

Defence Committee

Oral evidence: Defence Acquisition and Procurement, HC 698

Tuesday 31 January 2017

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Members present: Dr Julian Lewis (Chair); Douglas Chapman; Mr James Gray; Jack Lopresti; Mrs Madeleine Moon; Gavin Robinson; Mr John Spellar; Phil Wilson.

Questions 242-309

Witnesses

I: Harriett Baldwin MP, Minister for Defence Procurement, Stephen Lovegrove CB, Permanent Secretary, Ministry of Defence, Lieutenant General Mark Poffley OBE, Deputy Chief of the Defence Staff (Military Capability), and Tony Douglas, Chief Executive Officer, Defence Equipment and Support.

Written evidence from witnesses:

– [Ministry of Defence \(ACQ0017\)](#)

Examination of witnesses

Witnesses: Harriett Baldwin MP, Stephen Lovegrove CB, Lieutenant General Mark Poffley OBE and Tony Douglas.

Q242 **Chair:** Good morning. Welcome to this session on defence acquisition and procurement. I would be grateful if our four panel members would introduce themselves for the record.

Stephen Lovegrove: Stephen Lovegrove, Permanent Secretary at the Ministry of Defence.

Harriett Baldwin: Harriett Baldwin MP, Minister for Defence Procurement.

Tony Douglas: Good morning. Tony Douglas, Chief Executive of Defence Equipment and Support, DE&S

Lieutenant General Mark Poffley: Mark Poffley. I am the Deputy Chief of Defence Staff, responsible for military capability.

Q243 **Chair:** Thank you all for coming today.



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The National Audit Office has produced a report that warns that the affordability of the equipment plan is now “at greater risk than at any time since reporting was introduced in 2012”. How do you respond to that overall assessment?

Harriett Baldwin: I’ll start, if I may. We very much value our engagement with the National Audit Office on this equipment plan, and we fully acknowledge that, at £178 billion over the next decade, it is the biggest equipment plan that the Ministry of Defence has had to work on, certainly for some considerable length of time. It is a larger—a deliberately larger—equipment plan as a result of SDSR ‘15 than it was before. I think the National Audit Office wording reflects that, so there is more equipment in it and, therefore, it is of more significance. I don’t know if my colleagues want to add anything to that.

Q244 **Chair:** Can you focus particularly on the risk factors that they identify?

Stephen Lovegrove: Yes. Clearly, any programme with a 1,000 projects in it is going to have risk in it, and each of the projects has a different degree of risk associated with it.

What I take from the NAO report is that we have appropriately costed all of these sources of funding, and indeed the uses of the funding, but it identifies—and is quite right to identify—that we are going to have to create a great many efficiencies in order to be able to afford it. That is where the risk lies, and that is where Mr Douglas, Lieutenant General Poffley, all of the MoD’s senior management and I are currently concentrating our focus, to make sure that those efficiencies do come through in all of their manifold forms over the coming years, and indeed decades. That is where the issue lies.

The NAO report doesn’t actually say that the sums don’t add up, because, obviously, they do add up, but in order to be able to get that funding in place, we have to do a lot to the defence enterprise across the board.

Q245 **Chair:** You are relying on efficiency savings of nearly £16 billion. Where do you think the bulk of those efficiency savings are going to come from?

Stephen Lovegrove: A brief word on the headroom that they identify in the report: the headroom is characterised by the NAO as being something that is no longer available to us; that is unfortunate. I don’t really see it quite like that. That was nearly £10 billion-worth of headroom that was set aside to spend on future equipment programmes, and the future equipment programmes are set in the SDSR. We are therefore using that money for the purpose for which it was intended.

On the rest of the efficiencies—I will hand over to Mr Douglas, possibly—there are going to be £3.3 billion-worth of efficiencies coming from savings within DE&S. There are going to be about £1.8 billion-worth of savings from the single-source regulations; about £0.8 billion of other savings within the programme; and about £1.5 billion from savings across defence, much of which will be associated with headcount reductions and pay restraint. Sources of these savings have been identified, but I am not



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going to shy away from the fact that achieving those savings at the scale we need is a very serious task, and it is something we are concentrating on every day.

Q246 **Chair:** Would you mind, because I don't want to prolong debate on this aspect too much, sending us a schedule that shows in proper detail exactly where you think these £16 billion will come from?

Stephen Lovegrove: With pleasure.

Q247 **Chair:** That would be very helpful. What about risks of increased costs involved in supporting existing equipment, or arising from over-optimistic costings for new projects, given the past record of projects ending up being considerably more expensive? Couldn't they eat up the savings that you are hoping to make in this way?

Stephen Lovegrove: I don't believe they will. We have a pretty sophisticated contingency set of arrangements within the many projects. Those projects that are at a more immature state of development have a higher degree of contingency built into them. Projects that are very close to completion have a much lower degree of contingency built into them, on the basis that we know what the costs are likely to be. Not only do we have, within DE&S, about 6% of the entire programme held as contingency, but we have this £5.3 billion held in the centre as contingency. That is effectively how we manage the programme. Clearly there are risks in all of these things, but across the portfolio, we feel that we have enough contingency to be able to manage it.

Q248 **Chair:** You have certainly allowed this £10 billion contingency for Successor, which is quite an unusual up-front commitment. Is there any danger that that will start to be regarded as part of the basic cost of Successor, instead of being a contingency, and then costs will begin to rise on top of that?

Stephen Lovegrove: If there was a danger of that happening, I suspect that our friends at the Treasury would be very alive to it. We have no intention of going into that contingency, except under the most carefully scrutinised and discussed conditions. At £31 billion, this is a big part of our expenditure over the coming decades. We need to be very careful that it does not bend defence out of shape, and indeed some of the national finances more broadly.

Q249 **Chair:** So you would put odds on the fact that when this project comes to an end, if it does as well as some of the previous deterrent submarine building projects, it will come in at £31 billion, rather than £41 billion?

Stephen Lovegrove: I don't think I would be brave enough to predict now the eventual out-turn of what is a 20-year-build project. The Treasury recognises that it was prudent to have a significant contingency in there with a project of this type. We will only go into it under the most stringent conditions, and after extensive consultation.

Q250 **Chair:** Any other comments from anybody else about what costs are most at risk of growing?



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Lieutenant General Mark Poffley: Could I make a comment on whether we are alive to the risks that you suggest of optimism bias and, inevitably, uncontrolled cost growth? The transformation agenda we apply—not just in DE&S but in the rest of the structure of the Ministry of Defence—has certainly got that front and centre of its agenda, so there is a better statement of a requirement with a range of outputs that might come from some of those requirements, a better, earlier and more rigorous understanding as you go through the approvals process of what is involved in one of those programmes, and of course a clear understanding of how we are going to draw down against the risk provision that we have got inside the programme. All of those give us a greater degree of confidence that the optimism bias that may have played a role in the programme in the past is at least more front and centre in our discussions on an ongoing basis.

Q251 **Chair:** What about the impact of future exchange rate fluctuations on the affordability of the plan? Could that blow it off course?

Harriett Baldwin: Shall I speak to that? In terms of the exchange rate, the equipment that we have ordered from the States would be the obvious example of where that could have an effect. As you know, the Department has a systematic approach to hedging its currency risks out for the next three years, so we are protected from any immediate fluctuations that we have seen this year, in terms of the dollar-sterling exchange rate. In terms of the more medium-term expectations, obviously we will have liabilities in our equipment plan in dollars further out than that—

Q252 **Chair:** Let's get this absolutely clear: even though there has been this dramatic fall in the value of the pound against other currencies, the hedging for the next three years would cover that completely.

