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Defence Committee

The Defence Industrial Strategy: update

Sixth Report of Session 2006–07

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written evidence*

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The Defence Committee

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Cover image of a Type 45 Destroyer.
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Summary

The Government's Defence Industrial Strategy (DIS) was published on 15 December 2005. The Minister for Defence Procurement, Lord Drayson, considered that 2006 was the year in which the DIS would be implemented; and overall, good progress has been made.

However, progress in reshaping the maritime sector, both surface ships and submarines, has been disappointing. The Ministry of Defence (MoD) requires the restructuring of the surface ship sector to be completed before it makes the main investment decision on the Future Carrier programme and places contracts for the construction stage. There are signs that the restructuring is underway. This needs to be pushed forward quickly to avoid delays to when the new carriers and associated aircraft come into operational service.

A key theme of the Strategy is operational sovereignty, enabling the UK to maintain, upgrade and use equipment independently. This is a central issue on the Joint Strike Fighter (JSF) programme. At the end of 2006, the MoD obtained assurances from the US that the UK would receive all the information it required to operate the JSF aircraft independently and signed the Memorandum of Understanding (MOU) for the next stage of the programme. This news is to be welcomed, but the MoD would not provide us with the supplement to the MOU detailing the nature of the assurances given. We have concerns about how things will work out in practice and intend to take further evidence on this.

The DIS identified alternatives to competitive procurement, including long-term partnering arrangements. The MoD has announced a number of such arrangements which, because of limited opportunities for competition within the UK, are let with monopoly suppliers. The MoD needs to incentivise these partners to improve the efficiency of their businesses to match the best overseas suppliers. The MoD must also ensure that opportunities are provided for small and medium size suppliers to compete for the work underpinning the long-term partnering arrangements.

Realising the substantial benefits offered by the DIS will cost money. In addition to the MoD's internal implementation costs is the much larger cost of the future equipment programme. The outcome of the Comprehensive Spending Review will determine whether the benefits and improvements offered by the DIS are fully realised. It would be a real missed opportunity if adequate funding were not provided.

To assess whether the Strategy has been successful, the MoD will need both to ask the Armed Forces whether they are seeing improvements and to measure its own performance in acquiring equipment and managing equipment on a through-life basis.

1 Introduction

1. The Government's Defence Industrial Strategy (DIS) was published on 15 December 2005¹ with the aim of providing greater transparency to the UK's future defence requirements and, for the first time, setting out those industrial capabilities the UK needs to maintain appropriate sovereignty and operate equipment independently.

2. Following the publication of the DIS we undertook an inquiry and reported on 10 May 2006.² During our inquiry we examined the implementation timetable for the DIS and the Minister for Defence Procurement, Lord Drayson, told us that:

2006 is the year that we seriously implement it [the DIS] to be able to show results...that we really have made a difference...I am in a hurry to show in 2007 that this has made a real difference to our defence capability and the strength of our defence industry.³

3. Lord Drayson helpfully provided us with a checklist setting out when the various actions in the different areas were to be completed by, for example, completion of the Maritime and the Research and Technology (R&T) strategies.⁴ The vast majority of these actions were to be completed during 2006. Given the importance of the DIS we planned to monitor closely the progress in implementing it and whether the expected benefits were delivered. This inquiry examines the progress made in the first 12 months following the publication of the DIS.

4. In undertaking our inquiry, we took oral evidence on 19 December 2006 from Lord Drayson, Minister for Defence Procurement; Mr David Gould CB, Deputy Chief Executive, Defence Procurement Agency; Mr Amyas Morse, Defence Commercial Director; and Mr Mark Gibson, Director General Enterprise and Business Group, Department of Trade and Industry (DTI).⁵ We received written evidence from the Ministry of Defence (MoD) and others.⁶ We are grateful to all those who contributed to our inquiry including our specialist advisers.

1 Ministry of Defence, *Defence Industrial Strategy*, December 2005, Cm 6697

2 Defence Committee, Seventh Report of Session 2005–06, *The Defence Industrial Strategy*, HC 824

3 HC (2005–06) 824, Q 289

4 HC (2005–06) 824, Ev 118–120

5 Ev 1–20

6 Ev 21–43

2 Progress in implementing the DIS

Overview of progress

5. Just prior to our oral evidence session on 19 December 2006, the MoD provided us with a “Summary Progress Report on significant DIS Milestones”.⁷ This sets out in detail the progress made against the checklist provided to us during our first inquiry into the DIS.⁸ A summary of progress at 19 December 2006 for the various areas is provided at Table 1.

Table 1: Summary of progress against DIS implementation milestones at 19 December 2006

Area	Progress against planned actions
Maritime	The planned action of achieving a programme level partnering agreement with a single industrial entity for the full lifecycle of the submarine flotilla is on-going (the second part of this action of implementing a unified submarine Programme Management organisation within the MoD was achieved). The planned action of arriving at a common understanding for surface ship design and build of the core load required to sustain the high-end design, systems engineering and combat systems integration skills was not achieved and is on-going. The planned action of exploring with industry alternative contracting arrangements and the “way ahead for contracting the next upkeep periods” was achieved.
Fixed Wing	The planned action of agreeing a Long Term Partnering Agreement was not achieved and is on-going. The planned action of moving ahead with a substantial Uninhabited Aerial Vehicle Technology Demonstrator Programme was achieved, with the award of a contract in December 2006, for a programme to build an experimental Unmanned Air Vehicle (TARANIS).
Armoured Fighting Vehicles	The one planned action in this area was achieved in December 2005 with the signing of an Armoured Fighting Vehicle Partnering Agreement with BAE Systems Land Systems.
Helicopters	The one planned action in this area was achieved in June 2006 with the signing of a Strategic Partnering Arrangement and Business Transformation Incentivisation Agreement with AgustaWestland.
Complex Weapons	The one planned action in this area was achieved, with the formation of Team CW (Complex Weapons)
General Munitions	The one planned action in this area was not achieved by Summer 2006 and is on-going.
Research and Technology	Three of the four planned actions in this area were achieved, including the publication of the Defence Technology Strategy which was launched on 17 October 2006. The remaining action is on-going.
Internal Change	Seven of the eight planned actions in this area were achieved with the remaining action on-going. Among the actions achieved were the publication of the Enabling Acquisition Change report in July 2006 and the appointment of a Defence Commercial Director in June 2006.

Source: MoD⁹

7 Ev 28–33

8 HC (2005–06) 824, Ev 118–120

9 Ev 28–33

6. In summary, progress in implementing the planned actions in the various areas during 2006 was mixed. There had been good progress in several areas, namely Armoured Fighting Vehicles, Helicopters, Complex Weapons, Research and Technology (R&T) and Internal Change, but disappointing performance in the Maritime area.

7. We asked Lord Drayson for his overall assessment of the progress which had been made during 2006. He told us that he was

pleased with the progress which we have made. It is not a complete picture where we have achieved everything which we set out to do, but we have achieved, I believe, an awful lot.... Overall, I think we have established some real momentum, both in terms of changes in the sectors in line with what we said we would do within each of the sectors, and secondly, change within the Department.¹⁰

8. In its written submission, the Society of British Aerospace Companies (SBAC) noted the momentum in implementing the DIS and said “the determination of Lord Drayson and his senior level team to drive this change programme forward continues to impress”.¹¹ **With the notable exception of the Maritime sector, good progress was made in implementing the Defence Industrial Strategy in 2006. We congratulate the Minister for Defence Procurement for driving the process forward at a fast pace.**

Reshaping of the UK Defence Industry

9. The DIS stated that industry would have to reshape itself in order to improve productivity and to adjust to lower production levels once the current major equipment projects had been completed. Industry would also need to retain the specialist skills and systems engineering capabilities required to manage military capability on a through-life basis; and would need to adjust to sustain the capabilities the UK needed once the current production peaks had passed.¹² We have examined the progress made in reshaping industry in three key sectors: Maritime; Fixed-wing Aircraft and Complex Weapons. We have also examined the impact on jobs resulting from the reshaping of industry and possible further consolidation of the defence industry.

Maritime sector

10. The Secretary of State for Defence acknowledged in November 2006 that the progress made towards industrial consolidation in the maritime sector had been disappointing. In writing to the Committee, he said that he considered that the lack of progress reflected not only the complexity of the task, but also the fact that industry was “enjoying a period of high workload from MoD’s current shipbuilding and submarine programmes and does not feel a strong sense of urgency to implement the necessary changes”. He considered that industry needed to be realistic about the MoD’s future orders as the market would get smaller.¹³

10 Q 2

11 Ev 22

12 Cm 6697, Foreword

13 Ev 34

11. Lord Drayson told us that he thought “the most difficult this year has been the maritime sector”¹⁴ and that this was the one he had “been pushing hardest to see progress on, and was getting a bit worried about... but I really do think we are now starting to see some real progress on that, both on ships and submarines”.¹⁵

12. We asked why the Maritime Industrial Strategy had not been implemented in 2006 as Lord Drayson had expected in February 2006. Lord Drayson told us that:

Within the maritime there are two sides to it: the submarines and surface ships. In both areas of the maritime industry we see that there is a need for the current situation to change, and our current situation is that we have patches of very good performance, modern facilities, globally competitive facilities, but we do not across the maritime industry see that. We have duplication; we have inefficiency. What we wanted to see was that industry change, where in the past businesses have competed for them to work together to provide a through-life solution to us.¹⁶

13. Lord Drayson considered that progress had been slow in part because industry was looking at ten years of very significant orders. However, he had told industry that the orders would not be coming unless the consolidation and the changes happened.¹⁷

Surface ships

14. There have been some moves towards consolidation of the surface ship industry. Press reports in mid-November 2006 referred to discussions between BAE Systems and the VT Group to consolidate their shipbuilding assets. The reports claimed that an initial attempt to merge the assets at the start of 2006 had failed because Babcock International had demanded too high a price for its ship-repair facilities. Several options were being discussed: BAE Systems could buy out VT; the two companies could create an alliance but continue to operate as separate entities; or they could form a joint venture spun out of the parent companies. BAE Systems has yards in Scotstoun and Govan, Scotland, and the VT Group owns Portsmouth shipyard. The press reports suggested that the MoD was forcing the pace of the negotiations and was using the Future Carrier programme as an incentive to speed up the consolidation in shipbuilding.¹⁸

Future Carrier

15. Lord Drayson told us he was very pleased to see the announcement¹⁹ that BAE Systems and the VT Group were discussing a joint venture: the MoD considered that the structure was the right one, unlike some of the deals which were looked at earlier in the year.²⁰ He

14 Q 25

15 Q 26

16 Q 42

17 *Ibid.*

18 The Times, *Ministry urges VT Group and BAE to tie knot*, 15 November 2006

19 VT Group website, News and Events, *VT Group and BAE Systems announce discussions regarding future joint venture*.

20 Q 42

said that if the deal went through it put the Future Carrier programme in a good position: “this is exactly what we need to see to be able to contract with confidence”.²¹ He had told industry that there would not be an order for the Future Carriers until consolidation happened and that consolidation was a pre-condition for signing the contract.²²

16. We asked Lord Drayson whether he was saying that the consolidation of industry would determine when the Royal Navy got its Future Carriers. He said that “that is the reality anyway”.²³ The in-service date for the Future Carrier would be set when the MoD made the Main Gate decision and that decision would be taken when the right industry structure was in place. Lord Drayson thought that “we are really close now”.²⁴

17. We asked Lord Drayson if the delay would impact on the date when the Future Carriers were to come into service. He said that delays in the consolidation would push back the Main Gate decision, but that this

actually provides us with the environment within which we can have the highest level of confidence that: the in-service date will be met; the costs will be delivered; and that the key user requirements for the ships will be delivered.²⁵

18. Lord Drayson said that good progress had been made over the last year in reducing risk on the Future Carrier programme by identifying opportunities to introduce commercial build standards. These were practices which the MoD wanted to bring into the Future Carrier programme as it was going to be important to the modernisation of the shipbuilding industry.²⁶ It would appear that the reason for the continuing delay in the placing of the order is therefore no longer the level of risk but rather the need for restructuring of industry.

19. We are disappointed that the required restructuring of the surface ship industry has not taken place and that this has delayed the main investment decision on the Future Carriers. It is possible, though not inevitable, that this may result in later delivery of the carriers. This in turn may lead to a capability gap which could be both damaging to the defence of the country and expensive to deal with. On the other hand it might lead to the project being better managed. We accept that the MoD is right to insist on the speedy restructuring of industry, and we will be keeping a close eye on this important matter as it progresses.

20. In mid-January 2007 press reports suggested that the delay in making the main investment decision was because the Future Carrier programme was to be cancelled because of budgetary pressure on the Royal Navy.²⁷ Lord Drayson was asked whether the Future Carrier programme would be cancelled. He said the rumours should be considered

21 Q 43

22 Qq 44–45

23 Q 46

24 Q 47

25 Q 50

26 Q 61

27 DefenseNews, French, *UK Defense Chiefs To Discuss Carrier*, 22 January 2007

“quashed”.²⁸ We were concerned to hear reports that the Future Carrier programme might have been cancelled because of budgetary pressures. The programme is a key element of the ‘Carrier Strike’ capability needed by our Armed Forces and vital to the future of the UK maritime sector. We welcome the assurance provided by the Minister for Defence Procurement of the Government’s continuing commitment to this programme.

Type 45 Destroyer and warship support

21. The Type 45 Destroyer programme is a new class of Anti-Air Warfare Destroyers to replace the Anti-Air capability provided by the Royal Navy’s existing Type 42 Destroyers. The Type 45 is a planned class of eight ships but approval, so far, has only been given for six. A contract for the first three ships was placed in December 2000 and a contract for a further three ships was placed in February 2002. The ships are being built by BAE Systems Naval Ships and VT Shipbuilding.²⁹

22. Press reports at the end of December 2006 suggested that the MoD would not place orders for the last two of the eight Type 45 destroyers.³⁰ They also claimed that six destroyers and frigates and two other vessels were expected to be put into reduced readiness—“mothballing”—to achieve savings of more than £250 million.³¹ The impact of such cuts would reduce the workload for UK naval surface shipbuilding, and the amount of maintenance and repair work. For maintenance and repair, the MoD is developing a Surface Ship Support Alliance and the first contracts to be managed as part of this alliance were announced in November 2006.³²

23. We asked Lord Drayson about these reports and how they affected the negotiations to reshape the surface ship sector. He would make no comment on the decisions on these ships, but he acknowledged that the outcome of the Spending Review 2007 would affect everything. He looked forward to being in a position to give greater clarity to industry in the second half of 2007”.³³

24. Rt Hon Adam Ingram MP, Minister for the Armed Forces, told the House on 15 January 2007 that no decision had been taken to reduce the number of Type 45 destroyers.³⁴ He told the House on 18 January 2007 that:

Decisions on whether to make adjustments to the readiness states of warships will be taken in the MoD’s current planning round, the results of which are currently planned to be announced in the spring of this year.³⁵

28 HL Deb, 18 January 2007, col 776

29 National Audit Office, *Major Projects Report 2006 Project Summary Sheets*, Session 2006–07, HC 23-II, p 141

30 The Sunday Times, *Half of Royal Navy’s ships in mothballs as defence cuts bite*, 31 December 2006

31 *Ibid.*

32 MoD Press Notice, *Warship support moves forward with five new contracts*, 30 November 2006, and Ev 21–22

33 Qq 66–67

34 HC Deb, 15 January 2007, col 775WA

35 HC Deb, 18 January 2007, col 1265WA

We await this announcement with the greatest interest, since it has enormous implications for the future capability of the Royal Navy.

25. The surface ship sector needs clarity about future design and build work, and maintenance and repair work, to make appropriate decisions about the best way to restructure. However, until the outcome of the Spending Review 2007 is known, the level of future funding for naval equipment and support remains unclear. It is hoped that the outcome of the Spending Review, expected in the Summer, will provide the clarity the surface ship sector needs to proceed with the restructuring required to deliver equipment and support in the most efficient way.

Submarines

26. We examined industrial collaboration in the submarine sector in our report *The Future of the UK's Strategic Nuclear Deterrent: the Manufacturing and Skills Base*.³⁶ In its written submission to that inquiry, the MoD stated that there was

much to be gained from cooperation and rationalisation [in the submarine programme] between the build entity (principally BAE Systems at Barrow-in-Furness), the two support entities (Devonport Management Ltd and Babcock Naval Services at Faslane) and the Nuclear Steam Raising Plant provider (Rolls-Royce), together with the Ministry of Defence as the customer/operator.³⁷

27. There were press reports in 2006 of moves to consolidate the submarine sector. Lord Drayson said what the MoD wanted in submarines was the development of Through Life Capability³⁸ and industry to come together in a way which enabled this. The MoD had been pushing industry to do this since the publication of the DIS and there had been some progress, such as improvements in performance at Barrow and at Devonport.³⁹

28. Press reports in mid-January 2007 claimed that BAE Systems had teamed up with Carlyle, to launch a joint bid for control of the UK nuclear submarine industry and that the two companies were planning a joint offer to take over the Devonport yard in Plymouth. The reports suggested that if the bid succeeded, BAE Systems would put its submarine business into a joint venture with Carlyle alongside the Devonport assets. The reports also suggested that there could be a rival bid from Babcock International which owns Rosyth naval dockyard on the Firth of Forth, and runs the Royal Navy's submarine base at Faslane on the Clyde.⁴⁰

29. It is disappointing that the consolidation in the submarine industry did not take place in 2006 as expected. We look to the MoD to continue to encourage industry to integrate, as this will be vital to ensuring that there is a focus on Through Life

36 Defence Committee, Fourth Report of Session 2006–07, *The Future of the UK's Strategic Nuclear Deterrent: the Manufacturing and Skills Base*, HC 59, paras 100–105

37 *Ibid.*, Ev 86

38 Through Life Capability Management aims to build on Smart Acquisition and improve the MoD's assessment of the affordability of Defence Programmes and provide better delivery of integrated military capability as opposed to individual lines of equipment (National Audit Office, *Major Projects Report 2006*, Session 2006–2007, HC 23-I, p 29)

39 Q 65

40 The Times, *Carlyle and BAE bid for missile subs*, 14 January 2007

Capability which should deliver substantial savings to the MoD. If the Government's proposal for a new generation of nuclear missile submarines is accepted, it will be essential to have an efficient submarine industry focused on through-life costs.

30. At the evidence session, we also asked Lord Drayson about the award of the contract for the fourth Astute submarine. He expected to be able to be in a position to make a decision on boat 4 early in 2007. He recognised that orders needed to be placed at a regular frequency—approximately every 22 months—to maintain capability in the submarine industry, but he wanted to see improvements which would deliver value for money. We wondered whether industry was taking the boat 4 order for granted. Lord Drayson assured us that industry was “very clear that we are very serious about price; we are very serious about the changes.... I think what we are seeing is that the industry has got this message and is making the changes”.⁴¹ **We note the Minister for Defence Procurement's confidence that the submarine industry is making the value for money improvements required by the MoD, which should enable the MoD to make a decision on Astute boat 4 in early 2007. Given the importance of this contract to maintaining capability in the UK's submarine industry, we plan to watch this closely.**

31. We asked when the Maritime Industrial Strategy would be implemented. Lord Drayson said that he “would be very disappointed indeed, if, six months from now, we did not have the answer to this”. He thought that within six months we would see that the Maritime Industrial Strategy implemented in both the submarines and ships sectors.⁴²

Fixed-wing aircraft sector

32. Section B4 of the DIS considers the fixed-wing sector, which includes fast jets, air transport, air refuelling, maritime patrol, airborne surveillance, uninhabited aerial vehicles and aerospace sub-systems.⁴³ In our first report into the DIS, we noted that the Royal Air Force was in the middle of a substantial re-equipment programme, with the introduction of Typhoon aircraft and the Joint Strike Fighter expected to enter service in the next decade. Both of these aircraft were expected to remain in service for at least thirty years and the MoD's plans did not envisage the UK needing to design a build a future generation of manned fast jet aircraft beyond these projects. The UK needed to retain aerospace engineering and design capability to support, operate and upgrade these aircraft through life.⁴⁴

33. In the checklist provided by the MoD during our first inquiry into the DIS, the MoD was to “work with BAE systems and the other companies in the defence aerospace sector so that it can reach the appropriate size and shape for demand.... we aim during 2006 to agree the way ahead”⁴⁵ Lord Drayson told us that the MoD was pretty close to an agreement with BAE Systems. The MoD's Commercial Director was leading the negotiations with the aerospace industry to ensure that the MoD “get value out of the changes, and we are not

41 Q 72 and Q 74

42 Qq 52–53

43 Cm 6697, pp 84–94 and para B4.1

44 HC (2005–06) 824, paras 35–36

45 *Ibid.*, Ev 118

paying for the industry to do things which we do not need the industry to do”.⁴⁶ **We note that the MoD is still working with BAE Systems and other companies in the aerospace sector to reach agreement on the appropriate size of the sector given current and future demand.**

Typhoon

34. Typhoon, formerly known as Eurofighter, was originally designed for air superiority, but will also be capable of delivering a precision ground attack capability. The aircraft is a collaborative project with Germany, Italy and Spain.⁴⁷ Lord Drayson told us that he wanted to deliver further changes in 2007 in the “Typhoon industrial structure relationship with the other partner nations”. He considered that there had been some good progress, but significant change and improvement was needed in the Typhoon arrangements between the four partner nations.⁴⁸ Before the MoD could place an order for the third tranche of Typhoon aircraft, it wanted to see a remodelling of the Typhoon structure. Lord Drayson said it was about

getting agreement within the four partner nations upon the way in which we can make changes to the structure for.... Typhoon to deliver better performance in terms of value for money.... We do not think that has been good enough up to now and we really do need to see that happening in 2007.⁴⁹

35. While other collaborative nations shared the wish to improve the structure of the Typhoon programme, Lord Drayson considered that there was a “difference of opinion on the urgency”.⁵⁰ The UK’s urgency was because it needed “to see the changes in terms of upgrades to the fighter to give it a ground attack capability”.⁵¹ He considered that the Typhoon “could have a very big effect if given ground attack capability, for example in Afghanistan”. He said that this needed to be done efficiently and considered that there were real opportunities to improve efficiency.⁵²

36. The Typhoon aircraft needs to be upgraded so that it can take on the ground attack role required in current operations. We support the MoD in its aim to improve the industrial structure of the Typhoon collaborative programme, so that the required upgrading of Typhoon aircraft can be undertaken as efficiently as possible and better value for money delivered across the whole Typhoon programme.

