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D/PUS/11/7/1(232) 17 December 2020

Meg Hillier MP
Chair of the Public Accounts Committee
Sent electronically

Dear Chair,

Following the publication of Second Report of Session, 2019-2021 on Defence Nuclear Infrastructure, I undertook to provide a written update to Committee's 6th Recommendation. Breaking down the key points within the 6th Recommendation, the PAC recommended;

i. **Risk.** The MOD ensures its contractual arrangements are explicit regarding risk ownership and risk management;

and requested;

ii. **Ownership Arrangements.** The MOD provide Committee with a detailed assessment of whether the current ownership arrangements for nuclear regulated sites are in the best interests of the taxpayer;

iii. **Intellectual Property.** The MOD assess whether more can be done to exploit the intellectual property arising from developments on these sites.

In response, I offer the following, taking each issue respectively:

Risk

The level of complexity and innovation within the Defence Nuclear Enterprise inherently comes with a high degree of risk. The mitigation of that risk is clearly a priority and the Department continues to learn and adapt to manage this burden more effectively with delivery partners. As stated, historically the MOD has transferred submarine build risk to industry without the full characterisation of that risk and at a point in time when industry was not equipped to manage it. The aim is to now transfer risk to industry incrementally, as and when it is appropriate to do so. Our contractual arrangements with BAE Systems are now starting to reflect this shift on the Dreadnought programme.

In the context of the Warhead Programme, the Management and Operating (MO) contract in place at the Atomic Weapons Establishment (AWE) has served as a mechanism through which to transfer risk to Industry partners. This is, however, due to cease in 2021, bringing risk ownership back fully within the MOD, as explained below.

Ownership of Defence Nuclear-Regulated Sites

The MOD routinely evaluates and reviews all major contracts as they near their end dates, to ensure we achieve the best outcome for both the taxpayer and the needs of the Enterprise. In the context of nuclear regulated sites, and the ownership arrangements surrounding these, this has been recently demonstrated with the Department's decision to bring the AWE back under direct government ownership, as an Arms Length Body (ALB). An outline of the ownership arrangements at AWE and the other nuclear regulated sites under the Defence Nuclear Enterprise (across the production, operational, and disposal phases) is as follows:

AWE. Since 2000, AWE has been operated by AWE Management Limited (ML), a private sector consortium, through a M&O contract using a Government owned Contractor operated (GoCo) construct[1]. On the 1 July 2019 the MOD triggered the Successor Arrangements clause with AWE ML, to enable it to consider alternative viable management options ahead of the current contract expiration. Although it is acknowledged that the existing arrangements have brought stability to the organisation, the MOD concluded that AWE should revert to a direct Government ownership model. As such, the Department decided to terminate the contract with AWE ML under a Termination for Convenience clause. Notice of this termination was provided on 2 November 2020 and the MOD is now closely engaged with AWE ML in managing the transition between now and 1 July 2021, when the new operating model will take effect.

As per the Secretary of State's statement[2], this change in governance will remove the current commercial arrangements, enhancing the MOD's agility in the future management of the Warhead Programme, while also delivering on core MOD objectives. The model will simplify and further strengthen the relationship between the MOD and AWE plc, enhancing the MOD's ability to invest in the development of the workforce, technology and infrastructure, and therefore in the future of AWE plc.

The MOD recognises the achievements of everyone involved with AWE and thank AWE ML and its shareholders for their support in stewarding the organisation through crucial phases of delivery and planning.

I am confident that the new model will provide closer alignment between the MOD and AWE plc in delivering the challenging programmes ahead, and more direct control for the Department in managing the inherent risks.

BAE Systems Marine Ltd, Barrow-in-Furness. BAE Systems Marine Ltd (BAES) owns and operates the Barrow site. This is the main UK facility for the design and build of the UK's fleet of nuclear-powered submarines. Where subject to Nuclear regulation, BAES are the Site licensee for the Devonshire Dock Complex on the site; they are regulated by the Office of Nuclear Regulation (ONR). The MOD is not legally part of this licensing construct. The primary contractual authority for the procurement of the products and

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[1] The AWE GoCo model has been in place since 1993, when Huntingdon-BRAE was awarded the contract – AWE ML took over following re-competition in 2000.

[2] Written Ministerial Statement (HCWS544), 2 November 2020, Defence Update: **{** HYPERLINK "https://questions-statements.parliament.uk/written-statements/detail/2020-11-02/hcws544" **}**.

services delivered at Barrow is the Submarine Delivery Agency's (SDA) Acquisition Directorate. The current commercial construct between the SDA and BAES provides for a series of individual product contracts underpinned by a Foundation Contract that specifies business wide management controls, including cost recovery for the operation and management of the site, and provides for the management of the Nuclear Site Services. Subject to investment decisions, the next significant uplift to this contract will occur with effect from 1 April 2022 and interactions between it and future product contacts will be considered as part of that work although there is no intention to change the current arrangements for Barrow site ownership.