Harriett Baldwin: Not completely. We hedge a portion of it, which does significantly protect the Department's budget from the fluctuation we have seen since the referendum. It is one that we have worked into our numbers, in terms of our projections going forward. The NAO points to it as a medium-term risk, rather than a short-term risk, because of the steps that the Department takes on an ongoing basis. We also have a hedging programme on the cost of fuel, for example, so we have a way that we systematically hedge ourselves against that. On the medium-term exchange rate, the Committee will be well aware that it is not possible to forecast what exchange rates are going to do. There will continue to be a hedging process that we follow in the Department that will give us that intermediate certainty, in terms of our exposure to the dollar—which, I think I am right in saying, represents less than 10% of our total equipment purchases, in terms of the total £178 billion 10-year plan.

Q253 **Chair:** I understand that some of the new projects do not have the factors fully worked into the calculations yet. I have been handed a note that says that the MoD's independent cost estimating body says that the most likely out-turn for project costs in the plan is £4.8 billion more than MoD budgets. Does that figure mean anything to you?

Harriett Baldwin: In terms of the ongoing quarterly process and assessment?

Stephen Lovegrove: Yes.

Harriett Baldwin: We can certainly speak to that.

Stephen Lovegrove: The £4.8 billion is, on the current view of the cost assessment analysis services, an assumption of where we may be over budget, over and above the contingency that is held for those programmes in DE&S. That is what we hold £5.3 billion-worth of contingency against, within the Department.

Q254 **Chair:** So right at this early stage, we are already looking at £4.8 billion out of the £5.3 billion contingency being called in?

Stephen Lovegrove: I don't think I would characterise it like that. Project and programme costing and the analysis of risk would always tell you that you need to hold a contingency against cost overrun within the project, and you need to hold a further contingency against cost overrun at head office. That is across the whole suite of the programmes that we have—and they are looking across the whole suite of programmes that we have. They are basically saying, at the moment, "We think the appropriate amount for you to be holding at head office, as a contingency against cost overrun across the whole of this programme, is £4.8 billion", and we are holding £5.3 billion.

Q255 **Chair:** So you think you've got a bit of spare capacity?

Stephen Lovegrove: The analysis shows us that we are covered. As I said, there are 1,000 different projects and programmes here, so I am not going to sit here and say that there will never be any change, because that is not in the nature of these things, but I feel at the moment that we have an appropriate level of centrally held contingency.

Q256 **Chair:** Just a couple more before we move on to other colleagues. How does the equipment plan help to deliver Joint Force 2025 and what assumptions are being made about the needs of this future force?

Lieutenant General Mark Poffley: The SDSR set out what our ambitions were for that force structure, and inevitably equipment was but one part of that aspiration. Our current programme absolutely attends to the ambition of the Joint Force 2025 structure along the timelines that we set out in the SDSR, but again, that is not to say it is not going to require some pretty active management to keep that programme on track. It is of course heavily influenced by a raft of variables, not least world events, the cost of support, manpower and so on. So it sits there, and part of the rationale for delegation into the TLBs was absolutely to allow everybody at the various levels to apply sensible management action to keep the equipment line in kilter with the rest of the lines of development, as we describe them in the Ministry of Defence. From my point of view, this plan attends to the Joint Force 2025 ambition. It carries some risk, as we have just described, but we think that is manageable in the timeframe.

Q257 Chair: We were told that this is the last time the National Audit Office will review the equipment plan. Can you explain why this decision has been made and how you will ensure that continued independent scrutiny of your spending on equipment carries on as effectively as in the past?

Harriett Baldwin: Yes, of course. We have found our working relationship with the National Audit Office very helpful and valuable. We now have our own internal way of measuring and approaching these projects on a quarterly basis and I think the NAO is comfortable that that process is working well, but we will always be able to engage the National Audit Office if we think that that would supplement what we are doing internally. Stephen, do you want to add anything to that?

Stephen Lovegrove: I think that is absolutely right. We regard the National Audit Office's involvement as very helpful. It may be that what we want to do in the future is less to ask them to look across the whole piece, but to home in on some of the individual projects that we have going for the assurance that they can provide.

Q258 Chair: Whose idea was it to make this change?

Stephen Lovegrove: I'm afraid I do not know the answer to that question. I am happy to write back. It probably predated my time in the Department.

Q259 Chair: Yes, I believe it was mentioned somewhere in the small print of a previous NAO major projects report.

Stephen Lovegrove: Right.

Chair: It just seemed rather surprising, given the centrality of that report normally to keeping an eye on what goes on with the most expensive equipment projects.

Stephen Lovegrove: Chairman, I am very happy to write to you about how the decision was made and about our future arrangements with the NAO.

Q260 Chair: And if it is found not to be working effectively, obviously it could be looked at again.

Stephen Lovegrove: That must be right.

Q261 Douglas Chapman: Sounds a bit like a football manager when he does not see an incident on the pitch and everyone says, "There's nothing to be seen." However, we will move on. Have the Government introduced a new type of contract with BAE Systems and Rolls-Royce to encourage the delivery of new submarines on schedule?

Harriett Baldwin: I'll start off with that and then I'll bring in Tony on the detail. From where I sit, it seems to me that one of the big issues that we have always had in defence procurement is that if you set up a cost-plus contract, you are sending an incentive to the system to put in a lot of cost, and therefore there must be a better way of contracting that actually gives incentives to bring things in ahead of budget and under cost. In terms of



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the frontline, since Tony has been brought in he has been very much at the forefront in those discussions, trying to bring the right kinds of incentives to the way that we contract not just in the projects that you mention but across the whole of the Department's contracting. Tony, do you want to elaborate a bit more on that?

Tony Douglas: Of course, Minister. First, the very simple answer to the question is yes. The basis of that response is as follows: as the Minister has said, the previous methodology was one of a cost-plus mindset. Going back to the earlier comment as to whether £32 billion is the right number and £10 billion is the right number in contingency, if I bridge to that—

Q262 **Chair:** I think it's £31 billion. I know it's only £1 billion, but we need to be careful.

Tony Douglas: It's a lot of money to a chap like me, I can tell you. But in terms of the £31 billion, is that the right number? The parametrics of the Vanguard class and the American Ohio class would definitely support that £31 billion is the right number. However, history, which I think you were alluding to earlier, would suggest that complex programmes in nuclear submarine building have had a rather regrettable track record of being more likely to be late and therefore over budget. One of the principal commercial reasons behind that has been a cost-plus type of commercial construct.

We have now agreed heads of terms with BAE Systems and, importantly, Rolls-Royce for a performance-based contracting methodology that has an alliance arrangement between BAE Systems, Rolls-Royce and the Ministry of Defence—because we supply so much of the Government-furnished equipment, such as the guided missile compartment. That establishes a target cost with an incentive that, in simple terms, has a pain-gain formula. They are incentivised to beat the target, and if they do so it is a win-win for the taxpayer, Her Majesty's Royal Navy and obviously the submarine delivery body; if they fail to hit the target, they wear the pain of it. That is in contrast with the historical construct, where you could be commercially cynical and almost suggest that if they were late, it was in their best interest. In short, we have fundamentally departed from the way in which we have gone about building submarines in the past.

Q263 **Douglas Chapman:** How much will BAE Systems and Rolls-Royce receive if they deliver ahead of schedule, and how much will they forfeit if they fall behind?

Tony Douglas: The detail of the arrangements is obviously commercially sensitive, but what is very clear is that there is a punitive pain relationship with being late and over budget, and equally there is an encouraging incentive for them to put all their best brains into mitigating risk, such that they can compress time and therefore realise better value. It is a classic construct of a pain-gain formula set against a series of milestones and target costs.

Q264 **Douglas Chapman:** Can we expect the SSRO to oversee this programme to make sure everything is on track and on budget? What role will the



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submarine delivery authority have in this?