Unmanned Aerial Vehicles

37. In the DIS, the MoD acknowledged that it shared “a close alignment of interest” with industry in unmanned aerial vehicles (UAVs) and uninhabited combat aerial vehicles

46 Q 75

47 National Audit Office, *Major Projects Report 2006 Project Summary Sheets*, Session 2006–07, HC 23-II, p 133

48 Q 75

49 Q 76

50 Q 78

51 Q 76

52 Q 78

(UCAVs). However, there was no funded UCAV programme and a targeted investment in UCAV technology demonstrator programmes would help to sustain the aerospace and design capabilities which the UK needed.⁵³ In our first report on the DIS we examined the MoD's investment in UAVs and UCAVs. The Royal Aeronautical Society told us during our first inquiry into the DIS that it was imperative that the DIS proposals for UAV and UCAV technology demonstration were fully implemented as an onshore UK capability would be essential for the UK to participate in international programmes.⁵⁴

38. On 11 December 2006, the MoD announced that it had taken a major step towards the UK's first unmanned combat aircraft: a four-year development programme, Taranis. The programme will provide the RAF with a demonstrator that will form the basis of its plans to build the first pilotless front line fighter-bomber. BAE Systems has been awarded the lead contract, worth £124 million, to develop a world class UAV demonstrator programme.⁵⁵ Lord Drayson told us that it had taken a year to put together the Taranis programme and that this was "going to be another important part of future workload for the industry".⁵⁶ **We welcome the MoD's decision to fund a four year UAV Technology Demonstrator Programme. UAVs have the potential to provide a new dimension to the force mix in the future.**

Complex weapons sector

39. The DIS defines complex weapons as "strategic and tactical weapons reliant upon guidance systems to achieve precision effects". Tactical complex weapons fall largely into five categories: Air-to-Air; Air Defence; Air to Surface; Anti-Ship/Submarine (including Torpedoes); and Surface to Surface.⁵⁷ Such weapons provided UK Armed Forces with battle-winning precision effects and the UK had made significant investment in the upgrade and development of complex weapons. The investment in 2006 was still forecast to be just over £1 billion, but would reduce by some 40% cent over the following five years. The DIS acknowledged that this would present a substantial challenge to industry: the MoD planned to work with the onshore industry to assess whether it was possible to achieve a sustainable industry that met the UK's requirements. The DIS noted that there was potential for industrial rationalisation and consolidation.⁵⁸

40. On 19 July 2006, the MoD announced that a new industrial partnership had been formed to meet the challenge of maintaining key skills in missile development within the UK. "Team CW" (Complex Weapons) is led by MBDA Missile Systems. The MoD also announced the procurement strategy for the Loitering Munition Demonstration and Manufacture programme, potentially worth more than £500 million. The procurement strategy will see a contract awarded single-source to Team CW, subject to the successful

53 Cm 6697, para B4.45

54 HC (2005–06) 824, paras 38–39

55 MoD Press Notice, *RAF takes next step towards pilotless combat aircraft*, 11 December 2006

56 Q 75

57 Cm 6697, para B7.1

58 *Ibid.*, para xxxv and xxxvii

conclusion of the programme's assessment phase.⁵⁹ Lord Drayson considered that there had been good early progress in the complex weapons sector. However, he wished to see “Team Complex Weapons coming together to manage a very difficult decline in future orders for complex weapons—we need to see that agreement concluded and signed in the early part of next year”.⁶⁰ **We welcome the formation of Team Complex Weapons which should help sustain key skills and capability within the UK. We look to the MoD to ensure that the required agreement in this area is concluded and signed early in 2007.**

Impact on different sectors

41. In our first report on the DIS, we examined the impact on jobs of the reshaping of the defence industry. We were told that there would be job increases in some sectors and decreases in others.⁶¹

42. The reshaping of the complex weapons sector has led to job losses. Lord Drayson told us that “we are talking about hundreds of people in different businesses”.⁶² However, the MoD considered that without the DIS, the approach in this sector would have been less strategic and would have resulted in greater job losses.⁶³

43. The DTI acknowledges that, given that it was the “Government’s Defence Industrial Strategy”, it has an obligation to work closely with the MoD where there are job losses in the defence industry. Regional Development Agencies “try and do as much as possible to work with the local providers on the ground, the job centres and the Learning and Skills Council, to put together packages of support to try and help in these circumstances and to try and look ahead and ameliorate the situation”.⁶⁴

44. For job losses in the aerospace sector, there tended to be more of a lead time and it was possible to do more planning and put in place programmes that helped the industry adjust over a longer period. Mr Gibson, Director General Enterprise and Business Group, DTI, considered that “the bigger the job losses the more the regional agencies have to step up to the mark”. In his view “they have done pretty well recently”.⁶⁵

45. The DTI also works closely with the devolved agencies and the working relations were considered to be very good. Mr Gibson considered the relationship between the DTI and the MoD to be “the best ever” and that the DIS had played a major role in that.⁶⁶

46. It is regrettable that the reshaping of the defence industry required by the Defence Industrial Strategy has resulted in job decreases in some sectors of the defence industry. However, a more streamlined defence industry will better match the MoD’s current and

59 MoD Press Notice, *Defence Industrial Strategy delivers missile development skills under new industrial partnership*, 19 July 2006

60 Q 26

61 HC (2005–06) 824, para 27

62 Q 34

63 Q 33

64 Q 35

65 Q 36

66 Q 37

future requirements and ensure that the industry remains competitive when bidding for overseas defence contracts. We note that the MoD, the Department for Trade and Industry, the Regional Development Agencies and the devolved agencies are working closely together to provide appropriate support to those areas affected by reductions in defence work. Value for money in defence procurement is important to the defence budget as well as to industry.

Retaining skills in the defence sector

47. In many sectors of the defence industry there will be less focus on the design and development of new platforms and more of a focus on the insertion of upgrades and new capabilities and through-life maintenance of existing platforms. This change risks making the defence industry less attractive to engineers, scientists and technicians whose interest might be in working at the cutting edge of design for new equipment. The MoD is aware of this risk and with industry has set up “team defence” to promote opportunities for scientists and engineers working within the defence industry. One of the approaches is to raise the profile of defence and of the rewarding and interesting careers that were available within the MoD and the defence industry. The MoD has made changes to its graduate recruitment programme, Lord Drayson considered that “the human resources picture is looking pretty healthy in terms of getting young people joining”, but he acknowledged that further work was needed in career development for scientists and engineers working within procurement.⁶⁷

48. **We consider it vital that the MoD and the defence industry continue to recruit and retain high quality staff, in particular, engineers, scientists and technicians, in this period of change. Such staff are key to ensuring that the benefits of the DIS are delivered. We welcome the joint “team defence” initiative which has been launched to promote the opportunities in the defence industry. We look to the MoD and industry to continue to review career development opportunities to ensure that high quality staff in specialist areas are not lost.**

Consolidation in the UK defence industry

49. Over the last decade the UK has seen substantial consolidation in the UK defence industry, including the acquisition of UK defence companies by foreign defence companies. Lord Drayson expected the pace of change within the defence industry at the international level to maintain the “fairly fast rate” seen in the recent past and further consolidation to take place.⁶⁸ Further consolidation in the defence industry has continued with the announcement in mid-January 2007 that the aerospace division of Smiths Group, a UK company which makes landing gear and propellers, was to be sold to General Electric, the US conglomerate.⁶⁹

67 Q 38

68 Q 39

69 The Times, *Smiths triggers break-up speculation with \$4.8bn aerospace to GE*, 16 January 2007

50. Lord Drayson told us that he

would prefer British defence industry not to be dominated, but what is most important is for the Armed Forces to get the equipment they need to do the job that they have to do, and to deliver value to the taxpayer. What is very important to do that is that we have access to the skills and the capacities here in this country. What we cannot have is a situation where, for those areas where we require operational sovereignty, those skills, that intellectual property is offshore of the United Kingdom, because that will prejudice our military effect.⁷⁰

51. Lord Drayson said that the Future Rapid Effect System (FRES) programme was one where the UK required the intellectual property and the design authority to reside in the UK, and companies had to compete on that basis. Boeing, a US company, was setting up facilities in the UK to put itself in a position to be able to compete for this programme.⁷¹ We are currently examining the FRES programme and the Army's requirement for fighting vehicles in a separate inquiry.⁷²

Changes to the MoD

52. During our first inquiry into the DIS, Lord Drayson told us that he thought that there was a duty on the MoD to demonstrate by changing its own working practices and culture that it was serious about the DIS.⁷³ He said that he aimed to surprise us “by the pace of change we are able to achieve in the Ministry of Defence”.⁷⁴ The MoD's Permanent Under Secretary of State commissioned a review at the end of 2005 to look at the way the MoD equipment acquisition function worked, how it was structured and how it could be made to work better.⁷⁵ The outcome of the review was published on 3 July 2006, *Enabling Acquisition Change, an examination of the Ministry of Defence's ability to undertake Through Life Capability Management*. The report examined the current structures, organisations and processes with the aim of maximising the MoD's ability to deliver a key objective of the DIS, Through Life Capability Management, which focuses on the costs and capabilities of equipment throughout its life, not just the purchase price. The report recommended the merger of the Defence Procurement Agency (DPA) and the Defence Logistics Organisation (DLO). The new merged organisation, Defence Equipment & Support, will begin operating on 2 April 2007.

53. We examined how the recommendations in the Enabling Acquisition Change report were being taken forward by the MoD in our *Defence Procurement 2006* report.⁷⁶ In our report, we recommended that the MoD provide us with quarterly reports on the progress

70 Q 41

71 Q 39

72 Oral evidence taken before the Defence Committee on 12 December 2006, *The Army's requirement for armoured vehicles: the FRES programme*, HC 159

73 HC (2005–06) 824, Q 289

74 *Ibid.*

75 Defence Committee, Sixth Report of Session 2005–06, *Ministry of Defence Annual Report and Accounts 2004–05*, HC 822, Q 31

76 Defence Committee, First Report of Session 2006–07, *Defence Procurement 2006*, HC 56, paras 19–38

of the merger of the DPA and DLO. **We plan to examine in a future inquiry the MoD's progress in implementing the recommendations of the Enabling Acquisition Change report and whether the expected improvements in equipment acquisition are delivered.**

54. The merged DPA and DLO will focus on improving Through Life Capability Management and responding with more agility to the needs of the Armed Forces. MoD staff will need to be trained in a range of skills to ensure that the expected improvements are delivered. RUSI's report *The Defence Industrial Strategy: An Analysis of Industry Response*, noted that there was a general concern in industry that the MoD would not be able to perform effectively as a customer as it lacked the necessary commercial expertise.⁷⁷ In its submission to our inquiry, the Defence Manufacturers Association (DMA) told us that the skills issue would continue to be a problem at many levels, especially for commercial and technical staff.⁷⁸

55. The Chief of Defence Procurement has acknowledged that more investment was needed in staff training in areas such as project management, finance, commercial skills and certain technical specialist skills.⁷⁹ During our *Defence Procurement 2006* inquiry, we were told that the MoD was seeking to identify the skills gaps and how to address these.⁸⁰ Mr Morse, the MoD's first Commercial Director, who had experience as a "manager of the business" at PricewaterhouseCoopers, told us during this inquiry that he was "in charge of developing the skills and capabilities of the commercial team across the MoD".⁸¹

56. Improving the skills of MoD staff, particularly commercial and technical skills, will be crucial to ensuring that the expected benefits from the DIS are delivered. The MoD is seeking to address skills gaps through training or external recruitment. The appointment of the first MoD Commercial Director is welcome, but he must be given the resources needed to develop the commercial skills of MoD staff.

77 RUSI Report, *The Defence Industrial Strategy: An Analysis of Industry Responses*, 5 October 2006, p 12

78 Ev 25

79 July 2006 issue of *Preview*, the journal for defence equipment acquisition, p 4

80 HC (2006–07) 56, paras 27–31

81 Q 14 and Q 18

Research and Technology

57. The MoD's Defence Technology Strategy (DTS) was launched on 17 October 2006.⁸² At the launch, Lord Drayson said:

This strategy will help MoD and industry plan future investment in research and development (R&D). In particular, it allows us to identify clear R&D priorities, including those areas in which we believe it is important to maintain sovereign control, highlight opportunities for collaboration, and provide long-term support of to the UK's science and technology skill base.⁸³

58. Included in the DTS were several initiatives aimed at supporting and encouraging innovation and the science and engineering base in the UK. The 'Competition of Ideas' is an internet-based competition which aims to encourage innovators including individuals, academia and Small and Medium-size Enterprises (SMEs), to suggest practical solutions to specific technical challenges facing the MoD. The 'Grand Challenge' is an initiative to produce an autonomous or semi-autonomous system designed to detect, identify, monitor and report a comprehensive range of physical threats in a complex urban environment.⁸⁴

59. In our first report on the DIS, we expressed concern about the decline in defence research spending and the impact of this on the quality of future equipment for the Armed Forces. We looked to the MoD to address the level of spending on defence research in the DTS and to make a strong case for increased funding of defence research during the discussions with HM Treasury on the Comprehensive Spending Review. We saw this as a key investment for the future.⁸⁵

60. In their written submissions to this inquiry, the DMA, SBAC and QinetiQ commented on the DTS and specifically on the investment in defence research. Their views on the issue of investment in defence research are set out in Table 2.

82 Ministry of Defence, *Defence Technology Strategy for the demands of the 21st century*, October 2006

83 MoD Press Notice, *Lord Drayson launches Defence Technology Strategy*, 17 October 2006

84 *Ibid.*

85 HC (2005–06) 824, paras 63–64

Table 2: Comments on the investment in defence research

	Comment
DMA	"The DMA welcomed the publication of the Defence Technology Strategy. It is a helpful document, albeit Industry is convinced that, without a real increase in MoD research investment, many of its aspirations will remain unfulfilled".
SBAC	"Despite the publication of the Defence Technology Strategy, there still appears to be a gap in understanding between Government and industry as to the incentives needed to achieve greater industry investment in support of defence technology programmes. The DTS does not give a picture which is sufficiently complete for industry to make investment decisions. Greater transparency on how research and technology investment will flow through to procurement and how Intellectual Property Rights will be protected are areas where greater clarity is needed".
QinetiQ	"to maintain the option to have 'smaller, smarter forces' the UK must reverse the long-term decline in defence R&D. This requires an increase in both near-horizon and far-horizon research.... Whether the investment is made direct by Government, or indirectly through accepting higher profit margins on supply contracts to incentivise this activity, the equivalent of some £250M is required to maintain our competitive position. This is not an affordable option for MoD within its current budget".

Source: DMA, SBAC and QinetiQ submissions⁸⁶

In its *Analysis of Industry Responses* to the DIS, RUSI noted that there was a "recurring message that research and technology is under-funded by MoD and that this situation is unlikely to change substantially in the future".⁸⁷

61. The DTS stated that "The Government has set a target to raise national investment in R&D to 2.5% of GDP by 2014. The Government has increased its own national R&D spending and is looking to industry to play its part in meeting this target".⁸⁸ We asked how much the MoD would be contributing to this target. Lord Drayson told us that:

we need to increase investment in defence research, we need to shift the balance in terms of the split between the development side of things and the earlier stage of research side of things.... The way in which that target gets hit in terms of the percentage is both the Ministry of Defence and industry investing in research and there have to be the appropriate incentives for industry to take risks on research.⁸⁹

62. Lord Drayson told us that the MoD was discussing with industry the issue of rewards and incentives for industry taking more risk in investing in research and expected this to become clearer in the first part of 2007 and then be part of an overall plan for MoD investment in research.⁹⁰ However, he could not say how much the MoD's cash contribution would be to defence research investment and would only know this once the discussions had ended with industry. It was acknowledged that industry would take "some convincing" on this issue.⁹¹ The MoD's supplementary memorandum states that "the

86 Ev 22–27

87 RUSI, *The Defence Industrial Strategy: An Analysis of Industry Responses*, 5 October 2006, p 24

88 Ministry of Defence, *Defence Technology Strategy for the demands of the 21st century*, October 2006, p 2

89 Q 102

90 *Ibid.*

91 Q 103

Defence Technology Strategy is affordable within the current research budget provided that both MoD and industry invest to develop and sustain the necessary technology base”.⁹²

63. Lord Drayson said that in addition to working on an agreed framework with industry on risk and reward, and how that is shared, the MoD was also looking at ways to cut out waste. The MoD was prepared to kill off projects early if they were not going well. Lord Drayson told us that the MoD had an effective process for the management of innovation and learning from other industries which use other techniques to manage innovation.⁹³

64. We note the publication of the Defence Technology Strategy and the MoD’s initiatives to encourage innovation, such as the *Competition of Ideas* and the *Grand Challenge*. We are disappointed that the Strategy did not set out how much the MoD would be investing of its budget in defence research. We will be examining the funding of Defence Research and Technology in our forthcoming report on the work of the Defence Science and Technology Laboratory.

Small and Medium-size Enterprises and the supply chain

65. The DIS states that “around 165,000 people are directly employed in defence manufacturing in the UK, with a further 135,000 people employed indirectly in supply chain activity”.⁹⁴ In our first report on the DIS we noted that the MoD had sought to become more “user friendly” to Small and Medium-size Enterprises (SMEs) and looked to the MoD to improve its visibility of such companies. We were concerned to learn that the MoD was at “the start of a journey “ in terms of understanding supply chains and how to manage them.⁹⁵ In its submission to this inquiry, the SBAC emphasised the importance of supply chains to the success of the DIS:

If DIS is to succeed it will also be important to gain the confidence of the whole supply chain. The SBAC’s 21 Century Supply Chain (SC21) initiative, which aims to achieve a modernised UK supply chain, that encourages innovation pull through, better relationships and better through-life capability management has an important role to play in contributing to the MoD’s aims. Key to success in this area will be to establish clear measures of success and failure that both industry and MoD can sign up to and a robust mechanism for dealing with problems in an effective but flexible manner.⁹⁶

66. The DMA considered that “considerable joint discussion” has gone on and working groups set up to consider issues concerning access to market, SMEs and Supply Chains, but that progress had been slow. The DMA had recently made proposals to the MoD which it believed could help, but would require some additional staff to be implemented effectively.⁹⁷

92 Ev 35

93 Q 112

94 Cm 6697, para A4.6

95 HC (2005–06) 824, paras 71 and 74

96 Ev 23

97 Ev 25

67. Lord Drayson considered it very important for the MoD as a customer to have a healthy supply chain. The MoD did two things to help ensure this. First, it assessed how well a potential contractor understood its supply chain. Secondly, it put in place “contractual elements to make sure that they are incentivised to fairly develop that supply chain”.⁹⁸ We asked how the MoD checked that contractors carried out their contractual obligations regarding supply chains. Mr Gould, Deputy Chief Executive of the Defence Procurement Agency, told us that the MoD obliged contractors to tell them what their supply chain were and that the move to longer term arrangements with contractors put the MoD in a stronger position to do this.⁹⁹

68. The MoD has sought to improve its understanding of Small and Medium-size Enterprises and the supply chain, but its progress has been considered slow by one of the major defence trade associations. The MoD should continue to work closely with the defence trade associations, the Department of Trade and Industry, the Treasury, Regional Development Agencies, and the devolved agencies, to identify approaches to improve its understanding in this area further. This will be vital to the success of the DIS. Prime contractors also need to improve their understanding of supply chains and the key role of Small and Medium-size Enterprises.

69. SMEs need to innovate to get into the supply chain and to get into business with the larger defence companies. They therefore tend to invest more in R&T. Mr Gould told us that “when you ask them [SMEs] “How much of your profit do you reinvest in research and technology” the answer is much more positive, much higher levels of reinvestment in medium-sized companies than you find in the big primes”.¹⁰⁰ **Small and Medium-size Enterprises are often the source of highly innovative ideas and products. In understanding supply chains, the MoD must improve its understanding of the contribution made by such companies and the impact if they disappeared from the supply chain. We look to the MoD to improve its understanding of the innovation provided by Small and Medium-size Enterprises and the investment they make in Research and Technology.**

Competition and partnering arrangements

70. The DIS stated that “Open and fair competition is a fundamental component of our procurement policy to deliver affordable defence capability at better overall value for money”.¹⁰¹ However, the DIS also identified alternatives to competitive procurement, and stated there would be more use of partnering arrangements. One of the major partnering arrangements announced in 2006 was with AgustaWestland which aims to improve the speed of delivery of new helicopters, reduce acquisition and support costs, and increase the availability of helicopters to the front line.¹⁰²

98 Q 115

99 Q 116

100 Q 116

101 Cm 6697, para A7.1

102 MoD press notice, *£1bn new helicopter contract a major step forward*, 22 June 2006

71. Many of the MoD's programmes have elements of partnering and in 2006 the MoD entered into several contracts for through-life support for major assets including: a £450 million Merlin helicopter Integrated Operational Support contract awarded to AgustaWestland; a £200 million Chinook helicopter Through Life Customer Support contract awarded to Boeing; and a £1.52 billion Hercules transport aircraft Integrated Operational Support contract awarded to Marshall Aerospace.¹⁰³

72. The new post of MoD Commercial Director has been given a range of responsibilities, including providing strategic leadership across all the MoD's commercial and procurement activities, championing best practice and leading on strategic relationships with industry.¹⁰⁴ We asked Mr Morse what experience he had of setting up and overseeing long-term partnering arrangements. He told us that when he worked for PricewaterhouseCoopers he was involved in looking at partnering arrangements, including looking at best practice round the world, but did not consider himself an expert on such arrangements and had not joined the MoD on that basis.¹⁰⁵ We enquired whether the MoD had the required skills to be able to partner properly. Mr Morse told us that "I am not going to pretend that we have them in the depth or the quantity that we would like, and therefore we have a programme in place to build those skills and capabilities to a requisite level within the MoD".¹⁰⁶

73. Long-term partnering arrangements are a new approach for the MoD and require specialist skills in negotiating and letting the contracts for such arrangements, and for monitoring performance once contracts have been let. We look to the MoD to ensure that its staff who deal with long-term partnering arrangements have sufficient training in such arrangements, or recruit staff with the experience required.