Rolls-Royce Raynesway. Rolls-Royce Submarines (RRS) operate the Raynesway site under contract to the MOD. RRS do not own the Raynesway site but lease it under the terms of their contract solely to support the UK's Naval Nuclear Propulsion Programme. Where subject to Nuclear regulation, RRS are the Site licensee for Raynesway (the Core Production and Neptune Test Facilities); they are regulated by the ONR; the MOD is not legally part of this licensing construct. The primary contractual authority for the product contracts is the SDA's Nuclear Propulsion Project Team, but the outputs support the entire submarine programme across the full life cycle. The current commercial construct between the SDA and RRS provides for a series of individual product contracts underpinned by a terms of business agreement that allows for coherency across the product contracts in terms of underpinning cost recovery for the operation and management of the site. Work is currently ongoing under the joint MOD/RRS Futures workstream aiming to bring in revised arrangements; this is currently in the concept phase of activity. This stream of work will take account of the constraints associated with a licensed site, the 1958 Mutual Defence Agreement with the US and the recommendations of the PAC and NAO associated with the nuclear programme.

CASD Operational and In-service Support Sites. Naval Base Services, surface HM Ship and Submarine engineering are currently delivered through the Maritime Support Delivery Framework (MSDF) contracts with Babcock. This covers the nuclear-regulated sites at HM Naval Bases Devonport and Clyde (including Royal Naval Arms Depot Coulport), as well as BAES facilities at HMNB Portsmouth. These contracts were awarded on 1 October 2014 and are due to be replaced by the Future Maritime Support Programme (FMSP) in 2021. FMSP is designed to ensure performance improvement and much increased efficiency in the delivery of engineering and Naval Base Services across the Maritime Domain. The ownership model associated to these sites and the MSDF contract was reviewed in the early days of the programme, but the cost of buying back the Devonport Babcock facility was considered financially prohibitive.

Rosyth Dockyard. Rosyth Dockyard, formerly owned and operated by MOD, was transferred to contractor operation in 1987 and subsequently sold to Rosyth Royal Dockyard Ltd in 1997. The management of Rosyth Dockyard, including the nuclear regulated site associated to the dismantling of out-of-service submarines, is currently governed by the Rosyth Future Business Agreement (RFBA), agreed between MOD and Babcock Marine in 2015 as a Commercial Settlement Agreement (CSA). The RFBA brought together and addressed multiple strands of MOD's current and former financial liabilities associated with the dockyard. A central feature of the RFBA CSA was an up-front investment by MOD, which secured a reduction in the long-term financial liability and uncertainty, through agreement of incentivised target pricing for fixed overhead costs until FY29/30. The RFBA is judged to provide excellent transparency and control of work and has enabled the MOD to exert a high level of customer influence to the benefit of the taxpayer.

Intellectual Property

Disposition of risk and questions of site ownership are largely independent of ownership and exploitation of intellectual property. The ownership of intellectual property (IP) generated under Department funded contracts, is in general by default left with Industry and the Department secures licence rights to that IP for UK Government purposes. This is because Industry is normally regarded as best placed to exploit the IP it develops. Where such intellectual property is commercially exploited by industry a levy is usually payable to the government.

By exception, the Department will seek ownership of IP generated under the contracts it places. This exception includes nuclear work where the IP developed may be building upon a substantial body of Crown-owned IP and provides a consistent approach to ownership. The sensitivity of certain nuclear work also means that associated IP is unlikely to be suitable for commercial exploitation by industry, while in some cases exploitation is constrained by international agreements, hence the MOD generally retains ownership and control. There are established mechanisms in place to identify, protect and attempt the commercial exploitation of IP when appropriate to do so in a manner consistent with meeting UK national security interests. MOD’s wholly owned commercial exploitation company, Ploughshare Innovations Ltd, is made aware of such IP as part of these processes to ensure that opportunities for commercial exploitation are considered and pursued in a consistent manner across the Department. Such exploitation activities must, however, strike a balance between the available opportunities and the costs of the resource required to pursue them, as there is no guarantee a financial return would be forthcoming. There is, however, nothing to prevent industry from approaching the Department with any proposals they might have to exploit IP owned by the Department and these would be considered on a case by case basis.

In closing, as work continues to ramp up with renewal of our nuclear deterrent, the challenges will continue to evolve. The changes we are making to the commercial arrangements that underpin these programmes are putting the MOD and its partners on a stronger footing to meet those challenges. We will, however, continue to monitor, evaluate, and adapt. Where we assess there is reason and opportunity to adjust these arrangements, in the interest of the taxpayer and the Defence Nuclear Enterprise, we will seek to employ the best model available.

Yours sincerely,

Stephen Lovegrove

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