Harriett Baldwin: Shall I start off on that one? I imagine there are going to be more questions about the SSRO a bit later on, but the Committee will be well aware of the purpose of the SSRO: where you cannot compete a contract, the contract is covered by the single source organisation. The intention is very much that the Dreadnought programme and a range of other single-source contracts will all be covered by Single Source Regulations Office rules.

I provided an update to the Committee just before Christmas on the progress that we are making in establishing the submarine delivery body for the 1 April deadline. Everything is on track to get to that place, and an interim chair has been appointed, whom I am sure the Committee will want to meet in due course. They are delivering in accordance with the timetable that we have set them, and that body will be responsible for delivering not only the existing submarine programme and the future build programme but ongoing support to the submarine programmes.

Q265 **Gavin Robinson:** Mr Douglas, you made reference to complex programmes having the feature that they tend to overrun, and you said that in the cost-plus scenario, there could be commercial cynicism—I think that is how you put it. We discussed earlier how that goes far beyond complex programmes—in fact, Committee members discussed a number of programmes that appear to be delayed and over budget. Given that you talked about the historical construct of contracts, what analysis has been conducted to see how many there are and what the cost risks are before you can establish new contracts on this better model? Can you give an assessment? Have you conducted that work?

I ask the question because we received a document about the upgrades to Warrior tanks that suggests that there is ongoing assessment and scrutiny with industry, but the industry are actually saying that that programme is fraught with delay and they do not see when it is going to conclude. Give us a picture of the risk associated with the historical construct of so many commercial contracts that are still under consideration and in operation today.

Harriett Baldwin: That was directly to you, Tony.

Tony Douglas: That's fine. First, I will state what is probably the obvious in terms of commercial constructs: one size seldom fits all. As you rightly suggest, it is a process of risk-assessing each project on its own merit. The point I was alluding to with Dreadnought before is that this is a very clear case where we have had a cost-plus type of methodology and also the lack of a joint and several relationship when you have multiple parties. What I mean by that is that the historical construct could have had one party essentially letting the side down and in so doing actually benefiting the other parties because of the prolongation benefit of a cost-plus type of environment. So where we see that on large complex projects, we are now replacing those sorts of constructs with performance-based contracts that have the sorts of pain-gain formulae that I referred to earlier, but also



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encourage people to be in a joint and several relationship, whereby you can't pass the problem around in the conventional way.

You referred to the breadth of programmes that DE&S is executing. As PUS referred to earlier, we have over 1,000 significant projects on the go at the moment. Another example I would give you is the TyTAN project, formerly known as FSOM, which is the future support contract to Typhoon. I would like to think that we have made a significant step forward in replacing traditional service contracts with a performance-based, availability-based contract that means that we can incentivise performance through the delivery of availability on fast jets, and in so doing, it becomes a win-win-win. By that, I mean it is established in such a way that it is generating over £400 million-worth of savings, thus allowing us to reinvest it back into Typhoon development. It is a £2.143 billion contract, and that is over 30% better value than what it succeeded. There are a number of really encouraging examples of that type.

You made a reference to Warrior; let me deal quickly with that one. Warrior is still in a development phase. There is a contract with Lockheed Martin at Ampthill whereby the turret is being developed to fit a new 40-mm cannon, with fire-on-the-move capability. On satisfactory completion of that development contract, we will look at the conditions under which we would want to novate into a manufacturing contract, and I think that when we do that I could happily assure this Committee that that will be on the basis of a performance-based construct that will have a pain-gain formula in it; it won't be cost-plus.

Q266 Gavin Robinson: That specific information is helpful, and the example of Typhoons is helpful also, but have you conducted a systemic risk analysis of all the contracts out there that are on this historical construct, and if so are you able to share that information, perhaps not today but formally, with the Committee?

Tony Douglas: The simple answer is yes, we have conducted a review of all contracts, and I would be delighted to respond in writing to the Committee to give you more detail in terms of what that landscape looks like.

Harriett Baldwin: When is your annual report published, Tony?

Tony Douglas: Normally in November we publish a DE&S independent annual report. That is consistent with the establishment of DE&S being a bespoke trading entity. I should probably share with you quickly as well that in having an independent board with an independent chair, what sits below that in normal corporate design is an audit committee as well as remuneration committees and so on, and there is a very disciplined structure as to how that governance is effected. In short, I will be happy to respond in writing to give you a feel for the landscape of the contract status.

Q267 Douglas Chapman: I have been on the Committee for almost two years and any time we have talked about procurement and delivery of the big-



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ticket items delay in decision making, failures in the actual kit and gaps in the budget leading to gaps in capability have always been part of our discussion. How are you assessing the effectiveness of the defence acquisition reform? How is that working and are you satisfied with the progress you have made to date? For big programmes, such as Successor, it is difficult for the Committee and others to understand the milestones in each of the contracts and how well you are doing against expectations and the budget. Although I recognise your point about commercial sensitivity, there needs to be something in there that gives us a clear vision of where you are in each of the programmes. Is that on your radar?

Harriett Baldwin: Absolutely, and that is very much behind us publishing the equipment plan. We want to have that degree of transparency in those programmes. For me, having come into this in the last year, it is clear that one of the things that has worked very well in terms of a management construct is something that Tony alluded to just now—setting up an alliance where there is the joint responsibility of the range of different firms. That has worked well in delivering the carrier, for example, so is something we have learned from and are trying to take on board and replicate in other major programmes, for example the Type 26 programme and the Dreadnought.

In terms of the transformation of DE&S, its establishment as a bespoke trading entity and the reforms that were put in place in the Defence Reform Act 2014, I think that progress is going well, but it is not yet complete. I will bring in Tony to talk about the remaining stages before it is what he would term “match fit” in terms of procurement.

Tony Douglas: Could I perhaps even make a plug? If you have a smartphone or an iPad and would like to download the Desider app, there is within that app a download, which is the DE&S Way. Why do I promote that in such an upfront fashion? The DE&S Way lays down the basis of the transformation that the Minister referred to and, specifically to your point, a very clear set of rules around project controls—the manner in which each programme will be properly baselined, the manner in which it will have a work breakdown structure, and how that establishes an earned value management measurement methodology that has a schedule performance indicator and a cost performance indicator. The take-out from that will be flying by instrument—that is, a dashboard that, on each programme, will be able to show performance against the schedule performance indicator and the cost performance indicator, and therefore far more analytical evidence of the trajectory the project is delivering on.

It is part of a roll-out of the DE&S Way of P3M. I don’t want to bore you with technical control gobbledegook, but that is about programmes, project and portfolio management. The idea is that you can then link all those controls of the 1,000-plus projects back to the overall portfolio, and with the same instrumentation get visibility of conformity against programme and cost. The important take-out from this is then being able to back that into contracts so that, for example, if you are now part of the supply chain and are not performing in line with expectation or your



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contractual responsibilities, action can be taken in a timely way to administer that professionally.

So there is the Desider app, the DE&S Way and going forward you will see a lot more evidence of CPI and SPI as a result of a big investment into modern project controls, the likes of which you would see on many other projects that come into Select Committees.

Chair: You had a run on that one Tony, but we need to crack on a bit faster now. We will hear from Madeleine and then Phil.

Q268 **Mrs Moon:** My apologies—as you know, Chair, I have been at another meeting, which has made me late.

Yesterday, Minister, you were asked two questions by Kevan Jones about the Queen Elizabeth and the sea trials. I checked the SDSR, which says that the ship will be commissioned in the spring, but now it will be the summer. When will we get it, and will your app, Mr Douglas, help us? As we were discussing, is there a delay in the building, is there a problem in the yards that we do not know about, is the Ministry of Defence having budget difficulties, or is it about Ocean and its decommissioning, and you need the crew? What is the problem that is causing the delay? How can we be sure that we know, when there are problems, what the problem is? Quite honestly, if we do not know, that is when we start chasing and chasing.