74. In its written submission, the SBAC notes that the MoD is still working on its models for long-term partnering agreements and considers it critical that the principles underpinning the agreements should be transparent to all. The MoD's publication *Capability Management Guiding Principles* is considered an excellent example of the proactive work that the MoD has been doing and the SBAC would welcome a similar publication giving guiding principles for partnering.¹⁰⁷ **We consider that there would be real benefit in the MoD producing a document for industry which set out what partnering relationships should look like, and the principles underpinning long-term partnering agreements. We look to the MoD to take this forward.**

75. In our first inquiry into the DIS, we recognised that some of the contracts for long-term partnering arrangements would be let on a non-competitive basis and that, in many areas, the MoD would be dealing with a monopoly supplier if the work was to be retained in the UK. We argued that there ought to be scope for competition for the work underlying such arrangements. We had heard concerns from some companies that they did not think they would get an opportunity to compete for work underlying these arrangements.¹⁰⁸ Mr

103 Ev 35

104 Q 14

105 Q 19 and Q 21

106 Q 18

107 Ev 23

108 HC (2005–06) 824, paras 86–94

Morse told us that he thought it was possible to introduce competition “both in the inception and in the phasing of some of these long-term relationships. In other words, if a contractor is not performing under a number of criteria in a satisfactory way you can create opportunities to introduce competition at various points”.¹⁰⁹

76. We asked the MoD whether the proportion of defence contracts let competitively would decline in the future because of the shift to long-term partnering arrangements. The MoD told us that there had been a reduction in the total number of contracts let competitively over the last four years, but not a significant reduction in the proportion, by value, of contracts that were subject to competition. MoD also told us that:

There is an underlying assumption that as DIS is more widely implemented the proportion of contracts let by competition may decline; however, in parallel the MoD will be seeking to work more closely in long-term partnering arrangements which would place a responsibility on primes to compete requirements at a sub-prime level wherever possible with full transparency of the value of work being offered across the supply chain.¹¹⁰

77. The MoD has taken a range of measures to ensure that sub-primes and SMEs have an opportunity to compete for work, including: the Defence Supplier Service which provides advice and guidance on becoming defence suppliers; encouraging Prime Contractors to advertise their sub-contract opportunities in the Defence Contracts Bulletin; and “a wide range of shop window events” organised for SMEs where they can “access the range of capabilities that the MoD is currently seeking to address”.¹¹¹

78. Some long-term partnering arrangements will be let on a non-competitive basis as in some sectors, if the work is to be retained in the UK, there is no other supplier. There is, therefore, a risk that the MoD may not be contracting with the most efficient supplier and achieving best value for money. We consider it vital that the MoD build into such long-term partnering arrangements incentives which drive real efficiency into the supplier’s organisation. This will be particularly important where the throughput of work for such arrangements may well reduce in the future.

79. We note that it is possible to have competition for the work underlying long-term partnering arrangements and that the MoD has introduced measures to encourage this. We consider it important that Small and Medium-size Enterprises are provided with an opportunity to compete for such work and look to the MoD to ensure such opportunities are provided.

109 Q 19

110 Ev 35

111 Ev 36

Sovereign capability

80. In his statement to the House on 15 December 2005, the Secretary of State said that the DIS

communicates for the first time to industry.... those skills, technologies and industrial capabilities that are assessed as being required onshore in the UK in order to sustain the armed forces' ability to operate with an appropriate level of sovereignty.¹¹²

As much future work will focus on maintaining and upgrading platforms, the MoD will need access to technical information and Intellectual Property Rights so it can maintain and upgrade platforms and ensure operational sovereignty.

Joint Strike Fighter

81. We have repeatedly raised concerns about technology transfer on the Joint Strike Fighter (JSF) programme. Most recently in our *Defence Procurement 2006* report we concluded that:

If the UK does not obtain the assurances it needs from the United States, then it should not sign the Memorandum of Understanding covering production, sustainment and follow-on development.¹¹³

82. The Memorandum of Understanding (MOU) for the next phase of the JSF programme was signed on 12 December 2006 by the Minister for Defence Procurement, following a meeting with the US Deputy Secretary of Defense, Gordon England, in Washington DC. Lord Drayson said:

I am delighted to be able to sign this MOU which will take the UK into the next phase of the JSF programme. I have always been clear that the UK would only sign if we were satisfied that we would have operational sovereignty over our aircraft. I have today received the necessary assurances from the US on technology transfer to allow me to sign the MOU.¹¹⁴

Lord Drayson told us that he was grateful for the stance this Committee had taken on the JSF and the issue of technology transfer, and considered that we had made a real difference in making clear what the UK required in order to proceed with the procurement of JSF aircraft.¹¹⁵

83. We asked Lord Drayson what was the nature of the assurances obtained and whether they covered the technology and information required, not just by the UK Government, but also by UK industry. Lord Drayson stated that the assurances also provided for what industry needed. He was confident that UK industry would have what it needed to deliver

¹¹² HC Deb, 15 December 2005, col 1463

¹¹³ HC (2006–07) 56, para 64

¹¹⁴ MoD Press Notice, *UK signs up for next phase of the Joint Strike Fighter Programme*, 12 December 2006

¹¹⁵ Q 75

operational sovereignty.¹¹⁶ He agreed that the MoD needed to make sure “that technology transfer happens”, and maintain the focus on the delivery of the technology transfer through the development of the JSF. He had a high degree of confidence that the technology transfer would be delivered and that the agreement reached with the US provided real clarity on this.¹¹⁷

84. We asked Lord Drayson whether the UK would be able to operate the aircraft and fly the aircraft from mission to mission independently of the US. He told us “absolutely, yes”.¹¹⁸ He said that a clear principle set out in the MOU was that “UK citizens will be in the chain of command to deliver operational sovereignty, unbroken, no US citizens in that chain of command”.¹¹⁹

85. Lord Drayson confirmed that the assurances relating to technology transfer were contained within the MOU.¹²⁰ This is not strictly correct. The MOU, which came into effect on 31 December 2006, sets out the general framework, but the MoD told us that the “specific assurances provided by the US are contained in a separate highly classified bilateral supplement to the MOU”.¹²¹ The supplement details the specific areas of information which are critical to the delivery of operational sovereignty. We were told that “due to the nature of the arrangements set out in this supplement and its classification”, it could not be released to this Committee.¹²²

86. We welcome the signature of the Memorandum of Understanding covering production, sustainment and follow-on development on the Joint Strike Fighter programme, and congratulate the Minister for Defence Procurement and his staff on its achievement. Because of the MoD’s unwillingness to provide us with the supplement to the Memorandum of Understanding, we can only report that the Minister for Defence Procurement has assured us that the UK will get all the technology transfer it requires to operate the Joint Strike Fighter independently. While we are of course pleased to hear this, we continue to have concerns about how things will work out. In particular, we will wish to probe how robust the Memorandum of Understanding will prove in practice and will seek an early opportunity to take oral evidence on this. UK industry also needs to know to what extent it will have access to the technology transferred under the Memorandum of Understanding agreement and its unpublished supplement. These are matters that we will monitor closely.

87. During our inquiry into the Future Carrier and Joint Combat Aircraft programmes, we were concerned to hear reports of possible cuts in the US JSF programme, and in particular to the Short Take Off and Vertical Landing (STOVL) variant of the JSF, the variant which the UK is procuring.¹²³ Lord Drayson told us that he had pressed the US Administration on

116 Q 85

117 *Ibid.*

118 Q 92

119 Q 87

120 Q 95

121 Ev 34

122 Ev 34

123 Defence Committee, Second Report of Session 2005–06, *Future Carrier and Joint Combat Aircraft Programmes*, HC 554, paras 114–120

its commitment to the JSF programme and the STOVL variant, and that he was reassured by the answers he got from the US Deputy Secretary of Defense who was “very hard in terms of the focus, in terms of the project not going to the right, the project being delivered and the necessary leadership being provided to ensure that happens”.¹²⁴ **The Minister for Defence Procurement assured us that the US Administration was still committed to the JSF programme and specifically the STOVL variant of the JSF which the UK is procuring. We expect the MoD to keep a close watch on any possible changes to the US JSF programme given the potential impact on the UK JSF programme.**

Wider lessons relating to technology transfer

88. Discussions about technology transfer on the JSF programme with the US were ongoing throughout 2006. Given that the UK is procuring a number of defence equipments from the US, the issue of technology transfer is likely to surface again. It would appear sensible to have an overarching agreement, rather than tackling each programme separately. The discussions on the JSF programme have resulted in improvements on other programmes. Lord Drayson told us that there had been an improvement over the last three months or so in terms of the speed and efficiency of the technology transfer decision-making process on other programmes, such as the future strategic tanker.¹²⁵ He also told us that:

There is a joint initiative going on between us and the United States to create a structure on technology transfer, an overarching structure, which facilitates greater efficiency.... the operational tempo that we have at the moment means that there is a real need to make this as efficient as it can be.... I hope that 2007 is a year when that framework is put in place such that we have not got to address these things on a project basis all the time but we have more of an overarching agreement which makes the whole process more efficient.¹²⁶

89. There is an initiative underway to create an overarching agreement with the US on the issue of technology transfer. We recommend that the UK Government attach the highest priority to achieving this aim, as a concrete embodiment of the relationship which the UK enjoys with the US. This is needed to ensure that separate negotiations do not have to take place for each future equipment programme and it should lead to quicker decision-making on the specific technology transfers for future programmes. We look to the MoD to ensure that the overarching agreement covers industry to industry technology transfer as well as Government to Government technology transfer, and clarifies the position of UK companies with subsidiaries within the USA.

Munitions

90. In our first report on the DIS we examined the issue of security of supply in the general munitions sector. We were concerned to learn that BAE Systems was closing two of the former Royal Ordnance Factories which it owned and that the MoD would be dependent

124 Q 88

125 Q 85

126 Q 85

on overseas sources for the supply of the munitions which were manufactured by these two factories. We were assured by the MoD that the two sites would not be closed until it was “absolutely sure” that a secure alternative supply of the munitions existed.¹²⁷

91. The MoD has informed us that it is now (mid-January 2007) finalising the alternative supply arrangements to replace production at the Bridgwater and Chorley sites. The MoD told us that:

Most of the initiator production is being transferred to the Nobel Energetics site at Ardeer in Scotland. The high-value and high technology aspects of explosive manufacture are being transferred to the BAES LSM [BAE Systems Land Systems Munitions] site at Glascoed in Wales.¹²⁸

92. Some of the raw materials for explosive manufacture are to be imported from the US and from France. The MoD have assured us that it has “carefully scrutinised” the proposed supply arrangements. If the supply was interrupted from one source, BAE Systems “will retain the technical ability to switch to the alternative.... or draw on existing stockpiles”. The MoD “is assured that the new arrangements will provide security of supply at least as great as that provided by Bridgwater and Chorley”.¹²⁹ **The MoD is finalising new arrangements for the supply of munitions after the former Royal Ordnance Factory sites at Bridgwater and Chorley close. It is confident that these arrangements will provide security of supply in this critical area.**

93. In the checklist provided by the MoD during our first inquiry into the DIS, the MoD was to “be taking forward Project MASS [Munitions Acquisition the Supply Solution], with a view to making decisions on how best to sustain our required access to general munitions in the summer of next year”¹³⁰ Project MASS was “charged with delivering a value for money and secure supply of general munitions” and approval was given to pursue a long term partnering agreement with BAES Land Systems Munitions. The MoD told us that “no decision has yet been taken on how best to sustain the required access to general munitions but the ongoing work with Project MASS and the General Munitions Industry Strategy (GMIS) will provide the basis of this decision”. The aim of the MoD was to have a firm investment commitment to proceed with Project MASS by the end of 2007.¹³¹ **Work on how best to sustain the required access to general munitions is ongoing. We look to the MoD to complete this work and commit the required investment by the end of 2007 as planned.**

127 HC (2005–06) 824, paras 100–107

128 Ev 37

129 *Ibid.*

130 HC (2005–06) 824, Ev 119

131 Ev 37

3 The challenges ahead

Keeping the DIS relevant

94. Defence is an ever-changing world. The tasks which our Armed Forces undertake are varied and new technologies offering more effective capabilities are constantly emerging. There is a need to ensure that the assumptions and proposals in the DIS remain relevant. We asked whether the assumptions and proposals in the DIS had been changed or revised since its publication. Lord Drayson told us:

the fundamentals of the Defence Industrial Strategy that we set out in some real detail still remain true, we believe. We said we would review the Defence Industrial Strategy on a sort of two-year basis, so I think it would be appropriate to have a look at the Defence Industrial Strategy at around this time next year, but I would say that the basis upon which the implementation has been done, the principles remains as true today as they were a year ago.¹³²

95. **It is important that the MoD, working with the defence industry, ensure that the assumptions and proposals in the DIS remain relevant. We note that the MoD plans to review the DIS at the end of 2007, two years after it was published. As the DIS is the Government's Strategy, we also look to other Government bodies, particularly the Department of Trade and Industry and the Treasury, to review the DIS to ensure it remains relevant.**

Embedding the DIS

96. Lord Drayson has given the impetus to both producing the DIS and pushing forward its implementation. Some concerns have been expressed by industry that the implementation of the DIS is dependent upon Lord Drayson's personal involvement and it could suffer if he left post.¹³³ We asked Lord Drayson whether the culture of change he was trying to implement would survive when he was no longer the Minister for Defence Procurement. He considered it his responsibility to embed the changes and was optimistic that it could be done. He told us that:

To deliver the results, what needs to happen is there has to be continual reinforcement of change within the Department and change within industry to deliver better performance.... The challenge for next year [2007] is to embed that: both embed that within the Department and embed it within industry, and to bring those sectors which have not come on board to the degree we would have liked up to speed.¹³⁴

97. Some companies are concerned that the internal MoD changes might be hindered by the MoD's culture, and that the commitment to the implementation of the DIS was not

132 Q 3

133 Ev 25 and RUSI Report, *The Defence Industrial Strategy: An Analysis of Industry Responses*, 5 October 2006, Executive Summary, p 4

134 Q 2

reflected at all levels and across all organisations within the MoD.¹³⁵ Lord Drayson acknowledged that there was resistance from MoD staff, but he expected that. He told us that “what one has to do is show leadership; one has to understand the causes of the resistance to change and put in place the necessary actions to get it done despite the natural organisational resistance”. As part of the work to produce the Enabling Acquisition Change report, an analysis was undertaken of past change programmes to see which ones had been successful and which had not been successful. One of the conclusions from this work was that unsuccessful change programmes had not been embedded in the culture and in the behaviours of the Department.¹³⁶

98. The Minister for Defence Procurement is confident that the changes being introduced will be permanent, but this remains to be seen. We look to the MoD to ensure that the changes being implemented as a result of the DIS are fully embedded so that they deliver the expected benefits.

Funding the DIS

99. There is concern in industry about funding and whether the required funding for the DIS to be successful will be made available. In its written submission the SBAC noted that:

There is concern in industry as to whether the resources will be made available in the Comprehensive Spending Review to enable the MoD to sustain its overall programme.... With the strategy in place and implementation underway, it is absolutely crucial that sufficient funds are made available to the department to ensure that the value of the DIS is fully realised. Not least because this is a time when there are understandable pressures on the department to make funds available to operations.¹³⁷

100. The MoD informed us that “DIS implementation costs within MoD are estimated at being £23 million in the current financial year, and some £30 million for the coming financial year”. These costs cover the teams which are taking forward sector implementation, the specialist legal and financial advice supporting those teams, and the initial costs of the Defence Acquisition Change Programme. Budget holders within the MoD have found these costs within their existing budgets. The MoD considered that “set against the £18.2 billion of contracts that MoD placed during the last financial year, this is a small investment for the future with the potential for major payoff”.¹³⁸

101. The MoD’s estimate of the cost of implementing the DIS does not include the cost of funding the equipment programme. Lord Drayson said that, once the outcome of the Comprehensive Spending Review (CSR) was known, the MoD would be able to provide further clarity and transparency to industry. Providing this clarity and transparency was an objective for the end of 2007. He acknowledged that the CSR “has an effect on everything”, but would not make any comment on what the outcome might be or the impact of “any

135 RUSI Report, *The Defence Industrial Strategy: An Analysis of Industry Responses*, 5 October 2006, Executive Summary, p 3

136 Q 9

137 Ev 23

138 Ev 36

settlement on any particular decisions; because those decisions have not been taken and the settlement has not been resolved”.¹³⁹

102. We asked the MoD whether the funding needed to support current military operations would reduce the funding available to implement the DIS. The MoD told us that:

Funding to support operations should not affect DIS implementation although operational experience often drives future equipment requirements which may become part of the DIS. MoD attaches priority to operational needs, but recognises the need to strike a sensible balance between short term needs and the long term sustainment of an efficient and competitive industrial base.¹⁴⁰

103. **The MoD estimates that the costs of implementing the DIS in 2006-07 and 2007-08 will total just over £50 million. However, these costs only cover the MoD internal costs, and do not include the costs which will be incurred in the move away from competitive procurement in many areas, and from sustaining technological and industrial capabilities in the UK. We look to the MoD to estimate the overall costs of implementing the Defence Industrial Strategy.**

104. **The DIS has, in the MoD’s own words, the potential for “major pay-off”. However, to realise the pay-off, the required funding must be made available to fund the future equipment programme. We would consider it a real missed opportunity if adequate funding for the MoD to realise the full benefits of the DIS were not provided. We plan to take a close interest in the outcome of the Comprehensive Spending Review.**

Measuring whether the DIS delivers

105. In our first inquiry into the DIS, Lord Drayson told us that he was “in a hurry to show in 2007 that this has made a real difference to our defence capability and the strength of our defence industry”.¹⁴¹ We asked how the benefits and improvements expected to flow from the DIS would be measured and what indicators the MoD would use to check whether progress was being made. Lord Drayson considered that:

asking the Armed Forces: “Can you see the evidence of improvement?” ask the industry: “Do you feel you are given a framework” (which is, I think, really the Government’s responsibility) “within which you can make business decisions which allow you to fulfil the needs that the Ministry of Defence has, more effectively?”.... Also, I think, in terms of embedding the change, asking the military and the civil servants within the Department who are responsible for procurement: “Does it feel different to you? Has there been the achievement of significant change in the way in which things are done?”¹⁴²

139 Qq 66–67

140 Ev 37

141 HC (2005–06) 824, Q 289

142 Q 11

106. The MoD plans to assess whether the DIS is delivering the expected benefits by asking the Armed Forces, the defence industry and MoD staff whether they can see improvements or a changes in the processes. We welcome such an approach and look to the MoD to ensure that this is undertaken on a regular basis and represents a representative cross-section of different ranks, grades and company sizes. However, we also expect the MoD to continue to measure its performance in procuring equipment to cost, time and quality and to develop metrics to measure its success in managing equipment on a through-life basis.

DIS checklist

107. We asked Lord Drayson whether there would be a DIS checklist for 2007. He told us that the MoD was producing the checklist for 2007 and this would be forwarded to us.¹⁴³ We received the checklist on 29 January 2007. We note in particular that the MoD expects to

- agree a route map to a Long Term Collaboration Agreement between the MoD and key Industrial Partners covering full submarine life-cycle by Summer 2007;
- achieve industrial restructuring for surface ships which delivers potential cost improvements across the maritime programme by Summer 2007;
- reach a firm decision on the viability, shape and scope of the proposed LTPA [Long Term Partnering Arrangement for the Fixed-wing aircraft sector] by the end of 2007 and be positioned to place relevant supporting contracts as appropriate; and
- publish R&D Business Models for Investment by Autumn 2007.¹⁴⁴

We plan to continue to monitor the progress in implementing the DIS and whether the expected benefits are delivered, and will use the MoD's checklist for 2007 as the basis for doing this.

