we would be keen to hear him. First, I think that is slightly unfair because the defence chain resilience work started, as I recall, last year, so that was something we are conscious of. We started that process pre-covid because we are aware of the importance of the issue, and work has been ongoing on that point.

The second point I would raise is about our resilience to covid specifically. We identified the 600 suppliers that are most critical very early on and maintained a dialogue with them. We may not have made a big issue of it, but there are 600 suppliers that we kept an eye on. I had weekly reports where concerns were flagged where necessary, and we had a dialogue with industry via the Defence Suppliers Forum and other fora, including ADS. One of the things I am very pleased about was how our primes lent in to support their supply chains. I am absolutely certain about that. In fact, one of them appeared before your Committee. SMEs say, "Well, we didn't know about that support." That is possible, and I am sorry if that is the case, but I know a lot of examples where SMEs were very pleased with both the interests of defence and how their primes were taking a close interest in their health. It is in no one's interest if we get through this pandemic—hopefully sooner rather than later—and suddenly find that whole chunks of the supply chain have become moribund, or that we have lost key skills. The whole of defence was aware of that, and they have been working together on it, but we did start early on.

Q156 **Chair:** Out of interest, there is now some feedback that the furlough



HOUSE OF COMMONS

scheme was adopted by some and not by others. In the private sector, which is what we are mainly talking about here, was there evidence that most companies just kept going and made a huge effort to keep the workforce there, and that the workforce wanted to keep working?

Jeremy Quin: Both of those. In defence, it was extremely positive how people kept going through the crisis—that was at every level inside those companies. There are obvious difficulties. If you are building a submarine and are used to having lots of your workforce crammed inside a submarine, that is just not possible with covid ongoing. You have to restrict and take safety measures that are appropriate and proportionate. We were absolutely expecting our suppliers to do just that, and that is what they were doing. There will inevitably be an impact on defence productivity, and we are discussing that with the companies concerned. But were they absolutely up for the task of conducting their essential defence work? They were. I had direct input from the unions and others about how keen they were to maintain their commitment to the country at this time, and it was a very heartening experience to see it.

Q157 **Chair:** General Jim, I assume that your intelligence world is very much playing a large part in ensuring that the defence supply chain is kept safe, is operating and is free from threat, particularly during this pandemic.

Lieutenant General Hockenhull: Yes, Chair. I might start my answer by contextualising where we have come from to where we are now. Back in 2016, there was a programme run in defence called “Defending Defence”. Although that looked at a number of capability areas, part of that work was to illuminate the supply chains of those capability areas in order to provide examples. We supported that work to try to illuminate where there were potential hostile actors who were paying particular interest to areas of defence capability.

We continue to support the existing work that is going on—it is now on a much more industrial scale—to provide insights from intelligence, and not just over what we see. We are also trying to understand the intent of actors who have reasonable calls to be particularly interested in areas of defence capability. We do that not just by the information that we receive; we also set out collection requirements both with our agency partners and, indeed, with our international partners to ensure we have the widest source of information and intelligence on those issues.

Chair: Air Marshal Richard, do you want to add anything?

Air Marshal Knighton: No, Chair. I think the Minister and Jim have covered it all.

Chair: You are happy. The last question comes from the Chairman of our Select Committee, Tobias Ellwood.

Q158 **Mr Ellwood:** I think I know what the response to my question will be, but can I ask the Minister when he thinks the integrated review will be published and presented to Parliament?



HOUSE OF COMMONS

Jeremy Quin: I think, Mr Chairman, the Chairman of the Committee has heard the answer before. I regret that it is still the same answer. I don't blame him for asking and I am sorry that I can't be more precise, but I don't know the date as yet.

I know the Chairman would have been delighted to have seen the announcement of the multi-year settlement in the spending review, as are we in defence. That has been built up from the threat assessment, which will be published as part of the IR, in due course, as they say.

Q159 **Mr Ellwood:** I am slightly concerned that the MoD will run away and spend it all before it has become clear what we should be spending it on.

Jeremy Quin: There are lots of capabilities in which we need to invest and there is a lot of work to be done, but it will all be based around that threat assessment. I have got every confidence that either the Secretary of State or myself will be talking to the Committee on this subject in due course.

Q160 **Chair:** The defence industry has remained broadly resilient throughout the pandemic, but the same cannot be said for civil aerospace. Given that civil aerospace also contributes much to UK defence, do you think you have done enough to support these companies, Minister?

Jeremy Quin: I hope so. We are very aware of the crossover. I think it is Minister Zahawi who is leading that in BEIS and who I am sure would be more granular on the depth of support than I will be. Suffice to say, there has been about £9 billion of covid corporate finance support, loan guarantees, export credits through the furlough scheme and business interruption loans. Help has been provided through the work being done on Jet Zero.

We are all very aware that in order to get confidence back into aerospace we need to get confidence back into aviation. The work on the aviation recovery plan is ongoing. A successful rollout of the vaccine is going to get people happier to be travelling again on planes, and able to do so for both business and leisure.

In terms of what we have been doing, there is of course a crossover. We have been doing a lot of work with our suppliers in the aerospace sector. They know that we have got ongoing orders coming through from defence. I am aware of companies that have shifted skilled personnel from the civil aviation side to military projects.

The work that we have announced on FCAS, and the ongoing work on FCAS, is extremely important in setting out provision for the future, in terms of military aerospace. We have really been moving in on exports and the potential that they have to maintain jobs, companies and the whole of the supply chain in the UK. I very much hope that we are doing our bit to maintain that incredibly important sector in the UK.

Q161 **Chair:** Huw, do you want to add anything?



HOUSE OF COMMONS

Huw Walters: I don't think so, other than the fact that a lot of companies have said that the continuing flow of defence orders and the things that we have done around prepayments have been vital in keeping their businesses afloat during this period.

Chair: We conclude the third and final public session of this Defence Sub-Committee, which has been an absolute pleasure to chair, looking at the threats and vulnerabilities of the defence supply chain.

I thank both panels, and our distinguished guests from panel two: Jeremy Quin, the Minister of State; Huw Walters, Director of Economic Security and Prosperity at the MoD; Air Marshal Richard Knighton, the Deputy Chief of the Defence Staff; and Lieutenant General Jim Hockenhull, Chief of Defence Intelligence.

I also thank my colleagues and the chief Clerk Mark Etherton, without whom we wouldn't be getting very far. Thank you very much for your time.