Harriett Baldwin: I acknowledge that the carrier is due in Portsmouth this year, but what I cannot give the Committee is the specific days of the week, because no one knows exactly what day of the week she will move from where she is currently into her sea-trial process and then sail down to Portsmouth. Those are the things that we cannot be pinned down on because no one can pin down those exact dates at this stage.

Q269 **Mrs Moon:** You moved it from spring to summer.

Harriett Baldwin: I am not sure what the exact date is—are we talking about 21 June as the date when spring becomes summer? In terms of spring versus summer—

Mrs Moon: See, that is where you lose our trust. That just wipes it out—

Harriett Baldwin: I honestly cannot give you a specific date, because the very definition of what you are going through when you are going through trials is that, potentially, in that trial process you will have to make some corrections to something. That is whole point of a trial.

What I would say is that the crew is stood up. It was stood up under Captain Jerry Kyd in time for Christmas. I believe that they had Christmas dinner on board—

Q270 **Mrs Moon:** So it is not the crew. Is it the budget or a delay in the build?

Harriett Baldwin: In terms of the Aircraft Carrier Alliance and its finances, those have been very much under management since the

process in which it was stood up as an alliance. Everything in terms of delivery against that is very much in line with what we are expecting.

What I think you are picking up on, in terms of what I acknowledge is real enthusiasm in the country to know exactly when these particular days are, is that we cannot at this point in time be pinned down to exact dates in the calendar, but we are expecting and continue to expect that the delivery into Portsmouth will happen in 2017.

Lieutenant General Mark Poffley: May I elaborate a little on that? What is absolutely clear is that the ambition was as is described in the strategic defence review. The key operational date is clearly centred on a date later in the year—to be defined, because it is conditions-based, but certainly within this calendar year—for us to take the ship from the contractor, the Aircraft Carrier Alliance, into service with the Royal Navy. We have set that date for inside this calendar year.

It would have been a fantastic achievement, well beyond any other programme, if this had progressed without some difficulty at this stage in the programme. There have been a series of technical issues associated with bringing the vessel to the point at which she can commence her sea trials. None of that is outside the tolerance that we had anticipated in the schedule or the programme. It is certainly not financially limiting and it is certainly nothing to do with our ability to crew the vessel.

The sea trials will commence at the point at which the ship is ready to deploy to sea. Inevitably, as she goes through her initial sea trials, as with the first in class of any class of ship, we will undoubtedly see some problems that will need to be fixed. The fine detail of those at the moment varies on a day-to-day basis, because this is a very complex stage of the programme and it is where all the technical risk lies—in the last 10% of a programme of this scale and magnitude.

Mrs Moon: Thank you. At least I have got my answer.

Tony Douglas: We are not exposed to contract either at this point, for the avoidance of doubt.

Q271 **Phil Wilson:** When we were at BAE Systems, we heard that the acquisition process has become more difficult, because in their words “there has been a serious loss of expertise at the top of MoD—they have all become generalists”. First, do you think that is true? If it is true, what plans do you have in place to rectify that? Are we going to compensate for any deficiency?

Lieutenant General Mark Poffley: Perhaps I can take that on. What is absolutely the case is that I think there was a generic problem of ensuring that we had identified who was properly skilled to conduct that sort of work in the acquisition field. Also, we did not track their careers in a sensible fashion such that we got continuity and return on the investment that we had perhaps applied to them. We are now conducting regular reviews and that goes hand in glove with the transformation agenda inside



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DE&S, but the MoD, as the customer of the delivery organisation, absolutely has a mandate to upskill itself.

We have an active programme under way, with external support coming in to support us on that. We have a schedule of courses that we run through the Defence Academy, such that 70% of the personnel engaged in the acquisition world have been through one of the two primary courses that we run to ensure that people are properly skilled. Some 90% of them have already done at least one of those two courses. We will continue to stay on top of that, and we will bring in external support on a case-by-case basis where that does not exist inside the Department. That is part of a collaborative venture with the DE&S to ensure that we exploit the mechanisms that Mr Douglas is driving forward down in Bristol with the ability of the frontline commands and the Ministry of Defence as a head office to interface into that in a coherent way.

Q272 Gavin Robinson: That was one proposition from BAE. The second thing we learned in our visit to Barrow was the particular difficulties that SMEs are having in accessing procurement opportunities. That is something that I have raised with the MoD in the past. We had a successful roundtable for Northern Ireland. There does seem to be an issue in particular about SMEs engaging with the MoD and benefiting from opportunities that we would like to see spread throughout the country. In terms of a refresh for the defence industry strategy, how is that informing or informed by the wider Government's industrial strategy? What plans do you have nationally to increase the opportunities and, more fundamentally, to help and assist those small and medium-sized enterprises? They are not only important to the economy, but have a good contribution to make for the Department.

Harriett Baldwin: That is an absolutely great question. I care passionately about increasing the amount we spend with small and medium-sized enterprises right across the UK. The £178 billion budget over the next decade is the largest single amount that any part of Government spends with industry. It is incredibly important that we do not only use that with our big prime contractors. We have to ensure that they are held to account in terms of involving a supply chain of small and medium-sized businesses, and we should also try to contract more with smaller businesses.

We are putting and have put in place a range of different initiatives to try to make that easier. We have set ourselves a target of moving from the 19% we spend at the moment with small and medium-sized businesses, representing 4,500 firms. We want to increase that to 25%, so that £1 in every £4 that we spend is with smaller businesses across the country. I am keen to get out into all the different regions. I have done a range of different regional events. I would be very happy to go to any member of the Committee's region to do an event for smaller businesses where we bring along our supply chain advocates. We have set up a network of supply chain advocates. They are designed to be an easy way for small businesses, start-up businesses and innovative businesses that might have

spun out of some of the bigger prime contractors to find a way in through the obviously quite complex procurement routes. That is one initiative.

The second initiative I announced last Thursday was to do with the defence and security accelerator. That is the way we want to accelerate innovations into the supply chain. That is meant to be a very easy front door for small businesses to go through if they have a good idea or innovation. Behind that front door, they will find someone called an innovation partner, who will help them to take that innovation and find the right place to slot it in, in terms of the equipment programme.

Those are a couple of initiatives that I highlight to the Committee. I would really appreciate your help in trying to make sure that we have made small and medium-sized businesses more aware of those opportunities, and also to make sure that they are working well for those small businesses.

Tony Douglas: If I may quickly add to that, the journey from 19% to 25% has rigorous governance around it. We have supplier leadership forums that meet on a regular basis; in fact, the most senior one meets next week. Back to BAE Systems, which you referred to Mr Robinson, part of the challenge is that, over the last 30 years, they and Babcock have been responsible for hoovering up most of the medium-sized enterprises through acquisition, so there is a challenge that they get from me as to what they're doing to also support us in stimulating the SME environment. The big fish have been eating an awful lot of the medium-sized ones over the last 25 years.

Q273 **Gavin Robinson:** Sorry, I should just ask about the connectivity between the industrial strategies—the defence-specific and the national industrial strategy?

Harriett Baldwin: Sorry, I should have picked up on that. Obviously, the whole of the Government are doing the industrial strategy Green Paper, and we in the Ministry of Defence have been working very closely and feeding into that work. That is a pan-UK economy piece of work that is being led by BEIS.

We have committed in the SDSR to refresh our defence-industrial policy. We did a consultation, which I think closed earlier this month, and we will be feeding that in and engaging as the industrial strategy takes place, in terms of the emphasis that we want to put on the refresh of our industrial policy. I hope that makes it clear how the two things fit together.

Q274 **Mr Spellar:** What critical skills does the Department think are required by the defence sector going forward? In your answer, could you include how you are going to go about securing those, what private sector skills are critical to the delivery of Joint Force 2025, and also how you are going to fund the development of mission critical skills?