143 Q 4

144 Ev 40–43

Conclusions and recommendations

1. With the notable exception of the Maritime sector, good progress was made in implementing the Defence Industrial Strategy in 2006. We congratulate the Minister for Defence Procurement for driving the process forward at a fast pace. (Paragraph 8)
2. We are disappointed that the required restructuring of the surface ship industry has not taken place and that this has delayed the main investment decision on the Future Carriers. It is possible, though not inevitable, that this may result in later delivery of the carriers. This in turn may lead to a capability gap which could be both damaging to the defence of the country and expensive to deal with. On the other hand it might lead to the project being better managed. We accept that the MoD is right to insist on the speedy restructuring of industry, and we will be keeping a close eye on this important matter as it progresses. (Paragraph 19)
3. We were concerned to hear reports that the Future Carrier programme might have been cancelled because of budgetary pressures. The programme is a key element of the 'Carrier Strike' capability needed by our Armed Forces and vital to the future of the UK maritime sector. We welcome the assurance provided by the Minister for Defence Procurement of the Government's continuing commitment to this programme. (Paragraph 20)
4. The surface ship sector needs clarity about future design and build work, and maintenance and repair work, to make appropriate decisions about the best way to restructure. However, until the outcome of the Spending Review 2007 is known, the level of future funding for naval equipment and support remains unclear. It is hoped that the outcome of the Spending Review, expected in the Summer, will provide the clarity the surface ship sector needs to proceed with the restructuring required to deliver equipment and support in the most efficient way. (Paragraph 25)
5. It is disappointing that the consolidation in the submarine industry did not take place in 2006 as expected. We look to the MoD to continue to encourage industry to integrate, as this will be vital to ensuring that there is a focus on Through Life Capability which should deliver substantial savings to the MoD. If the Government's proposal for a new generation of nuclear missile submarines is accepted, it will be essential to have an efficient submarine industry focused on through-life costs. (Paragraph 29)
6. We note the Minister for Defence Procurement's confidence that the submarine industry is making the value for money improvements required by the MoD, which should enable the MoD to make a decision on Astute boat 4 in early 2007. Given the importance of this contract to maintaining capability in the UK's submarine industry, we plan to watch this closely. (Paragraph 30)
7. We note that the MoD is still working with BAE Systems and other companies in the aerospace sector to reach agreement on the appropriate size of the sector given current and future demand. (Paragraph 33)

8. The Typhoon aircraft needs to be upgraded so that it can take on the ground attack role required in current operations. We support the MoD in its aim to improve the industrial structure of the Typhoon collaborative programme, so that the required upgrading of Typhoon aircraft can be undertaken as efficiently as possible and better value for money delivered across the whole Typhoon programme. (Paragraph 36)
9. We welcome the MoD's decision to fund a four year UAV Technology Demonstrator Programme. UAVs have the potential to provide a new dimension to the force mix in the future. (Paragraph 38)
10. We welcome the formation of Team Complex Weapons which should help sustain key skills and capability within the UK. We look to the MoD to ensure that the required agreement in this area is concluded and signed early in 2007. (Paragraph 40)
11. It is regrettable that the reshaping of the defence industry required by the Defence Industrial Strategy has resulted in job decreases in some sectors of the defence industry. However, a more streamlined defence industry will better match the MoD's current and future requirements and ensure that the industry remains competitive when bidding for overseas defence contracts. We note that the MoD, the Department for Trade and Industry, the Regional Development Agencies and the devolved agencies are working closely together to provide appropriate support to those areas affected by reductions in defence work. Value for money in defence procurement is important to the defence budget as well as to industry. (Paragraph 46)
12. We consider it vital that the MoD and the defence industry continue to recruit and retain high quality staff, in particular, engineers, scientists and technicians, in this period of change. Such staff are key to ensuring that the benefits of the DIS are delivered. We welcome the joint "team defence" initiative which has been launched to promote the opportunities in the defence industry. We look to the MoD and industry to continue to review career development opportunities to ensure that high quality staff in specialist areas are not lost. (Paragraph 48)
13. We plan to examine in a future inquiry the MoD's progress in implementing the recommendations of the Enabling Acquisition Change report and whether the expected improvements in equipment acquisition are delivered. (Paragraph 53)
14. Improving the skills of MoD staff, particularly commercial and technical skills, will be crucial to ensuring that the expected benefits from the DIS are delivered. The MoD is seeking to address skills gaps through training or external recruitment. The appointment of the first MoD Commercial Director is welcome, but he must be given the resources needed to develop the commercial skills of MoD staff. (Paragraph 56)
15. We note the publication of the Defence Technology Strategy and the MoD's initiatives to encourage innovation, such as the Competition of Ideas and the Grand Challenge. We are disappointed that the Strategy did not set out how much the MoD would be investing of its budget in defence research. We will be examining the

funding of Defence Research and Technology in our forthcoming report on the work of the Defence Science and Technology Laboratory. (Paragraph 64)

16. The MoD has sought to improve its understanding of Small and Medium-size Enterprises and the supply chain, but its progress has been considered slow by one of the major defence trade associations. The MoD should continue to work closely with the defence trade associations, the Department of Trade and Industry, the Treasury, Regional Development Agencies, and the devolved agencies, to identify approaches to improve its understanding in this area further. This will be vital to the success of the DIS. Prime contractors also need to improve their understanding of supply chains and the key role of Small and Medium-size Enterprises. (Paragraph 68)
17. Small and Medium-size Enterprises are often the source of highly innovative ideas and products. In understanding supply chains, the MoD must improve its understanding of the contribution made by such companies and the impact if they disappeared from the supply chain. We look to the MoD to improve its understanding of the innovation provided by Small and Medium-size Enterprises and the investment they make in Research and Technology. (Paragraph 69)
18. Long-term partnering arrangements are a new approach for the MoD and require specialist skills in negotiating and letting the contracts for such arrangements, and for monitoring performance once contracts have been let. We look to the MoD to ensure that its staff who deal with long-term partnering arrangements have sufficient training in such arrangements, or recruit staff with the experience required. (Paragraph 73)
19. We consider that there would be real benefit in the MoD producing a document for industry which set out what partnering relationships should look like, and the principles underpinning long-term partnering agreements. We look to the MoD to take this forward. (Paragraph 74)
20. Some long-term partnering arrangements will be let on a non-competitive basis as in some sectors, if the work is to be retained in the UK, there is no other supplier. There is, therefore, a risk that the MoD may not be contracting with the most efficient supplier and achieving best value for money. We consider it vital that the MoD build into such long-term partnering arrangements incentives which drive real efficiency into the supplier's organisation. This will be particularly important where the throughput of work for such arrangements may well reduce in the future. (Paragraph 78)
21. We note that it is possible to have competition for the work underlying long-term partnering arrangements and that the MoD has introduced measures to encourage this. We consider it important that Small and Medium-size Enterprises are provided with an opportunity to compete for such work and look to the MoD to ensure such opportunities are provided. (Paragraph 79)
22. We welcome the signature of the Memorandum of Understanding covering production, sustainment and follow-on development on the Joint Strike Fighter programme, and congratulate the Minister for Defence Procurement and his staff on its achievement. Because of the MoD's unwillingness to provide us with the

supplement to the Memorandum of Understanding, we can only report that the Minister for Defence Procurement has assured us that the UK will get all the technology transfer it requires to operate the Joint Strike Fighter independently. While we are of course pleased to hear this, we continue to have concerns about how things will work out. In particular, we will wish to probe how robust the Memorandum of Understanding will prove in practice and will seek an early opportunity to take oral evidence on this. UK industry also needs to know to what extent it will have access to the technology transferred under the Memorandum of Understanding agreement and its unpublished supplement. These are matters that we will monitor closely. (Paragraph 86)

23. The Minister for Defence Procurement assured us that the US Administration was still committed to the JSF programme and specifically the STOVL variant of the JSF which the UK is procuring. We expect the MoD to keep a close watch on any possible changes to the US JSF programme given the potential impact on the UK JSF programme. (Paragraph 87)
24. There is an initiative underway to create an overarching agreement with the US on the issue of technology transfer. We recommend that the UK Government attach the highest priority to achieving this aim, as a concrete embodiment of the relationship which the UK enjoys with the US. This is needed to ensure that separate negotiations do not have to take place for each future equipment programme and it should lead to quicker decision-making on the specific technology transfers for future programmes. We look to the MoD to ensure that the overarching agreement covers industry to industry technology transfer as well as Government to Government technology transfer, and clarifies the position of UK companies with subsidiaries within the USA. (Paragraph 89)
25. The MoD is finalising new arrangements for the supply of munitions after the former Royal Ordnance Factory sites at Bridgwater and Chorley close. It is confident that these arrangements will provide security of supply in this critical area. (Paragraph 92)
26. Work on how best to sustain the required access to general munitions is ongoing. We look to the MoD to complete this work and commit the required investment by the end of 2007 as planned. (Paragraph 93)
27. It is important that the MoD, working with the defence industry, ensure that the assumptions and proposals in the DIS remain relevant. We note that the MoD plans to review the DIS at the end of 2007, two years after it was published. As the DIS is the Government's Strategy, we also look to other Government bodies, particularly the Department of Trade and Industry and the Treasury, to review the DIS to ensure it remains relevant. (Paragraph 95)
28. The Minister for Defence Procurement is confident that the changes being introduced will be permanent, but this remains to be seen. We look to the MoD to ensure that the changes being implemented as a result of the DIS are fully embedded so that they deliver the expected benefits. (Paragraph 98)

29. The MoD estimates that the costs of implementing the DIS in 2006-07 and 2007-08 will total just over £50 million. However, these costs only cover the MoD internal costs, and do not include the costs which will be incurred in the move away from competitive procurement in many areas, and from sustaining technological and industrial capabilities in the UK. We look to the MoD to estimate the overall costs of implementing the Defence Industrial Strategy. (Paragraph 103)
30. The DIS has, in the MoD's own words, the potential for "major pay-off". However, to realise the pay-off, the required funding must be made available to fund the future equipment programme. We would consider it a real missed opportunity if adequate funding for the MoD to realise the full benefits of the DIS were not provided. We plan to take a close interest in the outcome of the Comprehensive Spending Review. (Paragraph 104)
31. The MoD plans to assess whether the DIS is delivering the expected benefits by asking the Armed Forces, the defence industry and MoD staff whether they can see improvements or a changes in the processes. We welcome such an approach and look to the MoD to ensure that this is undertaken on a regular basis and represents a representative cross-section of different ranks, grades and company sizes. However, we also expect the MoD to continue to measure its performance in procuring equipment to cost, time and quality and to develop metrics to measure its success in managing equipment on a through-life basis. (Paragraph 106)
32. We plan to continue to monitor the progress in implementing the DIS and whether the expected benefits are delivered, and will use the MoD's checklist for 2007 as the basis for doing this. (Paragraph 107)

Annex: List of Abbreviations

CSR	Comprehensive Spending Review
CW	Complex Weapons
DIS	Defence Industrial Strategy
DLO	Defence Logistics Organisation
DMA	Defence Manufacturers Association
DPA	Defence Procurement Agency
DTI	Department of Trade and Industry
DTS	Defence Technology Strategy
FRES	Future Rapid Effect System
JSF	Joint Strike Fighter
MoD	Ministry of Defence
MOU	Memorandum of Understanding
R&D	Research and Development
R&T	Research and Technology
RUSI	Royal United Services Institute
SBAC	Society of British Aerospace Companies
SMEs	Small and Medium-size Enterprises
STOVL	Short Take Off and Vertical Landing
UAV	Unmanned Aerial Vehicle
UCAV	Uninhabited Combat Aerial Vehicle
UK	United Kingdom
USA	United States of America

Formal minutes

Tuesday 30 January 2007
[Afternoon sitting]

Members present:

Mr James Arbuthnot, in the Chair

Mr David S Borrow
Linda Gilroy
Mr David Hamilton
Mr Dai Havard
Mr Adam Holloway
Mr Bernard Jenkin

Mr Brian Jenkins
Mr Kevan Jones
Robert Key
Willie Rennie
John Smith

Defence Industrial Strategy: update

The Committee considered this matter.

Draft Report (Defence Industrial Strategy: update), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 107 agreed to.

Annexes (Summary and List of Abbreviations) agreed to.

Resolved, That the Report be the Sixth Report of the Committee to the House.

Several papers were ordered to be appended to the Minutes of Evidence.

Ordered, That the Appendices to the Minutes of Evidence taken before the Committee be reported to the House.

Ordered, That the provisions of Standing Order No. 134 (select committee (reports)) be applied to the Report.

[Adjourned till Tuesday 6 February at 1.30 pm.]

List of witnesses

Tuesday 19 December 2006

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Lord Drayson, a Member of the House of Lords, Minister for Defence Procurement, **Mr David Gould CB**, Deputy Chief Executive, Defence Procurement Agency, **Mr Amyas Morse**, Defence Commercial Director, Ministry of Defence, and **Mr Mark Gibson**, Director General Enterprise and Business Group, Department of Trade and Industry

Ev 1

List of written evidence

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3	Defence Manufacturers Association	Ev 24
4	QinetiQ	Ev 25
5	Ministry of Defence: Summary Progress Report on significant DIS Milestones	Ev 28
6	Letter from the Secretary of State for Defence to the Chairman: UK Maritime Industrial Strategy	Ev 34
7	Letter from the Secretary of State for Defence to the Chairman: Memorandum of Understanding on the Joint Strike Fighter Programme	Ev 34
8	Supplementary memorandum from the Ministry of Defence: Follow-up questions	Ev 35
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Defence Committee Reports in this Parliament

Session 2005–06

First Report	Armed Forces Bill	HC 747 (<i>HC 1021</i>)
Second Report	Future Carrier and Joint Combat Aircraft Programmes	HC 554 (<i>HC 926</i>)
Third Report	Delivering Front Line Capability to the RAF	HC 557 (<i>HC 1000</i>)
Fourth Report	Costs of peace-keeping in Iraq and Afghanistan: Spring Supplementary Estimate 2005–06	HC 980 (<i>HC 1136</i>)
Fifth Report	The UK deployment to Afghanistan	HC 558 (<i>HC 1211</i>)
Sixth Report	Ministry of Defence Annual Report and Accounts 2004–05	HC 822 (<i>HC 1293</i>)
Seventh Report	The Defence Industrial Strategy	HC 824 (<i>HC 1488</i>)
Eighth Report	The Future of the UK's Strategic Nuclear Deterrent: the Strategic Context	HC 986 (<i>HC 1558</i>)
Ninth Report	Ministry of Defence Main Estimates 2006–07	HC 1366 (<i>HC 1601</i>)
Tenth Report	The work of the Met Office	HC 823 (<i>HC 1602</i>)
Eleventh Report	Educating Service Children	HC 1054 (<i>HC 58</i>)
Twelfth Report	Strategic Export Controls: Annual Report for 2004, Quarterly Reports for 2005, Licensing Policy and Parliamentary Scrutiny	HC 873 (<i>Cm 6954</i>)
Thirteenth Report	UK Operations in Iraq	HC 1241 (<i>HC 1603</i>)
Fourteenth Report	Armed Forces Bill: proposal for a Service Complaints Commissioner	HC 1711 (<i>HC 180</i>)

Session 2006–07

First Report	Defence Procurement 2006	HC 56
Second Report	Ministry of Defence Annual Report and Accounts 2005–06	HC 57
Third Report	Costs of operations in Iraq and Afghanistan: Winter Supplementary Estimate 2006–07	HC 129
Fourth Report	The Future of the UK's Strategic Nuclear Deterrent: the Manufacturing and Skills Base	HC 59
Fifth Report	The work of the Committee in 2005 and 2006	HC 233

Oral evidence

Taken before the Defence Committee

on Tuesday 19 December 2006

Members present:

Mr James Arbuthnot, in the Chair

Mr David S Borrow
Mr David Crausby
Linda Gilroy
Mr David Hamilton
Mr Dai Havard
Mr Adam Holloway

Mr Bernard Jenkin
Mr Brian Jenkins
Mr Kevan Jones
Willie Rennie
John Smith

Witnesses: **Lord Drayson**, a Member of the House of Lords, Minister for Defence Procurement, **Mr David Gould CB**, Deputy Chief Executive, Defence Procurement Agency, **Mr Amyas Morse**, Defence Commercial Director, MoD, and **Mr Mark Gibson**, Director General Enterprise and Business Group, DTI, gave evidence.

Q1 Chairman: Good morning and welcome to a follow-up inquiry into the Defence Industrial Strategy. Minister, welcome. I wonder if you would like to introduce your team, please.

Lord Drayson: Thank you, Chairman. On my left I have Mark Gibson from the DTI. Mark is responsible for the DTI's Enterprise and Business Group. On my right is David Gould, who is the Deputy Chief Executive of the Defence Procurement Agency, and Amyas Morse, who is the Department's new Commercial Director.

Q2 Chairman: Minister, about a year ago you said that you hoped to be making real progress and you sent us a checklist—very kind of you, we had never heard of this before—for the progress you hoped to make in 2006, and we will be asking various questions about that checklist during the course of this morning. I wonder if you could give us a very brief summary of the progress that you feel you have made. The trouble with some of these early questions that I am going to be asking is that they will give you the opportunity to expand generally—and I hope you will not take it. Roughly, what progress do you think you have made over the last year?

Lord Drayson: We said, almost exactly a year ago when we published the Defence Industrial Strategy, that 2005 was about us providing the clarity right in the strategy and 2006 was about implementing it such that in 2007 we could begin to see some clear results. I think, looking back at 2006, frankly, Chairman, I am pleased with the progress which we have made. It is not a complete picture where we have achieved everything which we set out to do, but we have achieved, I believe, an awful lot. I have given the Committee an update of the checklist, as of today, effectively, which goes through where we actually are compared to all of the things we said we would do by this time. Overall, I think we have established some real momentum, both in terms of changes in the sectors in line with what we said we

would do within each of the sectors, and, secondly, change within the Department. To deliver the results, what needs to happen is there has to be a continual reinforcement of change within the Department and change within industry to deliver better performance. I think we have seen the establishment of a critical mass of that improvement. The challenge for next year is to embed that: both embed that within the Department and embed it within industry, and to bring those sectors which have not come on board to the degree we would have liked up to speed. I hope, Chairman, to be able to come before your Committee this time next year and be able to report that we have truly embedded this improvement within the Department.

Q3 Chairman: Contained in the strategy are various assumptions and proposals. Have events or changed knowledge made you revise any of those during the course of the year?

Lord Drayson: Yes, in the sense that where we have seen slower progress than we would have liked, for example, on implementation of the maritime industrial strategy, we have had to think about what measures we can take to encourage those changes. However, the fundamentals of the Defence Industrial Strategy that we set out in some real detail still remain true, we believe. We said we would review the Defence Industrial Strategy on a sort of two-yearly basis, so I think it would be appropriate to have a look at the Defence Industrial Strategy at around about this time next year, but I would say that the basis upon which the implementation has been done, the principles remain as true today as they were a year ago.

Q4 Chairman: As I say, you kindly gave us the checklist for 2006. Do you have a checklist for 2007?

Lord Drayson: We had our industry and MoD review meeting last Friday—we had a conference last Friday. It was agreed that that was a useful process. We are going to repeat that next year and

so, yes, the Department is now producing the checklist for 2007. That will be produced in January and I will produce that for the Committee, as I have done before.¹

Q5 Chairman: You were at a seminar on Friday?

Lord Drayson: Yes.

Q6 Chairman: A celebratory seminar?

Lord Drayson: It was celebratory in the aspect that we felt real progress had been made. I think it is right, because there has been a lot of hard work both by the Department and by industry, doing some really quite difficult things, to thank people where that progress has been made, but also to point out where the progress has not been good enough. So I would not say it was a celebratory mood but it was about making sure that we recognise where we have made progress and where we have not, and that we build on this in a serious way. The challenge here is to embed all this such that it sticks and such that both industry and the Department feel that they are in a process of continuous improvement to deliver better performance for our Armed Forces and for the taxpayer, and that this is an inexorable process which is not going to go backwards, it is not going to slip back, there is a real momentum to it; there is a commitment to it within the Department and within industry and to maintain that. That is why it is important to hold these seminars, to make sure that people recognise that this was not a sort of “fire and forget” document; this was a clear strategy which we are serious about implementing, which has within it some pretty difficult things to do, and that we are committed to making sure that they get done.

Q7 Chairman: We have heard that the Ministry of Defence was prepared to take part in that seminar on Friday only on the basis that it was supportive of the DIS in general and of you in particular. Are you surprised to hear that?

Lord Drayson: Yes, I am. I have not heard that before.

Q8 Chairman: That is something that we have heard. You might like to take that back to your Department, because it does not sound very much like you. It sounds like your Department but it does not sound very much like you.

Lord Drayson: No, that is the first time I have heard that and I will follow that up.

Q9 Chairman: Do you get any feel of push-back from your Department, resistance from your Department, about the things that you are trying to push through?

Lord Drayson: I think in some areas, yes. I expect that. The experience I had in business, when implementing change, is that there is a natural resistance to change in any organisation, and there are good reasons for it. What one has to do is show leadership; one has to understand the causes of the resistance to change and put in place the necessary

actions to get it done despite that natural organisational resistance. I believe there is an opportunity to make a real step-change in performance. I think that we have put in place a lot of the steps that need to take place to implement that. One of the important things we did in the review which we undertook of the Department's processes (the McKane study on *Enabling Acquisition Change*) was a review of changed programmes in the past where they were successful and where they were unsuccessful. One of the conclusions from that was that changes in the past had not embedded in the culture and in the behaviours of the Department, and that is what I really intend to do this time around. I do believe that is possible because I do see that, at the top of the Department, I do have the commitment of the PUS, as the overall responsible owner for the change programme and taking that on board. The top leadership in the Department, clearly, I know, share with me this opportunity to make this real difference through the implementation of the DIS. We recognise that it is difficult to do but there is a commitment to do it. If I could sum up, Chairman, by saying, for me what it is all about is the difference between asking the question: what is needed to be done to make this real difference in improvement in performance, and getting that done, or asking (one of the phrases I like least is “the art of the possible”): what is it that it is possible to get done, given the existing constraints? So what I am trying to do is make sure that what we do is what is needed to deliver the results. That is what I expect to see happen.

Q10 Mr Jones: Minister, I do like your optimism but, to use a Robin Day phrase, you are a “here today, gone tomorrow” Minister—which we all are in that respect, as politicians. How confident are you that the culture of change that you are trying to put through, which I agree with, is actually going to be long term and embedded when you are not the Minister? I find it really difficult when I hear, for example, Sir Peter Spencer before us saying that these things would have happened without you anyway, if you had not been there. Personally, I do not believe that, but how confident are you that this will actually embed in the culture of the organisation?

Lord Drayson: I am an optimist, you are right, but I am also a realist and a pragmatist. I do believe it is possible—I really do believe it is possible—to embed this. It is my responsibility, as the Minister for Defence Procurement, to absolutely do my best to embed it. It is important for me, when I see a procurement problem on a project, to always ask myself not just how do you fix that problem, but what caused that problem to happen in the first place, and what can we do to change the whole way the system works—the interaction with industry? What is it that caused that such that you are not just fixing that one problem but you are making a change which will embed improvement in the Department on a wider basis such that these problems happen less and less? One of the things which I think it is very

¹ See Ev 40

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important for Ministers to do, whilst focusing very much on the nitty-gritty of the specific problems, like what is it going to take (earlier in the year) to get Protective Patrol Vehicles into operations quickly, is also to ask the question: what is it that we need to look at in terms of our processes to get a better procurement process? That is a specific example where I think we have had a real success this year in addressing the Protective Patrol Vehicles issue, but what we have also concluded from that is that we needed a procurement system which was not just good at the UORs, the very short-term operational requirements, and also had a less good longer-term procurement system, but also had a sparingly used but fast-track sort of middle way procurement system for equipment which was going to require development—it was not just an off-the-shelf buy but had a big operational payback. That is an example of putting in place a system to fix problems on a wider basis than just the particular one which we were addressing. So I am optimistic that it can be done, and already we are starting to see the proof of the pudding, but the key test next year will be: is it embedded? Is this a long-term change?

Chairman: We shall be asking you that, we hope, next year.

Q11 Mr Jenkins: That is fine, Minister, and I really do admire your enthusiasm and wish you all the best in your attempt to streamline this system or make it more productive, or try and alter the culture. It is almost a self-feeding animal, and you are looking at the supplier and I am looking as the customer: you are not sure where the problem starts. If you were to look, as we do, from the outside of the Department, what would you say we should look for? What are the indicators that you feel need to be in place to tick the boxes to say they are making progress; they are changing their attitudes; they are getting smarter, they are getting faster, they are getting more efficient—not only within the Department but, also, on the supplier which is as vital an element of this conundrum as anything.

Lord Drayson: The answer is asking the Armed Forces themselves do they feel that procurement has improved. That is the number one. This is what this is all about, in the end: are we delivering the equipment that the Armed Forces need to do the tough job that they have to do? So feedback on that. Feedback, also, from industry because the fundamental, if you like, implied contract in the Defence Industrial Strategy is that industry will improve its performance—in other words, deliver equipment on time, to budget and to the specification. That depends upon industry investing and modernising, and the quid pro quo is the Government providing the clarity to industry and transparency on forward plans and priorities, such that it can make sensible decisions. At the same time, I think, as asking the Armed Forces: “Can you see the evidence of improvement?” ask the industry: “Do you feel you are given a framework” (which is, I think, really the Government’s responsibility) “within which you can make business decisions which allow you to fulfil the needs that the Ministry

of Defence has, most effectively?” It is asking both those things. Also, I think, in terms of embedding the change, asking the military and the civil servants within the Department who are responsible for procurement: “Does it feel different to you? Has there been the achievement of significant change in the way in which things are done?”

Q12 Chairman: But they will not answer that “No”.
Lord Drayson: I think they will.

Q13 Mr Jenkins: “Yes, Minister”.

Lord Drayson: I think your Committee is good enough at grilling them to the point where you can take a clear view on it, anyway.

Q14 Chairman: Mr Morse, as the first Commercial Director, what do you do?

Mr Morse: What do I do? Okay. I am Head of the Defence Commercial Function, which means that I am in charge of developing the skills and capabilities of the commercial team across the MoD; I provide strategic leadership across all the commercial and procurement activities, and champion best practice there; I am, effectively, the owner of the procurement process; I have a responsibility and lead on strategic relationships with industry; I am responsible for driving the future development of DIS and I provide strategic advice and guidance on commercial issues to Ministers and senior colleagues. Finally, I review and advise on major investment decisions. I do that, apart from other things, as a member of the Investment Approval Board.

Q15 Chairman: Your background is in consultancy and accountancy, is it not?

Mr Morse: That is right, yes.

Q16 Chairman: How do you make progress in leading the MoD’s relationship with industry within the DIS framework?

Mr Morse: You do that, I think, first, by making sure that you understand industry’s agenda properly; so you understand what their aspirations are and you are able to take an intelligent analysis of what is driving them; you make sure you collect on a joined up basis what we think of the performance of particular suppliers and where you would like that to go, and you develop an approach to achieve, where possible, a mutual improvement in the relationship to deliver what both sides need—identify the issues there. So, in other words, you go through it methodically, you have a dialogue and you develop a planned approach to developing the relationship.

Q17 Chairman: How well do you think you are doing in developing these strategic commercial arrangements?

Mr Morse: I would say we are at quite early days, but in the areas where, with some of those suppliers, we have started that, taking a joined up approach across the MoD and building on the existing key supplier programme, it is clear that demonstrating

that we really do take that approach has a significant effect on our relationship with the supplier. So the answer is I am not going to say I am doing well at it but I am quite clear that this approach is effective.

Q18 John Smith: Clearly, a new objective of the DIS is the use of much more long-term partnering arrangements. What experience do you have of setting that up and overseeing such arrangements? What skills are needed within the MoD to be able to manage these relationships, because it is clearly under non-competitive pressure to single suppliers over long periods, and do the civil servants in the MoD have those skills in the Procurement Agency?

Mr Morse: There are quite a lot of elements in what you have asked, and I will invite my colleagues to answer some of them as well. Let me see if I have picked them up rightly. First, about my own experience; as it happens, I was involved for Pricewaterhouse in looking at partnering arrangements, and I was therefore quite specifically involved. They have not been in existence very widely across industry for all that long, it has to be said, but actually looking at best practice round the world is something that I happen to have done. A little bit, if I may, about my own experience, to say that actually my role in Pricewaterhouse for a long time was as a manager of the business. Effectively, I will say my background is as much as a manager as a consultant, but I do know something about partnering. I think you touch on a very good point, which is having the requisite skills to be able to partner properly. I am not going to pretend that we have them in the depth or the quantity that we would like, and therefore we have a programme in place to build those skills and capabilities to a requisite level within the MoD.

Q19 Mr Jones: So how many square pegs have you got to get rid of?

Mr Morse: I think square pegs may be susceptible to adjustment in many cases. No, no, I am serious. I think there is far more readiness to change among the colleagues that I find in the Civil Service than maybe I, ignorantly, expected; far more acceptance of change than I expected, and therefore there is talent there to be adapted. I believe that quite strongly. Finally, you talked about long-term contracting as if it were necessarily oppositional to competition, and I think it is possible to introduce competition, both in the inception and in the phasing of some of these long-term relationships. In other words, if a contractor is not performing under a number of criteria in a satisfactory way you can create opportunities to introduce competition at various points. The two things are not necessarily contradictory. There is sense in both of them. I hope I have covered the elements in your question.

Q20 Chairman: You said you had experience of partnering at PriceWaterhouse but that it had not been around for very long. Are you talking about in the UK?

Mr Morse: In Australia, obviously, it has been around for longer.

Q21 Chairman: Have you had international experience of partnering in those areas where it has been around?

Mr Morse: No, and I do not want to present myself, and nor did I join, on the basis of being a great partnering expert.

Q22 Chairman: That is the direction that DIS is moving in, is it not?

Mr Morse: It is. What I am simply saying is that, as it happens, I have experience of doing some work in partnering arrangements in the UK but drawing on international experience; because PW was, and is, an international organisation I was able to call on colleagues round the world for international experience.

Q23 Linda Gilroy: Minister, when you came before us on 28 February you said that pain comes from change and change is always painful. A major change for industry is to adjust to putting less focus on the design and development of new platforms and more of a focus on the insertion of upgrades and new capabilities and Through-Life maintenance of existing platforms. Is industry making the necessary adjustments and, if so, what evidence is there to bear that out?

Lord Drayson: Yes, I do believe industry is. An early example, I think, we secured was the agreement with Augusta Westland on helicopters where we negotiated a fundamentally new type of agreement which linked the procurement of a new helicopter, Future Lynx, to the performance of the company in the support of the existing fleet of helicopters. That was, in particular, the availability of those helicopters on operations in Iraq and Afghanistan. I remember having the conversation with the leadership of the company where I said how important it was for us to get better performance from our existing fleet of helicopters and that I was going to link that to negotiations of the future contract. They said to me: "Our ability to support (ie provide spares, servicing support) for the existing fleet of helicopters depends upon the Ministry of Defence making timely decisions. Are you going to commit to the MoD having criteria, metrics, in terms of timely decisions?" I said: "Absolutely, yes." So this was a first. This was a contract which had tough goals, metrics, linked to financial rewards to the company where both the company and the Ministry of Defence signed up to those performance metrics. I was there last week, at our largest helicopter base, getting the feedback and they were saying to me, yes, they were seeing that this was having a result in terms of the effect on the front line in terms of the provision of spares availability to helicopters. So there is an example—there are other examples on armoured fighting vehicles—where I do believe that we are implementing this effectively. It is requiring us to develop new types of contracts and it does require us, as Amyas has said, to develop within the Ministry of Defence the expertise to do this. I think we are at the stage of having done this in certain sectors, and what we need to make sure of is that we get efficient at the roll-out of this into other sectors

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by having a standard form of definition of what we mean in these different agreements, for example define clearly partnering, and that was one of the things which we discussed last week at the seminar—how we do that.

Q24 Linda Gilroy: Part of that whole history of Smart Acquisition and Smart Procurement has been about trying to get better value for money as well as delivery of things on time. What sort of scope do the early lessons of that suggest to you that there is for achieving that sort of value for money?

Lord Drayson: I think there is, in the end, a trade-off between the Department providing clarity to industry in terms of future plans and then industry being able to invest to provide improved efficiency and, therefore, better affordability. The more that the MoD can provide that clarity the better value for money we are going to achieve. The difficulty in that is that the world changes and, therefore, we have to balance the fact that the future is uncertain and we need to maintain the flexibility to do that, to flex our plans to meet how the future unfolds. However, we need to recognise, and this is where the MoD has to develop real expertise, both commercially and technically, and have a real understanding of how these procurement decisions and the level of future clarity and transparency impacts on delivery performance at cost. What we are aiming to do, and what has not been done before, is to take more of a portfolio approach across projects such that we have a clear view, building on the Defence Industrial Strategy, on how we make individual decisions on procurement projects, how that affects the capability within an area, and how we therefore overall get best value for money.

Q25 Linda Gilroy: You have also been quoted as saying that in some sectors you would have liked to have seen greater pace to the change that industry needs to make. You quoted some early success but what are the sectors that are proving most resistant, and where would you like to see a better pace of change?

Lord Drayson: I think the most difficult this year has been the maritime sector, although I am pleased that just in the last week we have seen some really good progress in the maritime sector.

Q26 Chairman: We will come on to the maritime sector separately.

Lord Drayson: Okay, but I think that is one example. We have seen good early progress in complex weapons missiles; we need to now see them, in terms of team complex weapons, coming together to manage a very difficult decline in future orders for complex weapons—we need to see that agreement concluded and signed in the early part of next year. I think we have made some good progress on armoured fighting vehicles, but I want to see that further developed in the early part of next year. Presumably we are going to talk about FRES at some point, but in terms of armoured fighting vehicles, FRES is a very important programme and we need to see the development in armoured fighting

vehicles linked to the implementation of our plans on FRES. The one which I have been pushing hardest to see progress on, and was getting a bit worried about, was maritime, but I really do think we are now starting to see some real progress on that, both on ships and submarines.

Q27 Mr Jones: Minister, you said you wanted to see movement on more than FRES. We had Sir Peter Spencer before us last week, and I have got to say it was not very good, to say the least; it was the worst performance I have ever seen before this Committee, and he would not give us an in-service date for FRES, and in fact this is a change in policy that no one seems to know about in this Committee. Have you got an idea of the in-service date for FRES?

Lord Drayson: If you recall, we had a discussion on in-service dates when I came before the Committee about aircraft carriers. In looking at the problems the Department has got into in the past, one of the things which I am really trying to do is put rigour and discipline into the procurement process, and that means having a project management system where the rules are clear, people stick to them and then they are judged by their performance against those rules. An important rule which I implemented last year was that at the Main Gate decision, at the main investment decision, we would publish publicly the cost target, the key user requirements and the in-service date for projects. Until that Main Gate decision has been taken we do not publish, talk about, in-service dates because there is a negotiation that takes place right up until the conclusion of the contract which allows us to go through the main gate. It really prejudices your ability to negotiate with the different industrial partners, and FRES is a clear example of this, those issues around cost, time and performance. This is about the Department—

Q28 Mr Jones: No, he actually told us that industry knew what this in-service date was but they were not prepared to tell us. Can I just turn it round on you, if you are sat on this side of the table: how can we then judge that your Department is actually delivering what it says it is delivering if we do not even know what the in-service date is going to be?

Lord Drayson: You will know the in-service date for a project when we make the main investment decision, which is when we commit to buying a piece of equipment at a future date for a price to a set of requirements.

Q29 Mr Jones: You could go for years and years on this basis, could you not?

Lord Drayson: No. This is a really important principle because if you do not have these principles set down, you lose any ability for people to try and manage—that is both people within the procurement system and people within industry—expectations and negotiation positions without a clear set of rules through the process. You have a phase where you have the decision about what the

requirement is: what is this piece of equipment going to do; what is the military need; what is the general specification? You then go through an assessment of the different options, the different design ideas, the different alternatives, and then you explore, with industry, the possibilities. There is a trade-off. What is more important to you: something at a particular date, or something with a particular performance or something at a particular price?

Q30 Mr Jones: So the in-service dates that have been given to this Committee before by, I think, at least, two Secretaries of State on FRES and, also, by General Jackson, did not mean anything?

Lord Drayson: We have changed the policy to have a clear rule. I remember you saying to me you thought it was a brave move—

Q31 Mr Jones: “Refreshing”, I think it was.

Lord Drayson: Yes. I think it is key to good accountability and good project management. If you imagine: take a project, project X, and one company has got one particular solution which does not do such a good job but can be available very quickly; another company offers a solution which has more capability but needs longer—more development to get done. If you were in a phase where you have declared your date, then you have biased the negotiation between those different options before the Ministry of Defence has decided, with feedback from the user, which is the most important. So there is a time when it is absolutely right—and, I think, fundamentally important—to delivering value for money and the kit on time and to budget, where you are negotiating those three things. We have done exactly this on the aircraft.

Chairman: I want to move us back to Linda’s questions now, because I think we are getting blown off course, rather.

Mr Jenkin: Is the in-service date not crucial to the requirement of the Armed Services? What is the point of bringing something into service if it is much too late for what the Armed Services require? The in-service date should be up front as part of the requirement.

Q32 Chairman: Answer that briefly, Minister, if you would and then we will get back to Linda Gilroy.

Lord Drayson: There are often (I would not say always) different pieces of kit to solve a particular problem or to do a particular job, and they will have different levels of development. Therefore they can be available at different times. So, for instance, you say to the Army: “Which is more important to you? Is it to have this thing which can do all of this but is going to be later, or is it more important for you to have not such a good thing but to have it sooner?” That is a decision which needs to be taken carefully in conjunction with the end-user. There will be different views for different types of equipment. For some pieces of equipment, absolutely right: “The most important thing is we get something with that

lower level of requirement faster”. At other times it will be: “No, we really want to take longer to get this additional capability”.

Q33 Linda Gilroy: I am tempted to pursue that but I think the Chairman might stop me! We talked in previous sessions about the way in which the big changes with DIS would be job increases in some sectors and decreases in other sectors, but you want to manage that in a “Smart” way. Can you give us some indication of where those job increases and decreases are beginning to pan out and exactly how the Government is assisting those areas where there are, or are going to be, job decreases?

Lord Drayson: Clearly, for all of us, the most difficult areas are where there are job decreases. If I focus on that area, a clear example of that is in complex weapons, where, as we set out in the Defence Industrial Strategy, there were very significant declines in demand for complex weapons. What we wanted to do was manage our future orders in complex weapons in the most intelligent way, such that we minimise that effect and maximise the retention of skills and capability within the industry. We are doing that; I am pleased at the way in which team complex weapons has come together, but it has led to job losses in the different companies, as we expected, over the past year. What I can say is that (and I will turn to the market in a moment to talk about the mitigation of this) absent the Defence Industrial Strategy those job losses would be, I believe, greater and the approach would have been much less strategic, and we would not be retaining the key skills that we needed to.

Q34 Linda Gilroy: Can I just ask you, before you begin, if you can remind the Committee of the scale of the job decreases we are talking about in that particular area?

Mr Gibson: I do not know the answer.

Lord Drayson: We are talking about hundreds of people in different businesses.

Q35 Linda Gilroy: So what would be a large scale redundancy situation in DTI terms?

Lord Drayson: Yes, but spread across different businesses; not necessarily all in the same businesses; across the industry.

Mr Gibson: We do see an obligation in the DTI to work as closely as possible with the Ministry of Defence in these circumstances. It was the Government’s Defence Industrial Strategy, so I think there is a clear obligation on the part of the Department, and particularly the Regional Development Agencies, to be aware of these potential job losses and try and do as much as possible to work with the local providers on the ground, the job centres and the Learning and Skills Council, to put together packages of support to try and help in these circumstances and to try and look ahead and ameliorate the situation. An example is in fixed-wing aircraft in the North West where there will be job losses over a number of years, and the North West RDA has put in place a good

programme trying to help the supply chain in the North West improve its performance and, therefore, try and maximise employment in the long term.²

Q36 Linda Gilroy: In responding to those types of job losses which do tend to happen piecemeal rather than in one fell swoop, are there sort of particular challenges? I mentioned large-scale redundancies just now, but certainly in the situation, which I know from my own constituency, we face in relation to fairly major job losses arising from the lesser amount of submarine work, it is quite difficult to get an idea of who and when exactly the redundancies are going to occur and, therefore, how you can actually make sure that you do not lose the skills, which is presumably an aim you would have in the DTI.

Mr Gibson: Yes, it is an aim. I think honestly the bigger the job losses the more difficult it is. Against that, in the aerospace sector you do tend to have more warning than, say, in the automotive sector. We have handled MG Rover and Peugeot in the Department where you are talking of thousands of people—in Rover's case several thousands of people. In aerospace you do tend to have longer lead times; you can do more planning; and, therefore, you can try and put in place programmes that help the industry adjust over a longer period. The answer is: the bigger the job losses the more the regional agencies have to step up to the mark. In my view they have done it pretty well recently.

Q37 Willie Rennie: You referred to close working relationships between the DTI and the MoD in this area. Do the same kinds of relationships exist with the Scottish Executive and the Welsh Assembly?

Mr Gibson: The answer to that is: yes, we work well with the devolved agencies. An example is of R&D funding where we have received collaborative R&D funding with contributions from Scotland, Wales and the English RDAs, as well as the main department. I think the working relations are very good. Between the DTI and the MoD they are probably the best ever in my experience. The Defence Industrial Strategy has played a major part in that genuinely.

Mr Hamilton: My colleague for the Liberal Party has asked the question I was asking. It just goes to show that in Scotland Labour and Liberal are working all together!

Q38 Linda Gilroy: If I might turn to the Minister and just picking up on the point about trying to retain the skills, and the discussion we were having just now about the way in which Through Life Capability is very much a focus point in procurement. How can we keep engineers, scientists and technicians—both attract them into and retain them—in defence industries which are going to be geared to product

support and technology insertion into existing platforms, when they may feel that they want to be at the cutting edge of design and new equipment?

Lord Drayson: You are absolutely right, this is a very important issue which we need to handle and I think we have done a lot this year. We have identified there was an opportunity and a need to do better at this, so we set up with industry this idea of team defence—to go out and actively promote clear opportunities for scientists and engineers, working within the defence industry. I think there are some important lessons that the defence industry can learn from other industries, for example the pharmaceutical industry, and those have been taken on board. Those have led to specific actions; and those actions. For example, with the publication of the Defence Technology Strategy, we launched the grand challenge, the competition for ideas, and the research fellowships. All of these were to do two things: one, they were to get people to work on solving problems which are very real challenging problems that defence has today; but, two, they were about upping the profile of defence—the fact that people can have very rewarding and very interesting careers working within defence, either within the Ministry of Defence or within industry—just to get over how cool some of the technology is and how cutting edge it is, and to get a higher profile. I think we have been successful on that. The response we have had to the Grand Challenge, the Competition for ideas and the Defence Technology Strategy has been very positive indeed. We have also made changes to our graduate recruitment programme. That has really worked well. I would say that end of the human resources picture is looking pretty healthy in terms of getting young people joining. We need to further work in career development for scientists and engineers within procurement. One of the things which I want to achieve this next year is career structures, whereby it is possible for scientists and engineers to stay doing science and engineering within defence procurement as civil servants or someone within the military without having to move into other areas, such that we get deeper expertise in the technology. That is one of the objectives which we have for the implementation of the new defence equipment support organisation.

Q39 Linda Gilroy: Finally, turning to the general shape of the UK defence industry, do you expect to see significant mergers and further consolidation? In order to allow other colleagues to come in and move on, perhaps I could couple that with saying if you see consolidation is it within the UK; is it international; and, if it is international, is that mergers or takeovers involving UK defence companies? What is the general shape? Is it US; is it European?

Lord Drayson: I think the general view is that the pace of change within the industry internationally is going to maintain the fairly fast rate that it has had in the recent past and, therefore, we can expect to see further consolidation. We were pleased to see the recent announcement of the discussions around the joint venture in maritime between British Aerospace and VT. That is an example; there may well be

² The North West Regional Development Agency is supporting the North West Aerospace Alliance, a regional partner of the Society of British Aerospace Companies, which has developed and is now delivering the supply chain excellence programme to which reference was made.

others. The Defence Industrial Strategy sets out the Government's clear principles on this, which is that we are aiming to create the most open and healthy defence market in the world here in the United Kingdom; but we recognise that to deliver operational sovereignty, which is a clear objective that we have, we have to have a policy which is very strict on matters of skills, intellectual property and design authority. We have seen the effect of that happening, for example, at Boeing setting up facilities here in the United Kingdom, to put itself in a position to be able to compete for FRES; because what we have said on FRES is that, because FRES is going to be so fundamentally important to the British Army, that we need to make sure that the intellectual property and the design authority resides in the United Kingdom and, therefore, companies that wish to compete on FRES have to compete on the basis that those will be the rules. I think that is the way in which we effectively manage the consolidation which is going to take place in the industry, and is going to take place internationally as well as nationally.

Q40 Linda Gilroy: Do you think it is possible to look ahead, say, five years and say how DIS will have helped to create a sort of British dimension to the defence industry of providing capacity in the UK?

Lord Drayson: Absolutely. I have already had the feedback (and some of it has been public) both from international partners, other governments, and feedback from the management of international companies that the Defence Industrial Strategy sets out (I think in a way which is unique globally) the clear rules of engagement with the Ministry of Defence as the customer on these matters. We are being absolutely upfront and clear to people about what we expect. Therefore, whilst saying we are happy for foreign investment, we are happy for companies which have ownership outside the United Kingdom to supply us, but they must do so with the clear understanding of the rules which we expect them to adhere to, which relate to matters of management, intellectual property and design authority; because we need to make sure that we do not prejudice in any way, in fact we use opportunities to strengthen, the operational sovereignty the United Kingdom has over defence capability when this consolidation takes place, and in the way in which we do international collaborations. I think a good example of that was the progress which we have been able to make on the Joint Strike Fighters.

Q41 Chairman: Are you saying, Minister, that if those criteria are satisfied you would have no objection to British defence industry being dominated by foreign owned subsidiaries?

Lord Drayson: I would prefer British defence industry not to be dominated, but what is most important is for the Armed Forces to get the equipment they need to do the job that they have to do, and to deliver value to the taxpayer. What is very

important to do that is that we have access to the skills and the capacities here in this country. What we cannot have is a situation where, for those areas where we require operational sovereignty, those skills, that intellectual property is offshore of the United Kingdom, because that will prejudice our military effect. What I hope and expect is that by providing this clarity, in effect facing up to the challenges of globalisation, we have a government policy which actually has the best framework to enable British industry to compete globally and to win. I think by doing this you create a situation where actually you give industry the best possible chance in this country to actually do well internationally.

Q42 Mr Jones: Can I turn to the maritime sector. When you were before us in February of this year you said you wanted to see the Maritime Industrial Strategy implemented by 2006. Can you give us an update on where we are with the Maritime Strategy?