Harriett Baldwin: That is a great question; you could probably do a whole session on just that question alone, because it is incredibly important. At the foundation, I would put the nuclear skills as being a



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crucial piece, and defence plays into the overall nuclear cross-Government work. On top of that, there are the engineering skills and a range of different other specialist skills that we require, not only in the Armed Forces themselves but in the supply chain, where we work very closely with our skills strategy, in terms of our suppliers. Stephen, do you want to talk a bit about the cross-Government and nuclear aspect?

Stephen Lovegrove: Yes. My previous role was as permanent secretary of DECC, which looked after the energy policy and the new nuclear policy. When I was at DECC, it was pretty clear that the civil nuclear side was also suffering from a lack of skills. We made some overtures to the MoD while I was at DECC to try to look upon this in a rather more holistic way, because you can see that, in the mid-2020s, there is going to be considerably more demand for nuclear engineering skills than the nation is currently in a position to supply. I was very pleased to get over to the MoD and be able to make those joins tighter.

We had a session the other day with my counterparts at BEIS and also at the Department for Education—there is a very big component that we need to look at here, not only in secondary education but university education. I think there was a general recognition that this was a national issue that we needed to address in a national way.

The Secretary of State for Business, Energy and Industrial Strategy wrote to the Secretary of State for Defence at the back end of last year. There is going to be a summit of the relevant Government Departments and the industry to look at this particular issue and to try to come up with a policy that is capable of addressing it. That is one particular part of the landscape where we know we have to invest in skills development, but there are others. We need to identify those as they come up and work on them.

Q275 **Mr Spellar:** What will the funding stream be? Whatever day spring ends and summer begins and all the rest of it, we know when the academic year begins. Where will the funding stream be for these skills, which we know we will need and on which our defence capability depends, both operationally and in manufacturing?

Harriett Baldwin: I will give a couple of examples.

Stephen Lovegrove: Yes, but can I just say something? It is certainly not the case that the nuclear engineering expertise the nation needs should be paid for out of Government coffers solely. It is in the interests of the likes of EDF, Toshiba, Hitachi, BAE and Rolls-Royce, as much as anybody else's, to make sure sufficient focus is placed on this. Certainly BAE, Rolls-Royce and EDF are all putting very significant sums of money into the development of nuclear academies and so on. This is on the boundary of the private and public sectors.

Harriett Baldwin: We are proud that we are the biggest provider of apprenticeships in the Ministry of Defence and the Armed Forces of anyone in the UK, and also that the Navy is now sponsoring six university technical colleges and is looking to do more. That is an area where the



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Navy is using its own budget to tackle the pipeline of young people and skills that we will need in future. The permanent secretary made the point about the core suppliers themselves also doing a lot in terms of apprenticeships and engineering skills. General, did you want to add anything?

Lieutenant General Mark Poffley: You asked about the types of skills that will potentially prejudice achievement of Joint Force 2025. Those have been covered in the comments you have heard, but I would extend the list a little bit. They are the things that are a national problem anyway—the ability to work in cyberspace, to control information management and to deal with novel technologies. Of course, from a capability point of view, we are fundamentally interested in the ability to retain both sovereign and operational advantage—the latter is prime.

From our point of view, you have to be able to attend to these things, but an in-house solution may not be the best solution, and there are absolutely linkages into academia. Funnily enough, it is in small and medium-sized enterprises that we sometimes find some of these skill sets, because the deterministic notion of “I must survive” in that environment means that they come up with some very good ideas and think very laterally. The importing of ideas, capabilities and skills may not necessarily be best done by self-generating inside the Department. Indeed, it potentially is better done outside, but it is about how you now incentivise that interaction.

Tony Douglas: I will use a very specific example of a problem and the solution we have brought to bear. Within DE&S, we have more than 400 graduates and apprentices running through the system. Our historical challenge has been retaining them after they have completed what is a very intensive and expensive training undertaking, because the world of red-blooded capitalism has queued up at the door to pay them better to go and work in the private sector. From 14 April this year, through the bespoke trading enterprise and the freedoms that DE&S has been granted, we are implementing a completely different pay and grading structure that takes us out of the civil service construct. One of the many objectives of that is being able to retain the very people we have invested so heavily in developing, particularly in the area of nuclear and some of the other specific engineering disciplines and project controls I referred to earlier.

Q276 **Mr Spellar:** Do you put any requirements on your suppliers and contractors to have certain levels of training—I do not mean qualifications; I mean certain numbers—so that they are bearing their fair share of the burden? Do you do that in your contract negotiations?

Tony Douglas: We do that at the headline contract level. The tier 1s have that obligation. I think it is fair to say that, if you look at the big names—the BAE Systems, the Rolls-Royces, the Babcocks of this world—there is little question they are playing their part. Part of the challenge is how that goes through the medium and smaller enterprises.

Q277 **Mr Spellar:** But you could write that into the specifications?



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Tony Douglas: Only at the headline contract level.

Q278 **Mr Spellar:** No, you could say to them that your subcontractors should also be compliant. That could be part of the specification, could it not?

Tony Douglas: There are guidelines, for sure, but I cannot legally, contractually legislate it through somebody else's supply chain. But as guidelines, for sure.

Q279 **Mr Spellar:** Can I just go back to the nuclear side with the Permanent Secretary? I understand that work on nuclear skills was reported to senior management in October. Would you be able to share some of the findings?

Stephen Lovegrove: You are referring to the meeting I have just referred to where colleagues at BEIS, Education and Defence got together and had a look at a piece of project which I initiated at DECC and then followed through at the MoD. I can certainly have a look at that report and see what we can send across to the Committee. We may not be in a position to be able to communicate all of it, but I am sure quite a lot of it.

Q280 **Mr Spellar:** That would be very helpful. We look forward to that. The Committee went up to Barrow recently. Two issues arose. One was that after the carriers are finished there will be too much capacity in UK shipbuilding if only the Type 26 is to be built, certainly at current numbers.

Given that we now understand how crucial it is to keep the skilled workforce in place, how will the Government address this so that the UK does not once again lose capability and time in that crucial area.

The second question that was posed to the Committee was that the high-quality steel—you will be aware that this is a politically controversial area—for the pressure hull is not currently made in the UK. Should that be considered a sovereign capability that we should seek to restore, and if so how much would that cost?

Furthermore, are there other key elements of the supply chain for our ships and submarines that we still currently need to source from abroad?

Harriett Baldwin: I will answer those questions in reverse order. I think the estimates from the Barrow work and the future work programme are that something like 85% of the supply chain will be UK-procured. There will be some aspects of specialist equipment, in particular steel, where we did not get any UK qualifying bids. What we have done for our future steel requirements is that, as of the end of last year on gov.uk, there is a consolidated UK Government requirement—this is across HS2 and all the different programmes the Government are spending money on where steel is going to be required—which gives a future pipeline of those requirements. On a forward-looking basis, defence is not by any means the largest element of that.



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The goal behind doing that is to give a clear demand steer to the UK industry where it may need some advance lead times to be able to provide that particular category of steel.

Q281 Mr Spellar: I will interrupt there. Did we give those advance lead times to the possible suppliers? Did we take a proactive role in that or did we just throw it out into the market and wait to see who came back to us?

Harriett Baldwin: If you are referring to the specific matter of the hulls—

Q282 Mr Spellar: For the hulls, say.

Harriett Baldwin: For the matter of the hulls that was across the media in October, it was our prime contractor who did the procurement on that. No UK bid was deemed to be compliant with the specifications. That is why our prime contractor made the decision they did.

Going forward, we are making sure that that procurement requirement—that pipeline—is out there so that it can give suppliers of UK steel more lead time, more sight, of what is likely to be needed across the whole of the UK supply chain. Tony, you are itching to come in on this one as well.