Lord Drayson: Within the maritime there are two sides to it: the submarines and surface ships. In both areas of the maritime industry we see that there is a need for the current situation to change, and our current situation is that we have patches of very good performance, modern facilities, globally competitive facilities, but we do not across the maritime industry see that. We have duplication; we have inefficiency. What we wanted to see was that industry change, where in the past businesses have competed for them to work together to provide a Through Life solution to us. In the past we have had separate contracts with a company to design and build a ship, a company to maintain a ship, a company to upgrade a ship. What we need is to be able to get to the point, and the whole thinking behind the Defence Industrial Strategy, to be able to contract with people on a Through Life basis and design in maintainability. That is how you get better capability and better value for money. We have seen slow programmes on that; and I think part of that is because the industry is looking at 10 years of very significant orders. What I have said is that those orders are not going to come unless the consolidation and the changes happen. I am very pleased that now we are seeing the announcement last week of the BAE/VT joint venture, if that is consummated; and I think that is a structure which we within the Ministry of Defence think is the right structure—unlike some of the deals we looked at earlier in the year which looked like money being taken out of the industry because there were premiums being paid to shareholders to takeover companies which meant that money was not going to get invested in the industry. This joint venture structure creates the entity which we want to see, to be able to contract Through Life, but does not actually take money out of the industry. It means that the capital can stay in the industry.

Q43 Mr Jones: Where does that leave the CVF in terms of Main Gate?

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Lord Drayson: If that deal goes through, and we have seen the initial announcement, it puts the CVF in a good position. This is exactly what we need to see to be able to contract with confidence all the aircraft carriers.

Q44 Mr Jones: You are being a bit more forceful. I know it has already been quoted about the seminar last Friday, but what you actually said there was, “When I said there would not be an order for CVF until consolidation happens I meant it”?

Lord Drayson: That is absolutely right.

Q45 Mr Jones: You will not make any progress on CVF until consolidation actually happens?

Lord Drayson: I believe it would be quite wrong for the Department to close-contract for the CVF without it being in place. Industry knows that; I have been saying that consistently; and I think that clarity has helped industry get its thinking clear; and I do expect that this will happen. For me, as a Minister, that is the precondition for signing the contract.

Q46 Mr Jones: That is very interesting. Can I come back to where Bernard came in when asking his question in terms of delivering capacity. Are we saying that the thing which will determine when our Royal Navy gets its next generation of carriers is the consolidation of industry, which is actually influencing the in-service date?

Lord Drayson: Being completely clear on this, that is the reality anyway. The reality is that in this market in the maritime industry there is an inter-dependence between us as the customer and the yards as the supplier. Therefore, what we have to do is place these orders intelligently to get industry to changing the way to deliver these carriers on time, to budget with the requirements. I think fundamentally what I am trying to do with the Defence Industrial Strategy is to create a procurement framework which faces up to the reality of the inter-dependence in certain markets. Take submarines, there is only one shipyard in the country that can design and build submarines for us; so whether we like it or not we have to contract with that yard. The question is: how do we contract with that yard most intelligently such that we do get the best product, on time, with the best value for money? In some markets it is not like that.

Q47 Mr Jones: I might have said this before, it is a breath of fresh air when a Minister comes and gives straightforward answers. Just so I have got it clear, the in-service date for CVF will be determined by making sure that we have got the consolidation of the industry right first, is that right? You have not actually come up with the in-service date yet?

Lord Drayson: The in-service date will be set when we make the Main Gate decision. The investment decision will be taken when we have got the industry structure, and I think we are really close now, I really do.

Q48 Mr Jones: That is what will determine the next sequence of events?

Lord Drayson: Because the industry structure determines that we have got an efficient industry which will deliver the carriers on time and for the price. As the customer you have certain levers, and the most important lever you have as a customer is placing the order. It is tough because industry, people, rightly were saying that we need this product and, therefore, you cannot wait. What I have to do is make sure that I push both industry and the Ministry of Defence to come to deal with the reality that the performance on the design, build and delivery of these aircraft carriers is going to depend upon the implementation of these changes. Everyone has known this for years; what I am doing is providing the discipline to get it done and I think it is going to work.

Mr Jones: Thank you for your honesty. It is very unusual for the MoD!

Q49 Mr Havard: Is your assumption that that is going to slow it down a bit or speed it up a bit, or be largely neutral in terms of when the carriers will come anyway? Will that make a huge difference to the time of when it would come in?

Lord Drayson: It will make a difference.

Q50 Mr Havard: Adversely, or not?

Lord Drayson: Let us say the consolidation does not happen; it keeps not happening; then the time for the Main Gate is going to be pushed back. Frankly, being very candid on this, every month that the industry does not do this is a month added to our opportunity to make a decision on the Main Gate. Industry doing this actually provides us with the environment within which we can have the highest level of confidence that: the in-service date will be met; the costs will be delivered; and that the key user requirements for the ships will be delivered. It will give the platform, the basis upon which the project can be implemented effectively. Because the aircraft carriers are so big, two enormous ships involving the whole of the maritime industry, the pivotal effect that the aircraft carrier project has on the industry means that this is absolutely the right thing to do, I believe; and I know that the Navy supports that. I am optimistic in a pragmatic way that this is going to happen, and that this will put us in a position to get these aircraft carriers delivered as we want them.

Q51 Mr Havard: I wanted to ask a question related to that which is about your milestones. You gave us the milestones in February and you gave us the milestones again today and under “maritime” it says “within six months we want to arrive at a common understanding of the core load requirements to sustain the industry”, and the carriers are part of that. That is what you said in February, and that is what you said in December?

Lord Drayson: Yes.

Q52 Mr Havard: Six months. Then it says, “within six months from publication”. There are lots of “six months” here. When do these six months start and when do they finish?

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Lord Drayson: I think the maritime sector is the area where we have made slower progress than I had hoped. I think the reason for that we have discussed already this morning. The announcement last week, and the position this puts us in on the aircraft carrier project, I hope these are the cracks beginning to show of this now happening. I would be very disappointed indeed if, six months from now, we did not have the answer to this.

Q53 Mr Havard: Is this six months from now we are going to publish something, so that within six months of that then it happens?

Lord Drayson: No, that means within six months from now we will see that the maritime industrial strategy is being implemented both in terms of submarines and ships.

Q54 Willie Rennie: You have talked about consolidation within the industry in terms of bringing together the construction and the Through-Life support so it matches what the MoD is doing. Does the shape of those partners coming together determine the Through-Life support to tell you where it is going to be sited in the future, or does it have no effect at all?

Lord Drayson: It is about a modernisation of approach in contracting within the industry. An example on ships, VT, for the small end of warships, is able to enter into contracts with us on an availability basis. In other words, they contract to provide a warship at sea doing its military job 97% of the time. They design it to make sure that they can contract for that and not lose money because they design into it the attainability of all the systems within the ship. What we would like to see is that the industry develops that ability on much bigger ships in the future. For that know-how to happen those practices, those approaches, need to be rolled out within the industry; that is why we see that the BAE/VT proposed joint venture is a really positive development.

Q55 Willie Rennie: Does it mean they capture that refit work by doing the deal with a major constructor?

Lord Drayson: No, what it means is, it is like we have done with the surface ships/port alliance; what we have to do, given the workload that we have, is intelligently place the orders such that we maintain the capability within this country as we need it. The best way to do that is for industry to structure itself such that it can then, as a whole, contract with us on these Through Life contracts, and then decide how to best use the facilities that we have got efficiently; invest in those facilities efficiently across the United Kingdom.

Q56 Willie Rennie: You are saying the BAE Systems and the VT deal is only the start of this process. You need all the others to come into this process as well for it to be effective?

Lord Drayson: They do not necessarily have to come on board in terms of a mergers and acquisitions type approach; it can be done contractually. For

example, the best example of this is on the aircraft carrier alliance. Because the aircraft carriers are so big it needs most of the yards to be involved in building these aircraft carriers and, therefore, we formed an alliance structure. This time last year I would say I would attend the CEO Alliance Board meetings and they were starting to get the hang of working together; now it is working really well. I feel really positive about the way in which the industry has worked on the aircraft carrier alliance.

Mr Gould: I think what happens if BAE Systems and VT eventually goes ahead, they will actually put Fleet Support Limited, which is one of the repair companies, into that joint venture. There is a small part of BAE Systems called CS&S which does some maritime work which will go into that. The contracting pattern in the future will move towards the kind of pattern we now have for *HMS Clyde* where we are actually paying for ship time—we have not bought a ship. That is the smaller 60 metre one. That predetermines some of the structure of the industry; but even if you take that JV and it does come together, there is not enough refit capacity inside that company to do the whole job we need to do in the future. Even if we were contracting for the JV for availability for current destroyers and frigates, for example, they would not be able to do all of that work in their own premises and would have to have a contracting arrangement with other yards to enable that work to be done.

Q57 Willie Rennie: It can be as loose as the alliance?

Mr Gould: It could be an alliance, or it could be a contracting arrangement.

Q58 Willie Rennie: You could have a range of consolidation within the industry?

Mr Gould: Yes, indeed. The alliancing behaviour in the carrier alliance, because most of these people are involved in that in some degree, will actually help generate the right kind of behaviour in the refit work.

Q59 Mr Holloway: In a capitalist version of Soviet central planning, do you not to some extent trade-off in terms of delivery timings the needs of industry and their scheduling of things against the time that you require the individual pieces of equipment from a military perspective?

Lord Drayson: I would not describe it as a “capitalist version of Soviet central planning”. I had the experience of explaining the Maritime Industrial Strategy to all of the union convenors from the National Maritime Industry, and met all of the MPs and I described myself as a “capitalist”. I believe that the way in which this will work is by creating a framework where the market is able to respond to the reality of the interdependence between the supplier and the customer. If you take CBRN, that is a market which is healthy enough, with enough players in it, enough competition in it where you can adopt, if you like, traditional, competitive procurement; but the reality of the maritime market is that we have seen that competitive tendering has actually destroyed capability. We needed to

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recognise that reality. What we are doing is placing contracts on the basis of recognising that interdependence, incentivising the industry to change in the direction that we want but, at the same time, not getting involved in telling industry how to do it. It is up to industry how it restructures; but it is up to the Government to say, "We're the customer. This is what we need you to do".

Q60 Chairman: This time last year when you came before us you said that you were not formulating an in-service date because you wanted to drive out risk.

Lord Drayson: Yes.

Q61 Chairman: Now you are saying you do not want to place a contract until the industry consolidation has taken place. Do you regard those as different concepts or the same concept?

Lord Drayson: Actually I think they are in parallel. They are slightly different. In terms of risk, there is the technical risk in terms of doing the design of the ships; and one of the important things we have done over the past year and made a lot of progress on is in terms of issues relating to where we can introduce commercial build standards—for example, that are used in cruise ship design and construction—in an appropriate way for a warship; where modular design in terms of cabins and so forth are slotted into the hulls; the concurrent design that you use, so you are still designing some parts of the ship in parallel with certain elements of construction. These are practices which we wanted to bring into the carrier project because that was going to be important to the modernisation of the industry.

Q62 Chairman: Has that now been completed?

Lord Drayson: I would say that is largely completed, in terms of getting to the position where we are able to take a Main Gate decision, so the two come together. I am hoping we are in a position to see these things coming together shortly.

Q63 Chairman: The risk has been bottomed-out pretty much, but it is now the consolidation that has not?

Lord Drayson: Yes. The progress recently on the consolidation, this announcement recently I see as a very positive sign we are now seeing progress on consolidation.

Q64 Chairman: One final question on the carriers: the discipline you were talking about, would you breach that discipline if you were to tell us the planning assumptions on which industry is working in relation to an in-service date?

Lord Drayson: I really believe I would, Chairman, because I know that certain parts of the industry would prefer other ships to be built before the carriers were built and it is logical for them to want that. What I have to do is manage overall those tensions to deliver what the Armed Forces need by the date consistent with that.

Q65 Willie Rennie: It is probably going slightly off the track of what the others want to talk about. You have talked about BAE Systems and VT, but you have not talked about the Babcock DML rumours which are flying around. Would you like to comment on those at all?

Lord Drayson: Yes, in my comments so far I have focused on the surface ships. These arguments also apply to submarines. In submarines, where we have even greater clarity that we have certain dockyards within the country that provide an element of the provision of our submarine fleet, from design and build at Barrow, through to operations and support at Faslane, in terms of Devonport in terms of refuelling and maintenance of the submarines, again what we want in submarines is the development of Through Life Capability. We want our submarines to have designed in the maintainability. We want the industry to come together in a way which enables us to do that. We have been pushing industry to do that now since the Defence Industrial Strategy was published. I think we have seen progress, in the sense that I have been very impressed in the way in which the performance has improved at Barrow. I think the job that is being done in Barrow, working on the practices there (and you visited the yard, Chairman) that is good. The work which has been done at Devonport in terms of the improvement of the time it takes to refit submarines, that is good. What we need to see is this integration. I think we discussed this when I was here on the matter of the placement of the nuclear deterrent. We were very disappointed with the way in which KBR went ahead with the IPO of the company; and we are now actively managing that situation. It is important (and this is the nuclear deterrent we are talking about) that we ensure we have confidence on the development of this supply chain in submarines, and we need to manage that very actively to ensure that we do achieve that.

Q66 Linda Gilroy: Turning back to the formation of ShipCo—to what extent are the planning round 2007 rumours, that some ships, say six out of the 25 frigates and destroyers that there are, could be tied up and might never come out of the docks again, to what extent is the work, the support costs of that, tied up with negotiations on the whole arrangement with the formation of ShipCo?

Lord Drayson: Answering generally: I am looking forward to the conclusion of the CSR, such that we then have got absolute clarity; we can provide further transparency to industry across the board. That is one of the objectives we should have for the end of 2007, on the basis of the resolution of the CSR to be able to provide that; and that applies to everything, not just in terms of surface ship support. Clearly the CSR has an effect on everything.

Q67 Linda Gilroy: You are saying that the outcome of the Comprehensive Spending Review will impact on how many ships there will be in the Royal Navy in future?

Lord Drayson: No, I am not making a specific point about those numbers of ships. What I am saying is the outcome of the Comprehensive Spending

Review clearly provides us with clarity of where we stand on the defence budget and, within that, the equipment budget, all of these things. That is going to be very helpful in terms of being able to manage the implementation of the changeover in the second half of the year when it is expected that will be delivered. I am not making any comment about what the outcome of that will be—that is above my pay grade—or the impact of any settlement on any particular decisions; because those decisions have not been taken and the settlement has not been resolved.

Q68 Mr Jenkins: Minister, you just said that we have got the budget now. You have a clear budget line of procurement costs as well, do you, a year-on-year budget?

Lord Drayson: Yes.

Q69 Mr Jenkins: At one time we were not completely honest with the industry when we used to place orders and delay orders because we could not afford to place them in that year. The same thing with industry—which was not very honest with us. They used to tell us that things were going to cost £2 million when in fact it was going to cost £6 million. Have you mapped out now totally the requirements we need and the cost of these requirements and the amount of budget we have got on a year-on-year basis?

Lord Drayson: If we look at the Defence Industrial Strategy, in each of the sectors we set out a graph based upon the existing defence budget, the last settlement, of the equipment programme in each of these sectors; and it sets that out over 10 years. It has a tolerance band within it and that gives, I think, the top level of clarity that industry needs in terms of overall planning within the sectors, and we then have to manage within that. This was one of the things which came out of last Friday actually—which is why I was a bit surprised at your comment, Chairman, that it was a celebratory mood. A clear piece of feedback which the MoD got, I got, on Friday was the need for more transparency than this. I committed, as my objective for 2007, to deliver that clarity to industry; but what I said to industry was that industry needs to show through its performance that that clarity is having an effect.

Q70 Mr Jenkins: Do we have a condensed version of this within your Department; an actual budget line, so we know what we are going to be buying now, what our commitments are now, and what our commitments are for the next 10 years and where the costs are going to impact on us? Do we have that budget line all laid out?

Lord Drayson: Yes, but it is of course subject to the Comprehensive Spending Review settlement and negotiations which will take place.

Q71 Mr Jenkins: Is it possible to get a copy of that in a form I can read and understand?³

Lord Drayson: I will try and provide you with the further detail. I think a good starting point is what is published within the Defence Industrial Strategy. I will see what more we can provide in terms of the detail behind that; but it already provides over 10 years the shape of the demand. You will see from it some sectors show an increase in demand and some sectors show a decrease.

Q72 Mr Jones: Can I just finish this section in terms of maritime and talk about Astute. One of the milestones the two-page checklist you gave us was the award of the fourth contract and subsequent contracts. CDP told us on 10 October the prices for boats 2 and 3 had still not been agreed, and would not be agreed and that boat 4 would not be awarded before that had been decided. Can you just give us an update on what happened with the order of boat 4?

Lord Drayson: We expect to be in a position to make a decision on boat 4 reasonably early in the New Year. What we are doing is making sure we have got the best possible understanding in terms of how they got through the process of boat 1, encouraging the company to make the necessary changes to improve performance; there is therefore then a negotiation in terms of subsequent boats; all within the structure of a recognition by us, set out within the Defence Industrial Strategy, that we need to have a frequency of orders to maintain capability. We have said approximately 22 months. We know to maintain that capability in the submarine industry we have to place orders at that frequency but we want to see these improvements to deliver this value for money.

Mr Gould: We have made some very good progress on boats 2 and 3. Boat 1 has enabled us to actually rebuild the industry. We have had an external review to verify the quality of the industry, which has come out very well. The Minister is quite right, we would hope to be in a position to make a decision on boat 4 early next year.

Q73 Chairman: When would you expect to agree a price on boats 2 and 3?

Mr Gould: Just before we make a decision on boat 4.

Q74 Mr Crausby: Are you really saying you might not order boat 4 even though you have said that in order to maintain the capability it needs to be 22 months and 24 months, and we have already committed ourselves to a Vanguard replacement in 2024? Is there a realistic prospect of not ordering the boats? The point I make is that the Department has put that forward in its White Paper; it seems committed to a Vanguard replacement. It is committed to 22 months/24 months; yet it says it is not really committed to boat 4. I would have thought that the industry is pretty certain you will buy boat 4.

Lord Drayson: I think the industry also is very clear that we are very serious about price; we are very serious about the changes. We had a mini discussion on this on the aircraft carrier. We have taken a lot of trouble of understanding the procurement process, and we are only going to place orders when we are satisfied that we have got the answers that we need

³ See Ev 35

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on these three things. I think what we are seeing is that the industry has got this message and is making the changes.

Q75 Mr Borrow: In DIS you stated that the MoD will work with BAE Systems and the other companies to help restructure the aerospace sector and reach the appropriate size. What is the state of play at the moment?

Lord Drayson: I think we are pretty close to an agreement with BAE. The important factor of negotiation is that the restructuring and change which we need to see within the aerospace industry is linked to work which we need to see done by the Ministry of Defence. There is this clarity about workload which is related to decisions on things like Joint Strike Fighter, decisions on Typhoon, decisions on the Taranis Unmanned Aerial Vehicle project, which are tied up with coming to an agreement with the company about the changes which we need to see which affect fixed costs and so forth, to again get this balance right for the sustained capability. What has had to happen is that the Ministry of Defence had had to deliver on its side in terms of the decisions around specific areas; so, for example, the Joint Strike Fighter; and then in negotiation that Amyas is leading with the aerospace industry of how we ensure that we get value out of the changes, and we are not paying for the industry to do things which we do not need the industry to do. I think that the signature last week of the Memorandum of Understanding on the Joint Strike Fighter was a very helpful piece of progress to be able to give this clarity. If I may say so, Chairman, I would like to record my thanks to your Committee for the clear stance which you and your Committee took with Joint Strike Fighter, it was very helpful in me really persuading the United States that we were deadly serious about what we said about technology transfer. I am very pleased that we were able to get the technology transfer that we needed and therefore able to sign the Memorandum of Understanding; that, therefore, gives clarity to the aerospace industry in this country. Other things which we have gone: I remember seeing within BAE, within Rolls Royce, Smiths and QinetiQ very exciting stuff in terms of engine work, in terms of autonomous air vehicles. The United Kingdom clearly had some leadership in some areas of technology, which we think is going to be vitally important in the future. It has taken us a year, but we have now put together a project, the Teranis Project, which is to create a unique autonomous unmanned combat air vehicle in the future, and that is going to be another important part of future workload for the industry. The area which for 2007 is a big project for me to deliver is further changes that we need to see in the Typhoon industrial structure relationship with the other partner nations. We have seen some good progress on Typhoon, but not enough; and now that Typhoon is coming online as an important defence capability we really do need to see in 2007 some significant change and improvement in the Typhoon arrangements between the four partner nations.

Q76 Mr Borrow: Just coming straight to Typhoon, are you saying you are not in a position to order the third tranche or decide how many aircraft will be in Tranche 3 until you are sure that the industry has carried out the necessary changes itself in order to place that order?

Lord Drayson: Yes. Before we can go forward on a Tranche 3 decision—and we do not have to take that decision yet—I do believe that there needs to be a remodelling of the Typhoon structure. It is very important, I think, that I am not seen as beating up on industry on this point because it is political as much as industrial. It is about getting agreement within the four partner nations upon the way in which we can make changes to the structure for Eurofighter and the Typhoon to deliver better performance in terms of value for money, ability to carry out upgrades. For us we need to see the changes in terms of upgrades to the fighter to give it a ground attack capability to be done efficiently. We do not think that has been good enough up to now and we really do need to see that happening in 2007.

Q77 Mr Borrow: Your criticism is not simply of BAE Systems in Lancashire?

Lord Drayson: Not at all.

Q78 Mr Borrow: In terms of the way in which they have put the aircraft together, it is the overall structure involving partner nations and the way in which their parts of the jigsaw operate individually and then how they are all meshed together that is part of your criticism. Is that criticism shared by your opposite numbers in our partner nations?

Lord Drayson: I think that is the job that BAE does in Lancashire and they do a good job. It is not that I am criticising that company or the other UK companies involved in Typhoon, it is the structure under which Typhoon has been put together as a European international collaboration, that is what needs to change. I think it is shared by my opposite numbers. I think there is a difference of opinion on the urgency. From the United Kingdom's point of view this is now a very important military capability, these aircraft will be undertaking the air defence of the United Kingdom this year. These are aircraft which could have a very big effect if given ground attack capability, for example in Afghanistan. We need this to be done efficiently. We think there are real opportunities to improve efficiency. We see big differences in terms of spares prices, value for money for different parts of the aircraft, and this needs to change. I hope that this is something which I can effect in 2007.

Q79 Mr Havard: I agree with a lot of that. Just on JSF though, this is not about the technology transfer element of it but the Memorandum of Understanding, you are talking about a work mix of different things for the industry here and you were talking about JSF as part of that. As I understand it, it says in your latest press release that companies will be able to compete for work in the next phase. What about fabrication and what about deep maintenance? Are there any possibilities at some

point or another with JSF that fabrication will be seen in the UK and where will deep maintenance come into that? Will BAE Systems, for example, or somebody else be screwing these things together?

Lord Drayson: Yes to both of those parts but, talking about the fabrication, it is not so much the screwing bits together but it is recognising that the Joint Strike Fighter has a significant part of it—and that is all Joint Strike Fighters for all nations—which is British technology and it comes from British companies. The most visible, I think everybody recognises, is the lift fan that gives the STOVL the jump jet technology, that is all British. Not so widely known, I think, is the manufacturing know-how that goes into certain elements of the airframe and the ability to manufacture very close tolerances which came out of BAE, but also other parts of the British aerospace industry which are providing very important components to the Joint Strike Fighter which will be on every Joint Strike Fighter internationally. Turning to maintainability, very important to the United Kingdom is this concept of operational sovereignty—

Q80 Chairman: Can we come back to that.

Lord Drayson:—that is affected.

Chairman: There are several questions you still have to ask, David.

Q81 Mr Borrow: I will try and move on. Aerospace workers in Lancashire were very pleased with the announcement at the end of last week but I think they would expect me to ask you, Minister, whether there is still a requirement for a Tranche 3 of the Typhoon and even if you cannot say when the order will be placed I think the fact that you say there is a requirement will give further confidence to aerospace workers in Lancashire.

Lord Drayson: I can understand that. I cannot give an answer and the reason I cannot give an answer is because my ability to effect the change that I have talked about earlier in Typhoon Eurofighter is very much tied up with the answer to that question. If I may I really do have to keep my powder dry on that one to be able to best have the ability to effect the changes which we want to see in the overall Eurofighter Typhoon construct.

Q82 Mr Borrow: If I can pull two questions together in one over the UAVs. Are you absolutely certain that there is no long-term requirement for a manned fighter aircraft after JSF which I think seems to be the position at the moment, that we are not asking UK industry to think beyond the Joint Strike Fighter in terms of manned military aircraft, putting all our eggs in the basket of UAVs? Are you sure that is the right strategy? Whilst I welcome the agreement with BAE Systems and some of the other companies on UAVs there was a considerable feeling amongst the industry prior to that announcement that the amount of investment that was being put into UAVs is a long way behind our competitors. Are you now confident we are where we should be in that part of the defence market?

Lord Drayson: I think that the Royal Air Force have put considerable time into thinking about this question. When we launched the RANDs Project the System Chief of the Air Staff talked about what the future might look like in terms of air capability, of there being mixed fleets of fighters where you would have some manned combat fighters but they would also be flying with unmanned fighters, and he talked about the advantages that unmanned fighters bring but also where in certain circumstances you do need manned fighters. In terms of the sovereign capability the United Kingdom needs for the future and a realistic assessment of how it can best maintain that given the nature of the global aerospace industry, I think the decision is the right one to say focusing on this particular type of UAV it is important for us to recognise there is the autonomy, these aircraft being able to fly themselves. As you know, current unmanned air vehicles very much do not fly themselves, there are people on the ground effectively flying them. This is about autonomous UAVs, absolutely an area where the United Kingdom has a technology need, it is something which we build upon, it is something which we believe to be important to defence in the future. In terms of manned combat fighters it is absolutely the right decision I believe for us to be involved in that as part of an international consortium. Team JSF is about a recognition that the cost and complexity of creating a stealthy fighter like JSF is best done through international collaboration and that is the way we should go in the future, not be developing those ourselves, it is not realistic for us to do that.

Q83 Mr Borrow: In future anything after JSF will inevitably be a UK collaboration?

Lord Drayson: UK-US or UK with other partners, as we have seen with Typhoon and as we have seen with Joint Strike Fighter.

Chairman: Moving on to Joint Strike Fighter, David Crausby.

Q84 Mr Crausby: If we could turn to the issues of technology transfer, could the Committee congratulate you on obtaining the necessary assurances from the United States on technology transfer on the Joint Strike Fighter programme which has enabled us to sign the Memorandum of Understanding, although I have to say I confess to believing the proof of the pudding will be very much in the eating. I guess that is the situation that you would take.

Lord Drayson: I agree with you 100%.

Q85 Mr Crausby: Can you give us some insight into that? How confident are you that the issue has been put to bed completely now and it will not resurface as the programme moves forward? Do the assurances cover the technology and information required by not just the UK Government but UK industry as well? How can we guarantee that transfer of technology moves down the industrial line as well?

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Lord Drayson: I think that we have got a good agreement under the Memorandum of Understanding which is an agreement to provide us with the technology which we need. What we need to make sure is that that technology transfer happens. So it is about maintaining the focus that we had in these discussions this year in the run-up to the signing of the Memorandum of Understanding, maintaining that focus forward in terms of the delivery of the technology transfer as we go through the development of the aircraft. We need to recognise this is an aircraft which is not yet built, not yet even designed, although the aircraft in terms of an air frame is pretty largely designed, a lot of the combat systems, the clever stuff inside the aircraft is being designed. It is understandable that that technology transfer has not happened yet because the technology has not been created yet. We need to focus on making sure that we have good processes, good focus, ministers like myself continue to maintain the level of dialogue with opposite numbers in the United States to maintain the emphasis on this. I think if we maintain it at the level that we have got it today, yes, I have a high degree of confidence. The agreement that we have provides real clarity, I think that has been a really good thing about this whole process. It does provide what industry needs and so I am confident that industry will have what it needs to do the job industry needs to do for us to deliver operational sovereignty. The other thing which has been encouraging for me is that the Joint Strike Fighter project has been the core focus of discussions around technology transfer with the United States because of its importance over the past year. Of course there are many other things which we discuss with the United States on technology transfer, other projects, and we have seen, I think in part because of what we have been doing on Joint Strike Fighter but generally because of the effort that has been put in both by the American Administration and by the UK, an improvement over the last three months or so in terms of the speed and efficiency of the technology transfer decision-making process with the United States. I could mention a number of projects, things like the future strategic tanker, as an example where technology transfer decisions, licensing decisions, have been made more rapidly. We welcome this. There is a joint initiative going on between us and the United States to create a structure on technology transfer, an overarching structure, which facilitates greater efficiency. I think that the operational tempo that we have at the moment means that there is a real need to make this as efficient as it can be, that is recognised on both sides of the Atlantic, and I hope that 2007 is a year when that framework is put in place such that we have not got to address these things just on a project basis all the time but we have more of an overarching agreement which makes the whole process more efficient.

Q86 Mr Crausby: Will that cover us for upgrades in the future? We are talking about a very long time, are we not?

Lord Drayson: Yes.

Q87 Mr Crausby: How can we guarantee that in 10, 15, 20, 30 years' time—

Lord Drayson: Because the MoU sets out principles. Because a lot of the technology has not been developed yet and there are going to be changes in the future, the only way you address that is by setting out clear principles and getting that into the agreement. A clear principle, for example, that UK citizens will be in the chain of command to deliver operational sovereignty, unbroken, no US citizens in that chain of command, as a way of establishing a principle which makes it very clear that what happens in the future, with the future being uncertain, you have still got what you need to deliver what it is you want.

Q88 Mr Crausby: We have a Memorandum of Understanding and the spirit of that is good, but how committed are we? Is there still an exit strategy to all of this or are we completely locked in?

Lord Drayson: The Memorandum of Understanding does not commit us to buy aircraft, what the Memorandum does is take us to the next stage. We need to recognise this is a project of high complexity. There are things which could go wrong in the project in terms of technical issues. We have to focus very much on making sure that we manage this project from our point of view as a customer with the United States. The Memorandum gives us the clarity on the principles, the agreement on the transfer of technology, but we have to apply all of the other disciplines that we need to apply on projects. This is a very important project. One of the things which I pressed with the American Administration when I was there last week, particularly with Gordon England, the Deputy Secretary of Defence, was where does America stand on this project, how much of a priority and focus does it have within the defence budget, how committed is the United States on the STOVL variant, which is the variant which we want, and I was reassured by the answers that I got from Gordon England. He was very hard in terms of the focus, in terms of the project not going to the right, the project being delivered and the necessary leadership being provided to ensure that happens.

Q89 Mr Crausby: It has been a long and difficult process, has it not, when you couple that with the problems that we had with the ITAR waiver it seems to me that it was very much a crunch time, not just about JSF but about our relationship with the United States. What is the major lesson that we should learn in what has been a really difficult business of ensuring that we can get this technology transfer? How will we be able to ensure in the future that we can confidently deal with the Americans in particular for this kind of project?

Lord Drayson: The feedback that I have had on this, and that is feedback in terms of our staff within the embassy in the United States, feedback from the United States Administration itself, the Senate Armed Forces Committee, feedback from industry, both American industry and UK industry, was the key lesson that being absolutely crystal clear makes

a real difference. Setting out why we feel how we feel about technology transfer in sufficient detail, expressing that, and very clearly and plainly saying, "This is what we need to see to buy the aircraft" and then, if I may say so, putting the effort into making sure that clarity is maintained through months of the process. That was why I made the comment I made about this Committee, because this Committee made a real difference in terms of the United Kingdom being able to say, very clearly indeed, "Look, this is not personal, we are just saying this is the basis on which we are going to buy the aircraft and that is the only basis upon which we are going to buy the aircraft" and across political complexions of the United Kingdom this is the view. That clarity focuses everyone's mind that there is no discussion about the objective, it is focusing on getting the objective achieved. Given that these objectives are very difficult to achieve, technology transfer is very complicated, it is absolutely right the United States—like we are—are very careful in the way in which they handle proprietary information. The way in which you make these things happen is being crystal clear and then sticking to that clarity, and that takes work and commitment and I think on both sides of the House that has really helped.

Q90 Mr Jenkin: Minister, just to underline your achievement, can I ask you to clarify one or two aspects of this. When you talk about "operational sovereignty of JSF" does that mean effectively once we have the aircraft we will be able to operate it indefinitely without recourse to US technical support?

Lord Drayson: No. The key principle of this whole project is the concept of economies of scale such that by all these nations pooling together you get a class of aircraft of such a size that the whole process is efficient. Now what we need to do is these nations stick together such that in future, as the aircraft gets upgraded and developed, we all benefit from the economies of scale and people do not go it alone to destroy economies of scale. However, at the same time, we need to be clear about, once we have got these aircraft, how we ensure that we have operational sovereignty on their upgrade in terms of weapons that we fit to it, its maintenance, how we repair and maintain it, and how we use it, how we put the mission objectives in the aircraft and these things. In other words, you have an important management job of maintaining the economies of scale and separating those economies of scale issues from technology transfer issues which deliver you operational sovereignty, that is about getting into the detail of the engineering issues within the aircraft, systems Through Life, specifying which affects which and making the right decisions about that.

Q91 Mr Jenkin: I am distressed I asked you a yes/no question and you answered no and then gave me a very long explanation. We are talking about critically the source codes in the critical flight safety software which enables the aircraft to be reloaded

with software before each flight. It is as basic as that. If we did not have operational sovereignty we would not even be able to fly the aircraft, would we?

Lord Drayson: With respect, you are now asking a completely different question. This is not the same thing. I answered you directly, the importance for us, like all the other nations in the future is it is really important that we recognise the economies of scale point—

Q92 Mr Jenkin: I am sorry, that is not the question I am asking. Are we going to be able to fly this aircraft independently of US technical support, ie we are not going to be dependent upon US passport holders or US subcontractors in order to fly this aircraft from mission to mission?

Lord Drayson: I am sorry, I thought I had answered that very clearly, absolutely, yes.

Q93 Mr Jenkin: For how long?

Lord Drayson: We have a clear unbroken chain of command of UK citizens.

Q94 Mr Jenkin: I am not asking about chain of command, I am asking about technical support.

Lord Drayson: I am talking about all aspects of technology necessary to do what you have just described. There are some aspects which are of a level of classification and secrecy that that know-how cannot be in industry, therefore they need to be in the heads of RAF officers or UK civil servants but not US citizens. Therefore, to make it an absolutely crystal clear test that in the future you can judge me on, the British aircraft carriers in the future with the British JSFs flying on them, they do not have to have a US citizen on board that aircraft carrier to be able to load, maintain, fly these.

Q95 Mr Jenkin: Are these necessary assurances that you refer to contained within the Memorandum of Understanding?

Lord Drayson: Yes.

Q96 Mr Jenkin: Your co-signatory is?

Lord Drayson: The United States.

Q97 Chairman: Is it Gordon England?

Lord Drayson: Yes, Gordon England.

Q98 Mr Jenkin: There is absolutely no question of any misunderstanding in the United States that they have not given us what you think they have given us?

Lord Drayson: I am absolutely clear on that.

Q99 Mr Jenkin: Do you think the Congress will accept that as well?

Lord Drayson: Yes.

Mr Jenkin: Thank you very much, Minister.

Q100 Chairman: Thank you for what you have said about the role of this Committee. There is a worry in my mind that you will thank us and we will congratulate you and we will forget the important message that you had at the beginning of keeping absolute focus on this in the future as well as in the

past and thinking “That is right, job is done, we do not need to concentrate any more”. From what you say it is essential for everyone to concentrate very heavily on achieving something out of this.

Lord Drayson: I think that is absolutely right, Chairman. One of the things which I will be expecting in my checklist for 2007 is that this time next year, if you ask me to come before you this time next year, you will ask me “How is it going on the technology transfer on Joint Strike Fighter” because I am going to maintain my focus on the technology transfer being delivered as I have in terms of reaching the Memorandum of Understanding.

Q101 Chairman: Can we have a copy of that checklist, please?

Lord Drayson: Yes, that will be done in January and then you will be provided with a copy.⁴ On that very important point on Joint Strike Fighter, it is complex, a lot of this is detailed engineering stuff—your point about the source codes and so forth—it is having this absolute clarity of which aspects relate to sharing in the economies of scale long-term to make sure we get value for money of the aircraft and which aspects relate to delivery of operational sovereignty. We have got absolutely the operational sovereignty that we need but people should not forget that the whole affordability of this aircraft internationally comes from the pooling of the orders and the Through Life support.

Chairman: Minister, we would normally try and finish at 12.30 but you have got such an interesting job that we will go on for another 15 minutes. There will be some questions we will want to write to you about. We cannot leave research and technology without some questions being asked because it is central to the whole of our defence capability.

Q102 Willie Rennie: The Government stated a target of R&D investment of 2.5% of GDP, what is going to be the defence industry and the MoD’s contribution towards that target?

Lord Drayson: I believe that we need to increase investment in defence research, we need to shift the balance in terms of the split between the development side of things and the earlier stage of research side of things. That is the thinking which we set out in the Defence Technology Strategy. We are now talking with industry about how we implement that. The way in which that target gets hit in terms of the percentage is both the Ministry of Defence and industry investing in research and there have to be the appropriate incentives for industry to take risks on research. The dominant model for defence research in the past has been the Ministry of Defence deciding what the future is going to be and therefore telling industry, “This is what we want researched” and paying for it. That is fine but, alongside that, we have to encourage industry to use its own thinking about what the future might hold, to take risk, to invest in that research and then, if it is successful and we use it, to be good at getting it through to the frontline. For that to happen they need to be

rewarded for taking that risk. Some of the business models are used in other industries, such as the sovereign IT and the pharmaceutical industry. We are in discussions with industry to come up with that, that is a deliverable that has come out of the Defence Technology Strategy and I am expecting that to become clear in the first half of next year and that will then be part of the overall plan that we have for Ministry of Defence investment in research. We have already set out that we expect with the current plans to see a slight increase in defence research spending but we are looking at this whole area. What we are trying to shift is from a model which is 100% the Ministry of Defence determining what is done and funding what is done to having more of a mixed approach which needs us to look at the rewards and incentives for industry to do that. That is how I think we get towards this target of the appropriate level of investment invested in research.

Q103 Willie Rennie: Are you able to put a figure on it in cash terms about what the contribution from Defence would be?

Lord Drayson: I will be able to once we have got to the end of this discussion with industry. Industry is going to take some convincing on this because what industry rightly says is “But the MoD is the only customer for defence research, it is not like there is competition for the research that we do”. We do say to them—and I will bring Amyas in on this because he has been doing some of the negotiation—“Yes but you know that the model is often that cutting edge research is done for a defence need which leads to an innovation which then finds its way into the civilian sector, sonar for detecting submarines is now used in medical applications for looking at babies in the womb. There are good models for this innovation and what we want to see is that the risk/reward balance is shifted to incentivise industry to do more work investing and we recognise those. Do you want to say something, Amyas?”

Mr Morse: Yes. I am chairing a sub-committee of the Defence Industrial Council. Interestingly, industry has brought up some very good ideas in this area and it is mostly not on the theme of how much money is going to be put on the table, it is mostly about enabling them to change the balance. In this debate, keep on having a simple economic model in your mind. If you are asking industry to spend money on research and development and you look at the amount of spend, you look at the return they expect to get and you discount it for risk, if the answer of the sum is zero or minus zero they are not going to do it, it is as simple as that. The discussion is about changing that equation. There are various ways it can be done, mostly by reducing uncertainty in some way or by increasing economic leverage. Where we have got to in the Committee is we have got five or six recommendations. We are going to have a final look at them at the beginning of January and report back to the Industrial Council. We have only had a couple of meetings and come out with significant agreement. Mostly it is about being clear

⁴ See Ev 40

on looking at export potential, yes, giving some form of supportive commitment when industry is going forward and helping them with applications of intellectual property on a wider marketplace, seeing what we can do for them in the States and so forth. There are areas like that where we are exploring and mostly, as I say, what they choose to bring up to us is enabling assistance from Government. I do think there is a fruitful territory that we can develop.

Lord Drayson: SMEs are going to be very important to this. That is another thing which we have not talked about much.

Chairman: We will come on to that very briefly.

Willie Rennie: I think we have covered most of the issues if you want to move on.

Q104 Mr Jenkin: Can I just ask a short supplementary on technology. In the discussions with the United States about technology sharing, do people over there express anxiety about us sharing technology with our European partners and, therefore, the United Kingdom is potentially a leak into Europe?

Lord Drayson: Yes, they have expressed that concern.

Q105 Mr Jenkin: What do you have to say in order to reassure them?

Lord Drayson: "No, we do not".

Q106 Chairman: That is very satisfactory.

Lord Drayson: It is very important the United Kingdom respects technology transfer agreements and keeps secrets secret.

Q107 Chairman: They are convinced by your answer?

Lord Drayson: We have signed the MoU, Chairman.

Q108 Mr Jenkin: They are not worried about the role of the European Defence Agency in attempting to harmonise defence procurement in the EU?

Lord Drayson: No-one has specifically mentioned to me a concern about the European Defence Agency.

Q109 Willie Rennie: Just one more question: the US are very good at research and development investment, and they seem to be improving even more. Are you concerned about that gap and do you think we can catch up with the United States in defence?

Lord Drayson: I think we need to recognise that is the nature of the very different sizes in the markets but there are many examples, both within defence and within a number of industries. If you look at the pharmaceutical industry, this country spends considerably less on pharmaceutical research than the United States but in terms of the bang per buck we get for the research that we do spend, it is considerably higher. The UK is the world number two in pharmaceuticals and world number two in terms of defence. It is about making sure that we spend the money that we do spend as efficiently as possible but making sure, also, that we are spending

enough, which relates to the comments I made earlier, and being innovative in the relationship which we put in place to deliver this.

Q110 Willie Rennie: The SBAC have said that the Defence Technology Strategy "... does not give a picture which is sufficiently complete for industry to make the investment decisions". Have you addressed those concerns? Is that part of what you were saying?

Lord Drayson: The Defence Technology Strategy is a pretty thick document, full of clarity but a lot of stuff in defence technology we have to keep secret. This is all unclassified, there is a lot of defence technology science which is classified which we cannot publish in a document like this. This has gone far further than we have ever been able to go before and I think that is recognised.

Q111 Willie Rennie: Can you address those concerns?

Lord Drayson: Yes, we need to. I think it is the nature of the job that we do, and a lot of what we do in defence science and technology has to stay secret. In so far as we can give that information to industry we are doing that and we need to continually test what more can we give which is a greater level of clarity to enable the industry to know what we want. I think it is a pretty impressive level of detail already.

Q112 Willie Rennie: Having said I am finished I have got one more. The Defence Manufacturers Association said that the MoD will have to significantly increase its contribution to defence research rather than necessarily industry. Do you think that is the case?

Lord Drayson: We have got to do this together, that is the answer. It is about getting an agreed framework on risk and return, how that is shared and, as importantly, cutting out the waste. All this defence research in the end is about getting military capability, doing a better job for the Armed Forces. It is about the process of innovation too, how good is industry and the Ministry of Defence at getting science and technology through to military capability on the frontline. I think there it is about avoiding wasted effort, killing projects off early if they are not going well, having a good process for the management of innovation and that is about learning from other industries which use other techniques alongside the one which defence has used hitherto to manage innovation more effectively.

Q113 Chairman: There is just one question which I think industry does not fully understand, namely how industry is to be incentivised to spend more on research and technology. Can you explain that?

Lord Drayson: In the end it is about the Ministry of Defence paying a higher profit margin where industry has taken a risk.

Q114 Chairman: You will get that past the Treasury?

Lord Drayson: Yes, because I think that is the basis of how innovation works in every other industry. It needs to happen within defence because we need to

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incentivise people to think for themselves about what the future threats might be, to use their brains to come up with solutions and, if they are right, and we use that technology, we bring it through to the frontline, then they are rewarded for the risk they have taken, exactly as Amyas said, it is reflected in what is the discounted value of money for the risk that they have taken and provide them with an adequate return. What that means is the Ministry of Defence has to differentiate between research that the MoD has directed and paid for, for which there is zero risk for industry, therefore a lower return, and those areas where MoD has not funded it, has benefited from industry and industry's shareholders taking a risk and for which it therefore has to pay a higher return. Yes, we have to take that through, convince the Treasury that provides value for money and I believe we can make that case effectively.