Tony Douglas: I don't want to speak on behalf of the prime contractor, but they have gone through a rigorous exercise to determine the supply chain for the whole Dreadnought programme. As the Minister said, in excess of 85% of it is UK-sourced, and we are all very proud of that. Specifically on the pressure hull, the metallurgical content of the steel is such that very few suppliers have the approvals in place to have it certified. The tonnage, in the scheme of things, is actually not great. No UK supplier had the tooling in place or was able to make the investment for the tooling for what was, in the scheme of things, such a small run, with only four submarines being built. Consequently, they would not be able to get the necessary approvals, so BAE Systems could not source that particular pressure hull material within the UK. I think it is as straightforward as that.

Harriett Baldwin: John, can I pick up on your question from right at the beginning, on the demand for labour, effectively, in the shipbuilding pipeline?

Q283 Mr Spellar: On the supply of a skilled workforce, if there is a hiatus in the shipbuilding programme with Type 26?

Harriett Baldwin: We are providing a huge amount of work for UK shipyards for the next decade. Out of that £178 billion equipment plan over the next 10 years, more than £60 billion is for new shipbuilding, new submarine-building or support to our existing fleet, so there is an enormous amount of work. I have not had any particular concerns or complaints about that amount of work from industry. When the carriers come to an end, some labour will be redeployed to the other programmes such as Type 26 and Dreadnought. Tony, you work across all these specifics, but I understand that there will be some reallocation of the workforce.



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Tony Douglas: When we last met in the Committee specifically to discuss Type 26 and Type 45, I alluded to the fact that we would shortly be contracting for Type 26, as we did in November last year. We are working to a “cut steel” date in the summer of this year, so that is a massive commitment now to Type 26 on the Clyde.

Sir John Parker has also published his “National Shipbuilding Strategy”, which we believe is an extremely helpful document. We are in the process of responding to that. Within that, Type 31e—the “e” for an export-orientated design—is something that we are looking to industry to support us on, as it is a game-changer. I am being quite precise by using that vocabulary. This is being designed not only to a performance specification, but to a cost specification, which will allow us to export naval shipping for the first time in an awfully long time. We are working really hard on that at the moment. I believe there is an opportunity for us to redefine the way in which we contract with industry to be able to get that cost performance.

Q284 **Chair:** I have heard a suggestion that the Type 31 export vessel could be based on a stretched version of the offshore control vessels and that if that happened, the design effort could be compressed such that you would be able to build them alongside the Type 26, rather than waiting for the Type 26 to tail off and only then start to build the export-oriented frigate. Is that a practical possibility? I understand that you could even possibly produce such vessels at a cost of about £200 million apiece.

Harriett Baldwin: Perhaps I can start with that one, just by saying that I think Sir John Parker’s report is really helpful. It has recommendations for us as well as for industry. There is an enormous opportunity that we will be taking into account in our response, which we will publish in spring. I think one of the things that we will be looking at—as Tony is talking about—is that it is not just us as the customer, but whether we can do things that will enable it to be more exportable. The sort of things that you mention would be the kind of ideas that are floating around out there. We do have a good track record in terms of building offshore patrol vessels. Not only have we built five recently—or we are building five—for ourselves; also, some of the UK shipyards have built four for the Irish Government and three for the Omanis. So I think we have got potential as a country to regain some of our edge in terms of exporting, as a result of the excellent report that Sir John Parker has provided to us.

Q285 **Chair:** Sir John’s report did express some concern that it might be too much to try and build two new types of ships simultaneously, side by side; but this wouldn’t strictly be an entirely new type of ship, if it were based on an upgraded version of the OPV, would it?

Tony Douglas: I know that General Poffley wants to comment as well. There are a number of options that are currently being examined carefully. The headline would start from the premise that UK naval shipbuilding has historically been far too costly. The game-changer that I refer to is the manner by which instead of costing a design we will be putting a very clear request into the marketplace to design to a cost. It will be a competitive process, which will encourage a number of different

consortiums, probably from different combinations of UK shipyards, to compete for that opportunity. I think this is a great way of redefining the way in which we put that competitive tension into naval shipbuilding, so we can really grasp the export opportunity.

Q286 Chair: But do you all agree that it would be preferable not to have to wait till the end of the Type 26 before we get really well involved with producing a Type 31?

Tony Douglas: Our assumption is we would not be waiting till the end of Type 26.

Lieutenant General Mark Poffley: Indeed. I think we will be well ahead of that. That is our ambition.

Q287 Chair: Even to the extent of producing two vessels in parallel?

Lieutenant General Mark Poffley: It will depend on the complexity of the design that is agreed in the short term. There is active work and accelerated work to reach the sort of conclusions that you are alluding to.

Douglas Chapman: When you say your response will be in the spring, you do not mean the summer? I am just making sure.

Harriett Baldwin: Has the Committee decided where the boundary falls?

Q288 Douglas Chapman: On a serious point—very quickly, as we are running out of time—on the issue of shipbuilding and Type 31s, a lot of industry has been telling us that there is just not the current capability—skills-based or infrastructure-based—to spread that work around in the way that you perhaps envisage. How much is that playing on your minds, in terms of concentrating the work—obviously, I would want it on the Clyde—and the actual practicality of going ahead with the plan as you have suggested?

Lieutenant General Mark Poffley: First, much of that is going to depend pretty clearly on the design that we take forward into the Type 31e. If you think of that programme as a rolling programme through perhaps arguably two decades, the first batch may look very different to subsequent batches, so the thinking about where we go with a general-purpose frigate is not completely defined at this juncture.

The work we did with Sir John in the construction of his report has given us a very good understanding of quite where capacity sits, both in skills and, frankly, just in capacity, across the British yards. It will then come down to the commercials, and the various, I hope, bids that come in from companies as to where they can exploit either existing capacity or grow more capacity in order to fill the order book that we envisage. That is the next stage of the process.

Tony Douglas: Sir John's contention in his report is that the UK shipbuilding industry is actually, contrary to popular belief, alive and kicking. Indeed, there is evidence of a renaissance in some of the yards, which have forced themselves to be more competitive in different market



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sectors. That is part of his contention. On a personal level, I would concur. We would wish to stimulate through competitive dialogue all the people who believe they have the capability to respond to a very tight specification requirement but also a cost target. We are looking for a design to a cost this time, as opposed to trying to price somebody else's design a lot later on and concluding, for whatever reasons, that we cannot afford it.

Harriett Baldwin: We are working very closely with DSO in the Department for International Trade in terms of the export market and export potential for an exportable frigate.

Q289 **Mrs Moon:** The Government decided to purchase the P-8 without competition. That is a nil-nil sale, so it wouldn't go through the SSRO; is that right?

Harriett Baldwin: Correct.

Q290 **Mrs Moon:** What are the disadvantages for UK industry, jobs—bearing in mind that Typhoon had 16,000 jobs linked to it—and British sovereign defence capability? What have you looked at, in relation to those factors?

Harriett Baldwin: I would point to the fact that in terms of the long saga that you will be familiar with on defending our own sovereign capability, being able to buy the P-8s through a Government-to-Government deal with the States gives us a number of advantages. Obviously, we can bulk-buy alongside the US Navy, so that helps bring down the unit cost. I think the numbers that the US has published on this are \$2.3 billion, in terms of the total cost of the programme, so you can see in terms of value for money and capability that this was a good opportunity. On the fact that it is not built in the UK, obviously it is our role across Government to make sure that the supplier—in this case, Boeing—is held to the commitments that it made on inward investment into the UK and using a UK supply chain, not just for this particular line but for others. We and other areas in Government meet regularly with it, as a supplier, on that. We are very pleased that it has made the announcement that it has chosen the UK as its base for its European defence business, for support across the whole of Europe. It has also committed to increasing the number of people that it employs in the UK by 50% between now and 2020.

Q291 **Mrs Moon:** How many jobs is that?

Harriett Baldwin: From memory, I think it is a further 1,000 jobs. I will write to you to correct that, if it is not correct.

Q292 **Mrs Moon:** It is 1,000 jobs against the 16,000 we had for Typhoon.

Harriett Baldwin: As you know, we continue to invest in the Typhoon programme—

Q293 **Mrs Moon:** No, no. I was looking for at least an equivalent number of jobs.

Harriett Baldwin: We are buying a lot of Typhoons.



Q294 **Mrs Moon:** What lessons are you learning from these off-the-shelf procurements? I am trying to race this along because we are coming to the end. I am not trying to be rude; I am trying to make progress. Are there lessons to be learned from the P-8 and the F-35?

Harriett Baldwin: Definitely. You mentioned the F-35 as well, which I think is another good example. In terms of the total programme globally, that is 3,000 planes, of which the UK is buying 138 over the life of the programme. As we are the only tier 1 supplier here in the UK, that means that 15% of each of those 3,000 planes is being built in the UK and that is a bigger number, obviously, than if we were building 100% of 138.

It is fair to say that the US Department of Defence has made it very clear that they recognise that this is a two-way relationship, so in addition to that, there has been a significant announcement on north Wales being the global maintenance and repair hub for the F-35 and, to go back to the P-8, a significant announcement of a £100-million basing for the P-8s in Lossiemouth, which is going to lead to 400 jobs there. It is a two-way street; if you can be part of a bigger global programme and be a participant in that, the economic impact for the UK can be very positive, but I totally accept that that is something that we need to continue to be right across, and we need to make sure that the promises that we are given when we are about to sign are delivered on after signature.

Q295 **Mrs Moon:** The new American President slammed the F-35 in terms of its cost, and his criticism led to suggestions that the price may be reviewed. He has also said "America first"—American jobs, American industry and American sovereign capability first. With Brexit, and given that we do not have the same clout over programmes they do in America as we would if they were UK-built by UK firms, what will we be doing? Will you look at "Britain first" in relation to procurement? Bear in mind the excellent RUSI document—I cannot plug it enough—on the defence pound, which shows the returns every time to the Treasury from investing in Britain rather than in America.

Harriett Baldwin: We wholeheartedly support President Trump in his efforts to bring down the costs of the F-35 programme. As a customer of the F-35 programme, it can only benefit us if that is achieved. But as you will well know from our publication in 2012 about being international by design in terms of procurement, we will look at capability and value for money, and we will weight the UK and the amount of economic activity that generates for the UK. Those are all factors that we will take into account. What we will not do is rule out the potential of partnering, and of bulk-purchasing with the US Government pieces of equipment that will provide very good capability for our Armed Forces, where we can go in and get excellent value for money and excellent capability that will have a knock-on impact in terms of the UK supply chain and UK industry. I do not know whether anyone else wants to comment on capabilities, but the principles were spelled out in the document in 2012.

On Brexit, with regard to the potential for defence, again this is an opportunity for us to continue to work very closely with our European



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allies. We have worked with them closely on Typhoon and on A400M, and there are a number of different bilateral programmes with the Germans and the French as well. We are stepping forward, rather than stepping back, in terms of our engagement on defence and defence procurement with our European allies. We are very much emphasising that in our relationships, despite the country's decision to leave the European Union.

Lieutenant General Mark Poffley: If I can make one comment about F-35, I think there is no dispute between us, or indeed my colleagues in the United States: the F-35 is exactly the right platform to be engaged in and to be purchasing, given the advantages that accrue from its technologies. I point out that the UK involvement in that project is second to none. We are the senior partner in that multinational programme, and that affords us quite a lot of advantage in our discussions about the requirements associated with the current technology and the future. There are quite a few UK interests feeding into that, which will, I am certain, bring some economic benefit into this country.

Despite a certain amount of social media attention on the issue, I have seen no reduction whatsoever from any official in the United States with regard to the commitment to the F-35 programme. And I am sure—

Q296 **Mrs Moon:** I did not expect any reduction in commitment, but by being so loud and brash, he managed to put them on notice to keep their costs down, and that is one heck of a voice to have.

Tony Douglas: It is extremely helpful for us.

Q297 **Mrs Moon:** I appreciate it is helpful for us, but because it is an American programme, we cannot do that. That is what makes me uncomfortable.

Lieutenant General Mark Poffley: Well, absolutely. First, I agree that it is incredibly welcome if anybody drives down to the point where it becomes a more affordable position and offers us more chance for other capabilities. I think we do have some significant leverage in that programme, because of the technologies we are adding to the programme.

Q298 **Mrs Moon:** I advise you to go back and read the RUSI paper again. I just want to talk about technological spend. I know we have this 1.2% commitment on science and technology, but still, the amount of money being spent on research is going down and has gone down since 2001. What are we going to do about that? We have new and disruptive technologies that are being neglected. When I was in America last week with the NATO PA, one of the things highlighted to me was the Russian S-400 surface-to-air missile, which is the most capable, and we have nothing with which to deal with it. I asked why not, and I was told it was because procurement priorities are platforms, not weapons and not investment in new and disruptive technologies. I find that very worrying. What are you going to be doing about it?

Harriett Baldwin: You are right to highlight the importance of innovation, and that is why we have launched the £800 million innovation fund, which is designed specifically to find those disruptive technologies.



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Last week we launched, in terms of the defence and security accelerator, the Enduring Challenge, which is an open front door; if you have an innovative idea that is going to be potentially disruptive, come to us with it. It will harness, potentially, the whole of our capability budget.

Overall, we have a rising defence budget, so there is this double lock in the defence budget. It is increasing overall by 0.5% in real terms every year. For the equipment budget, the lock is 1% in real terms.

It is incredibly important that we have ring-fenced the amount we spend on science and technology, and that we continue to ensure we are investing enough in disruptive technologies, such as the future combat air systems, the mine countermeasures programme we are doing with the French, and the laser weapons demonstrator we announced over Christmas. It is incredibly important that we continue to find that cutting edge. Military capability is all about making sure you have got the edge. That is why we are so committed to innovation and science and technology.

Lieutenant General Mark Poffley: I cannot add much on the capability of the Russian S-400. It is quite clear that there will be a measure and a countermeasure, and that is part of our normal routine business. It is about us making sure that we are able to apply military force where, frankly, we don't want to enter an even contest. However, one single capability is never likely to be definitive in that context. While, inevitably, some of our potential opponents may develop technologies, I would think it wrong to conclude that our innovation agenda and our science and technology prioritisation had not looked to attend to platforms such as the S-400.

Q299 Douglas Chapman: Let us move on to the SSRO very quickly, because of time restraints. SSRO seems to be providing good value for money. Mr Lovegrove suggested that part of your savings—was it £1.8 billion?—would be down to the savings they could bring to the system. They only see a small percentage of the contracts—up to maybe 15% to 20% of the single-source contracts they have produced. While the Secretary of State has the ability to work within that regime, with the qualifying threshold, what circumstances could you see where more single-source contracts might be seen by the SSRO? Would that include Government-to-Government contracts?

Harriett Baldwin: Those are great questions because, as we were saying earlier, competition is the way you can make sure you are getting the best capabilities and value for money, but there will be some things on which we can't compete. That is where the SSRO comes into play, in terms of single source. I can update the Committee on the coverage, though. This is probably quite helpful, given that I do not think you have had an update since before the end of last year. There are 66 contracts and eight sub-contracts with a value of more than £10 billion that are now covered by the rules, and we anticipate that we are on track for 90% adoption by the end of this Parliament. Obviously, we increase the number of contracts that are covered when, for example, contracts come up for renegotiation.



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The question is asked, "Can this be competed?" and, if not, it will be covered as a qualifying contract. We anticipate that that will continue to accelerate over time, and we have some quite helpful documentation that we can provide to the Committee, on the record, if that would be of interest.

On the question of foreign military sales, and Government-to-Government contracts in particular, I understand that it was something that the Department looked at very closely back at the time when the Defence Reform Act was being brought into effect. It was decided at that time, for two main reasons. First of all, obviously the Department of Defence in the US already has its own way of assuring cost. We have heard about some extra efforts on the F-35 programme today, but they do already have some very rigorous ways of doing that cost control themselves. Secondly, in terms of the legal jurisdiction and the ability to enforce that in the US courts with US suppliers when we have gone in as part of a Government-to-Government contract, it was felt that that was not a legal position that was going to be a reasonable one to take. The SSRO are running their consultation at the moment, and we are expecting them to give us their response and recommendations sometime later this year. Obviously, we will pay attention to that when it comes in.

Q300 Douglas Chapman: Will you commit to providing the SSRO with a lot more information than they are getting at the moment? Part of their evidence to us was that they were not getting to see the detail of the contracts that they needed to see in order to come to informed conclusions. I think that the independence of the SSRO is a question that is obviously up for debate at the moment. How do you see that?

Harriett Baldwin: The SSRO is set up by the Ministry of Defence to deliver the role we have described, but also, of course, to ensure that our contractors get a fair rate of return. It is a very important function, and one that we value and that, as we were hearing earlier, we look to deliver in terms of savings. On the process, our intention is that these things are agreed between the supplier and the MoD when the contract comes up, that this is a qualifying contract, and that it is covered by the regulations. There should be very few exceptions when the SSRO is brought in to, effectively, act as the independent arbitrator. In a sense, if things are working well, you would expect them not to have to do too many of those determinations, because everyone has agreed that they should be considered qualifying defence contracts. Tony, do you want to add anything more on that front?

Tony Douglas: I think that is the principal point. As an arbitration process, the value of the SSRO, which is quite clear—it is absolutely the right mechanism to deploy—comes to the fore when there is a failure to agree, in a sole-source contracting case, on being able to land out on all the assumptions that lead to cost and performance. The SSRO going through every single assumption that got you to that point would probably almost double the time of the procurement, from a first principles point of view. As for "What does good look like?", as the Minister said, I think it is, over time, the SSRO probably being used less, but on more specific high-



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value opportunities, the likes of which we have referred to already today—the Dreadnoughts, the Astute submarines and the likes thereof.

Q301 Chair: Would not the SSRO be more effective if it were independent of the Ministry of Defence? Would it not be able to do its job better if, instead of requesting to see contracts, it could require the Government to show it contracts?

Harriett Baldwin: The SSRO is set up by the Ministry of Defence to perform the task that we have outlined in the legislation.

Chair: We know that Minister. We are asking you something else.

Harriett Baldwin: It is set up as an independent entity. As the Committee will know, we have recently appointed a new chair.

Chair: Sorry, Minister, but that is not answering the question.

Mrs Moon: Nice try!

Harriett Baldwin: From our perspective, we acknowledge that we are in our second or third year with this new organisation—

Mrs Moon: Not to mention the second or third chairman, Minister.

Harriett Baldwin: Not to mention the third chairman.

Q302 Chair: Does not the fact that we have had this rapid turnover of chairmen suggest that all is not right? Wouldn't it make it better, first, if the organisation were structurally independent of the MoD, and secondly, if the chairman of the organisation had the power to require to see contracts, rather than simply to make requests and then have those requests turned down?

Harriett Baldwin: This is a very interesting question. It is set up as an independent entity, answerable to the Secretary of State. In my previous role as Economic Secretary, I was responsible for the Bank of England and the FCA, which are very independent organisations. They did not have the wording that is set out in legislation such as the Defence Reform Act and the SSRO clauses around recommendations to the Secretary of State to do things. It is set up to be an independent entity of the MoD, but very much making recommendations to the Secretary of State.

Q303 Chair: Let me try another tack—just one more go, and then we will see. Would it help—even if the organisation remained a part of the MoD—if the chairman had the ability to require the MoD to show it the contracts that it considered it ought to see, rather than simply request them and have their requests turned down? Can we have a list of the requests that it has made, with a tick beside those that it was allowed to see and a cross beside those that were refused? Perhaps today you could even tell us roughly what percentage of the requests that it made were successful, and what percentage were turned down.

Harriett Baldwin: Yes, but on the other hand I would go back to the point that I was making about defining success as not having to



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necessarily go to the SSRO, because we have all the qualifying defence contractual information that we need anyway. But I have a very helpful chart here, which I am very happy to send to the Committee, about some of the detailed contracts that are covered by the regulations.

Q304 **Chair:** So you will let us know which requests were made, which were turned down and which were accepted?

Harriett Baldwin: I am sure we will, if we can.

Q305 **Chair:** Then we will be able to see what their success rate is. The fact that we are on our third chairman—is that right?—in a short period of time suggests that it is not working as well as it might. The suspicion has to be that these chairmen do not feel either that they are independent enough or that they have sufficient powers to do the job properly. How would you respond to that? Can you give any other reason for this quick turnover of chairmen?

Harriett Baldwin: In terms of their feelings and so on, I am sure the Committee will want to ask them specifically, but I am very pleased that we have a new chairman. He seems very well qualified to take on this role; he is putting together a strong board. This is an organisation that has an important function to play for the Ministry of Defence. They are going through this process of consultation at the moment; we are expecting them to come to us with recommendations, and obviously we will take those very seriously, because it is in everyone's interest that the SSRO works well on behalf of the Ministry of Defence, on behalf of the taxpayer and on behalf of getting a fair return for industry.

Q306 **Chair:** Finally, I believe it was made known to the MoD that this Committee would have quite liked to have a pre-appointment hearing with the new chairman of the SSRO, and we were disappointed that that did not happen. We had quite a successful pre-appointment hearing with the Service Complaints Commissioner a year or two ago, and I think that set a good precedent. Should the Committee have been given that opportunity? At the current rate of turnover, might we expect an opportunity to do so in the future, which we hope will not follow on too closely from the last occasion? Why did we not get that opportunity on this occasion?

Harriett Baldwin: Forgive me, I was not aware of that particular request, but I was keen to ensure that we had a new chairman appointed in time for the beginning of 2017. I think he took up his post at the beginning of January. The SSRO has an important role and body of work to do for the Ministry of Defence in 2017. We are all making sure that the lines of communication are working well with the new chairman. For example, I meet him personally on a monthly basis to make sure that we both agree that we should not be surprising each other with things that are not within the remit or in the current legislation. We look forward to hearing the recommendations for change that they put forward.

Q307 **Chair:** As a matter of principle, would you accept that it is a good idea for this Committee to have the opportunity for pre-appointment hearings in



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certain cases such as this?

Harriett Baldwin: I am hoping it will not happen again any time soon.

Chair: That wasn't the question.

Harriett Baldwin: It is a very sensible request for the Committee to be making.

Q308 **Chair:** And you might be inclined to respond positively to it in the future.

Harriett Baldwin: As I say, he has been appointed for a three-year term, so I am hoping that that will not happen.

Q309 **Chair:** Yes, but on the basis that there will be appointments of this nature from time to time, do you accept that in principle it would be a good idea for this Committee to have the opportunity—in a constructive way, just as we did with the Service Complaints Commissioner—to have a pre-appointment hearing when these appointments are made?

Harriett Baldwin: That is a very sensible request, which we will take very seriously, consider and reply to, but I am hoping that the occasion will not have to present itself any time soon.

Chair: Yes, but consider this a request from us to you, which I appreciate that you will have to speak about to other members of the ministerial team. Perhaps you will then write back to us in due course. May I thank you all very much indeed? The sitting is concluded.