Q115 Mr Hamilton: One of the things I think is quite important, listening to what you are saying, is the number of things you have clarified in my mind, which has been very refreshing because on many occasions when we leave the Defence Committee I am still puzzled by the answers we are given and have to refer back to them all the time. Could we continue that theme that you have just finished on. In your foreword you refer to small and medium companies and enterprises, how important they are. When I have been going around Scotland and different places in the United Kingdom talking to the supply chain, I am quite shocked in some cases to find how risk averse the major companies are and how they are able to pass it on to the SMEs and they do it quite regularly. The SMEs are in a position where they cannot complain formally because they need the business and therefore they have that problem to deal with major companies. You have indicated on two or three occasions in your answers about how important the relationship is between yourselves and the larger companies and the relationship with SMEs. How do you clarify that and how are you able to ensure that small and medium enterprises are not mitigated against?

Lord Drayson: We are very mindful of that. We recognise that there is always the temptation for the big companies at the top to vertically integrate and suck out the profitability from the supply chain. Where we have this inter-dependence between us as the customer and that sector it is very important for us as a customer to have a healthy supply chain. Therefore, when we are entering into long-term agreements, partnership agreements with the prime contractors, we recognise that we need top level systems integration prime contractors in this country. The contracts we enter into have to make sure that those contractors look after their supply chain. We are doing that in two ways. One, in the contracts we judge the contractor by how well it can explain to us what its supply chain is. You would be surprised some of them are not as good as you would hope at being able to explain to you the technology tree, where does all this stuff come from and what are the key inter-dependencies. You find, when you look at these supply chains, there will be a small company

employing 50–100 people doing a very clever thing which if that company disappears your ability to do the whole thing is hugely affected. That is the first thing: do they understand the supply chain and, secondly, put in place the contractual elements to make sure that they are incentivised to fairly develop that supply chain. That is about us making it easy, as easy as we can, for people to start up a business within the defence industry. Last Friday the SBAC announced their supply chain initiative, SC21, which sets out executive guidelines. It spells out to you, "If you want to get into the defence industry as a small company this is how you go about doing it and these are the things to think about in your relationships both with the MoD as customer and with your supply chain". It is about rewarding those companies at the top for looking after the supply chain properly. It is about training, motivating and developing the teams that report to David Gould and Amyas Morse, having an understanding of the commercial structure, having an understanding of the supply chain—we need people in the MoD who understand the supply chain properly—and then rewarding good behaviour and penalising bad behaviour.

Q116 Mr Hamilton: Notwithstanding the fact that you deal with a major contractor at the time, how do you do a check to make sure that is being done?

Mr Gould: We oblige them to tell us what their supply chain is and how they are treating them. The more we move into these long-term improvement arrangements with contractors the stronger we are able to do that. The other thing we can do is in particular use parts of the research programme which we compete which give us much more information about where innovation is taking place inside the supply chain. It is not just "tell us", but it is "why are you using big company, why are you using that particular technology, why did you not choose that, what was the basis of your choice", so we become much better informed about how we do it. I certainly do find, talking to small and indeed medium sized companies, who need to innovate to get into the supply chain, to get into business with the big prime contractors, you find that when you ask them "How much of your profit do you reinvest in research and technology" the answer is much more positive, much higher levels of reinvestment in medium-sized companies than you find in the big primes. That has to be a major part of any programme or project manager's skill, in particular the support they get from the commercial staff to make sure those right questions are being asked all the way through.

Mr Morse: The only thing I would add is as to transparency, going forward we are going to be requiring transparency so we can see into our major suppliers and know that they are applying what they said to us they would do.

Q117 Mr Hamilton: You are checking it?

Mr Morse: Yes.

Q118 Chairman: It is now 12.47 and I would quite like to stop. We could ask questions about munitions but I suspect it would probably be best to

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write rather than to do that because I know David Borrow and Adam Holloway want to pursue some lines on that. We have asked a lot of questions and there are a lot of questions we will ask in writing.⁵ We are most grateful to you all for coming. I am

sorry some of you have not been cross-questioned as closely as I know you would have liked! Minister, thank you very much indeed to you and your team for an excellent session. It has been very helpful.

Lord Drayson: Thank you very much, Chairman.

⁵ See Ev

Written evidence

Memorandum from the A&P Group

INTRODUCTION

1. The Defence Industrial Strategy has important implications for the A&P Group and other UK commercial shipyards undertaking maintenance, repair, refit, conversion and life-extension activities on vessels. In particular, the arrangements made by the MoD to establish the Warship Support Alliance comprising the three former Royal Dockyards (as announced by the then Secretary of Defence on 14 February 2006) could compromise the competitive position of A&P and similar commercial companies.

2. The A&P Group regards it as important that the possible repercussive effects of the Warship Support Alliance arrangements are given full consideration, including recognition that the search for value for money and optimum industrial performance from the marine sector as a whole might thereby be put at some risk.

3. This memorandum is intended, by highlighting these concerns at this stage, to assist the work of the Committee as it continues to enquire into how the maritime aspects of the Defence Industrial Strategy are being implemented.

BACKGROUND

4. A&P is the largest provider in the UK of commercial ship-conversion, ship-repair and ship-maintenance services, with its main facilities on Tyneside and at Falmouth.

5. A&P has been undertaking annually for some years a range of major refit, upgrading and life-extension projects for MoD on Fleet Auxiliary vessels. This represents a significant part of its business activity and of its total turnover.

6. It has also undertaken some work on warships both in its own right and as sub-contractor.

ISSUES

7. The White Paper on Defence Industrial Strategy published in December 2005 identified key capabilities required to support UK's Armed Forces and stated that "Core Work Load" arrangements would be agreed for the primary contractors engaged in warship maintenance and repair. The aim would be to ensure a level of allocated throughput which would provide a commercially viable basis for sustaining key capabilities.

8. For that purpose a Warship Support Alliance comprising the three former Royal Dockyards (Babcock at Rosyth, DML at Devonport, and FSL at Portsmouth) was established in early 2006 to handle future warship maintenance and support.

9. The potential effects of creating this Warship Support Alliance are matters of concern to A&P and other UK commercial companies undertaking ship-conversion, ship-repair and ship-maintenance activities.

CONCERNS

10. First, past experience of allocated programmes to maintain workload in the ex-Royal Dockyards is that the financial underpinning in such arrangements can lead to a situation in which the Alliance members will possess, and exercise, an unwarranted competitive advantage in bidding for other work (eg RFA refit work).

11. Second, any problems encountered by MoD in providing the agreed Core Work Load on a continuous basis might lead to pressure to allocate RFA etc work non-competitively to the members of the Alliance.

12. Third, any such detrimental effects on the business viability of A&P and other commercial shipyards could impact on the continuing capability to provide MoD with the current well-established and well-regarded support for RFA vessels (which form a key part of operational support to the Royal Navy).

IMPLEMENTATION

13. It is important that these possible repercussive effects are understood and debated before the industrial and commercial terms and conditions relating to the operations of the Warship Support Alliance, and their part within the MoD's total procurement arrangements relevant to shipyard activities, are finalised.

14. In practical terms, matters which need to be addressed, in particular include:

- How will MoD ensure that the terms for business negotiated with the Warship Support Alliance do not confer an unwarranted competitive advantage on the three former Royal Dockyards in bidding for other non-warship work (eg refit, maintenance and repair of RFAs and other marine support vessels)?
- What steps will MoD undertake to “police” bidding by members of the Alliance to ensure that there is no cross-subsidy of other work?
- Will MoD confirm its intention that, for all future requirements for refit, maintenance and repair of RFAs and other marine support vessels, competitive tenders will be sought from suitably qualified UK commercial shiprepairs?
- Will MoD provide an assurance that no non-warship work (such as refit, maintenance and repair of RFAs and other marine support vessels) will be allocated, without full competitive tendering, to members of the Alliance?
- Is it the MoD’s intention that the establishment of the Warship Support Alliance should create a monopoly for maintenance and support for warships?
- If not, what opportunities does MoD intend to provide for shipyards outside the Alliance to compete, in a demonstrable search for value for money, for refit and repair work on warships?

15. We believe that clarification of this kind forms an essential part in establishing a sound and proper basis for ensuring effective industrial support for the Royal Navy and for serving the taxpayer’s interests.

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Memorandum from the Society of British Aerospace Companies (SBAC)

1. SBAC welcomes the opportunity to contribute to the House of Commons Defence Committee on the implementation of the Defence Industrial Strategy (DIS).

2. Over the 11 months since the DIS was published the Ministry of Defence (MoD) has maintained a fast pace in launching initiatives under its two year implementation programme. The determination of Lord Drayson and his senior level team to drive this change programme forward continues to impress, and SBAC have remained supportive of the effort to achieve the DIS goals. MoD has also continued to talk to industry extensively, through the National Defence Industries Council and a range of other channels, including direct meetings with SBAC.

3. In the first half of the year SBAC was principally concerned to understand how MoD would go about the implementation process and what effect this would have on its relationships with industry. As the year has progressed MoD has taken a range of significant steps on the implementation path. The key developments have been:

- The publication of the Enabling Acquisition Change Report and launch of the Enabling Acquisition Change Programme.
- The accompanying announcement that the Defence Procurement Agency and Defence Logistics Organisation would be merged.
- The appointment of Amyas Morse, from outside MoD, to take up the new post of Commercial Director for MoD.
- The conclusion of the first long-term partnering agreement with industry, on rotorcraft with Agusta Westland.
- The publication of the Defence Technology Strategy.

4. These steps are the highlights of a broader picture of change, much of which has been enabling or incremental in nature. For example, Lord Drayson announced the Team Complex Weapons at the Farnborough Airshow in July, which presages a long-term partnering agreement in the guided weapons sector; this is a very positive step forward with MoD and Industry working in partnership to achieve the agreement over the coming months. Another example is the good progress on the Armoured Fighting Vehicle Partnering agreement with BAE Systems.

5. Given the scale of the change programme being undertaken at MoD, it is inevitably still early to make considered judgments about the output of the reforms launched by the DIS. A great deal more work remains to be done and a coherent picture of a changed approach has yet to emerge. Industry still expresses concern about different messages coming from different parts of MoD. But industry also accepts that it must play a part in delivering the DIS, and intensive discussions continue in many areas, including for example a range of sectoral negotiations (eg in the naval industry sector), the SBAC’s own initiative on supply chain excellence (SC21) and the support signalled by industry on the Defence Values for Acquisition. SBAC believes it is essential that the DIS succeeds if the Armed Forces are to be supported effectively in the future, and that the UK industrial base is to remain important in providing that support and bringing a significant benefit to the UK economy.

6. SBAC therefore remains keen to support the implementation of DIS. In doing so, it believes a number of key issues must be resolved if the implementation programme is to deliver the changes the DIS, and now the Defence Technology Strategy (DTS), propose. These are as follows:

6a Impact of the Comprehensive Spending Review

There is concern in industry as to whether the resources will be made available in the Comprehensive Spending Review to enable the MoD to sustain its overall programme and, in particular, to sustain sufficient research, technology demonstration and procurement spending to support the Armed Forces of the future. With the strategy in place and implementation underway, it is absolutely crucial that sufficient funds are made available to the department to ensure that the value of the DIS is fully realised. Not least because this is a time when there are understandable pressures on the department to make funds available to operations. In the areas of research and technology, there is a need for clearer benchmarks that identify the level of resources that are needed.

6b Promoting more investment in new technology

Despite the publication of the Defence Technology Strategy (DTS), there still appears to be a gap in understanding between Government and industry as to the incentives needed to achieve greater industry investment in support of defence technology programmes. The DTS does not give a picture which is sufficiently complete for industry to make investment decisions. Greater transparency on how research and technology investment will flow through to procurement and how Intellectual Property Rights will be protected are areas where greater clarity is needed. The “National Aerospace Technology Strategy” cuts across both civil and defence aerospace investment. However, investment in the strategy has been largely sourced from the DTI research technology programme. There is an opportunity for MoD to align its investment along the lines of this already agreed strategy.

6c Innovation

Innovation and problem-solving for our hard-pressed Armed Forces is a vital issue. Both government and industry want to promote greater innovation in the supply chain, and to encourage the involvement of SMEs, especially from outside the defence sector. The best way to achieve this end remains under discussion; SBAC supports the willingness of MoD to consider radical measures if a genuine change of culture is to be achieved, but some skill will be needed to strike the right balance.

6d Partnering

The MoD is clearly still working on its models for long-term partnering agreements and through-life capability planning. Industry wants to contribute constructively to that process. These agreements will affect the industry as a whole, not just the partners involved. It is therefore critical that the principles underpinning the agreements should be transparent to all. The recent MoD publication “Capability Management Guiding Principles” is an excellent example of the proactive work that MoD has been doing, where it has actively consulted and involved industry. A similar paper giving Guiding Principles for Partnering could be a good way to define generalised model(s) for partnering. Such a “Blueprint” would be helpful in showing what partnering relationships should look like and might also help speed up the MoD’s internal processes for addressing sectoral partnering arrangements.

6e Supply chain relationships

If DIS is to succeed it will also be important to gain the confidence of the whole supply chain. The SBAC’s 21 Century Supply Chain (SC21) initiative, which aims to achieve a modernised UK supply chain, that encourages innovation pull through, better relationships and better through-life capability management has an important role to play in contributing to the MoD’s aims. Key to success in this area will be to establish clear measures of success and failure that both industry and MOD can sign up to and a robust mechanism for dealing with problems in an effective but flexible manner.

6f The international dimension

The DIS has considerable implications for UK co-operation on acquisition with key partners, especially the USA and major European countries. At this stage the effect of the DIS on these relationships remains one of the least well articulated aspects of the DIS and one on which engagement between Government and industry is relatively limited.

6g *The DIS vision*

The key question for industry is what MoD will look like in 10 years time as a result of implementing DIS. Industry needs to have sight of MoD's vision, as the "customer" of where it is going and how it sees the future state of the UK defence industrial base through the DIS, to enable it to meet the changes and challenges of DIS and ensure that it fulfils the future needs and requirements of the armed services. The relationship between defence and security is another interesting aspect looking forward, reinforcing the need to understand better the interaction between civil and defence technology development. Greater exposure to government's thinking would therefore be welcome.

7. SBAC is committed to engage with MoD, other Government Departments and the rest of industry to making progress towards a coherent and comprehensive overall implementation of the DIS during 2007. In the meantime we would welcome a further contribution from the Committee to help create the right climate for a productive debate and an active resolution to the difficult issues outlined in this Memorandum.

1 December 2006

Memorandum from the Defence Manufacturers Association (DMA)

BACKGROUND

In giving evidence to the Committee in January on the newly published Defence Industrial Strategy (DIS), the DMA welcomed it and noted that implementation would be critical.

We noted a number of issues that were key to this implementation. These, and others, are addressed below.

The overall position on implementation can, probably, be fairly summed up as follows. There has been a considerable amount of work done, studies embarked upon, plans for organisation change made. Some partnership arrangements have been agreed. Industry has been offered unprecedented involvement in this work and activity. However, measurable progress and achievement is more elusive, albeit some of the measures proposed in the Enabling Acquisition Change Programme (ACP) are profound in their implications for the way business will be done in the future.

A concern considered even by the MoD itself, and expressed by Industry, is whether the changes envisaged are too much to manage, whilst fighting two major campaigns, without damage and delay to routine acquisition business—it is too early to judge.

BUDGETARY/FINANCIAL PLANNING CHANGES

The intention to streamline IAB and Approvals procedures (only the most significant projects will be submitted to the IAB in future but there will be increased scrutiny for these, including an external "due diligence" review) is welcome and highly significant. This could lead to increased delay, prior to Main Gate Approval, for the largest projects, hopefully compensated for by less delay/cost overrun downstream. Meanwhile any improvement in the Approvals process for lesser projects will depend on the degree and level of delegation of authority and streamlining of bureaucracy. The detailed plans for this have yet to be seen.

The intent that the IAB should, in future, consider future support costs in their deliberations is also welcome and essential if the through life costs of capability are to be effectively managed.

DATA

A major problem facing the MoD (and, indirectly, Industry), in trying to implement these changes is a lack of data. This is an acknowledged limitation. Much data is available but it is dispersed, fragmented and not available in useable form. For example, central MoD, generally, can identify how much money it has spent overall on buying spares. What it does not easily know is how many of them have actually been used, or indeed, for spares that have application on more than one platform, which ones they have been used on. Similarly, manpower costs for maintenance are not easily attributed. Thus establishing true running costs for in-service equipment, for comparative purposes, is notoriously difficult. Much of the relevant data also lies with Industry and there is a concern that companies will incur costs in providing it to MoD. Much work is necessary in this area if aspirations are to be met.

DE&S

The plan to create DE&S is, again, a welcome and sensible move in trying to eliminate the stove piping of acquisition and its through life support. We note, and are somewhat reassured by the determination of CDP and CDL not to allow the re-organisation to disrupt business with Industry—we keep our fingers crossed.

One key DE&S question that has not been satisfactorily made clear, yet, is the role of the three three-star officers. The Committee might help here.

SKILLS/TRAINING

The skills issue will continue to be a problem at many levels especially for commercial and technical staff. A sensible initiative is proposed for more MoD/Industry joint, post-graduate level courses (and others) to be held at Cranfield on defence acquisition issues. This is welcome but is likely only to attract industrial attendance from the larger, better resources companies.

DEFINITIONS/METRICS

Our earlier input noted an important need for agreed definitions between MoD and Industry of concepts such as “operational sovereignty”, “value for money” and “metrics to validate success”. Agreement and clarity is still elusive, although we applaud Lord Drayson’s success on securing agreement with the US on JSF source codes. This suggests that, although “operational sovereignty” is hard to define, we can recognise it when we see it!

ACCESS TO MARKET/SUPPLY CHAINS/SMEs

Considerable joint discussion has gone on, reference made and working groups set up, to consider these issues. Progress has been slow but we have recently made proposals to the MoD which we believe could help, albeit they would require a few additional, or a re-brigading of, staff within the MoD to be implemented effectively. MoD’s plans for the future of the Defence Diversification Agency might provide a source of staff effort.

RESEARCH

The DMA welcomed the publication of the Defence Technology Strategy. It is a helpful document, albeit Industry is convinced that, without a real increase in MoD research investment, many of its aspirations will remain unfulfilled—a point we made to the Committee in January.

SUMMARY

Concern has sometimes been expressed from time to time about the fate of the DIS and ACP were Lord Drayson to move on. We do not share this concern with regard to the ACP; it has considerable momentum and “top of the shop” support. Of more concern is whether key (for Industry) elements of the DIS, as reflected in hundreds of day to day decisions made in IPTs, DECs, etc, will be lost in the overarching changes and restructuring of the ACP.

14 December 2006

Memorandum from QinetiQ

INTRODUCTION

QinetiQ welcomes the broad thrust of the way the DIS is being implemented, in particular the key themes of ensuring innovation in defence capabilities and creating an agile industry base through open acquisition supply chains that have been developed since the publication of DIS. The emphasis on architecting and on the MoD establishing relationships that extend below the “platform prime” is commended, although we note there is still much detail to put in place. Defence industry has also evolved since publication, and there has been a step change increase in dialogue within the sector which we expect will, in time, create the richer “partnering” climate that DIS is encouraging.

However, QinetiQ remains concerned that the extent of increased funding needed for defence research is still not recognised, and our main contribution is on this point.

ABOUT QINETIQ

QinetiQ is the UK's second largest defence and security company, one of Europe's largest employers of scientists and a leading organisation in technology transfer. Over the past 50 years QinetiQ and its predecessors have built up significant intellectual capital and expertise in innovation. We exploit our strengths in technology research, evaluation and management by delivering solutions into a broad spectrum of defence, security, transport and related markets. We have delivered such technological advances as liquid crystal displays, carbon fibre and thermal imaging into both the civilian and military sectors.

Our 11,400 staff are continuing our commitment to pushing forward the boundaries of innovation in scientific and technological knowledge and in the provision of first class managed services to customers including the Ministry of Defence, US Department of Defense, National Audit Office and Highways Agency, as well as private companies.

THE NEED FOR INCREASED DEFENCE RESEARCH

1. It is now widely accepted that the combination of competition for resources and the stress of climate change will make the world less stable and predictable. The United Kingdom will need both industrial and military strength to maintain prosperity and resist buffeting. The Government's policy is to have small but highly effective military forces to preserve freedom of action for the UK. This is well judged because people under arms are people removed from our productive industrial base. With a high and growing GDP per head, the UK pays a higher industrial opportunity cost per serviceman than many nations, and this opportunity cost will grow with increasing UK prosperity.

2. Having good equipment is key to the Government's strategy. More than 50% of the UK's defence costs is allocated to the purchase, maintenance and deployment of equipment. The major nation with still higher GDP/head, the USA, goes even further. As with industrial investment to increase productivity, equipment investment goes hand in hand with ever higher skills and training.

3. This is an issue for the economy as a whole. Besides the manpower issue, there is the possibility, best demonstrated by the USA, of using defence innovation to seed technology into the wider industrial base. Defence is a necessity, but it can contribute to virtue.

4. It is clear that these issues are central to the future of the UK, but how far should the nation go down this track of investment in defence quality?

5. We suggest that the answer lies in considering a few basic principles, then directing the MoD in the context of a wider national policy which recognises that defence can contribute to national industrial innovation. The MoD has researched this question and, unusually, has published important research findings to allow them to be subjected to academic scrutiny.¹ It perhaps foresaw that the issue would become one for Government and not a single department and that, without wider debate, it would be asked to address a problem insoluble without increased resource.

6. The principles are these:

- (a) Do we accept the proposition that defence can be achieved through "smaller, smarter forces"? It appears to make economic sense in a nation with high industrial productivity, and it has been repeatedly demonstrated in the military sense as well. The need to use manpower efficiently will apply just as much to the urban scenarios we currently face as it does to the historically more conventional conflicts.
- (b) Do we accept that modern defence has many of the characteristics of modern enterprise; that defence can also offer "productivity" by investment in equipment, skills and training? It appears an obvious parallel.
- (c) Do we accept that, as with the industrial parallel, the outcome of competition or conflict is determined not by the absolute quality of equipment and skills, but by how much better it is than the competition? Again, few doubt this to be true. It's not about "doing a job"; you have to win, in competition or in conflict.
- (d) Has a new post cold-war military norm been established in Iraq, Afghanistan and the daily experience of Israel? Instead of anticipating conflict with the big "cold war" players such as the Soviet Union and China, or their close allies, will the UK in future predominantly face opponents armed by major exporting nations? This is the key question. If this is the case, then it inevitably leads to a policy of increased investment in defence R&D.

¹ Middleton A, Bowns S *et al* (2006) *The effect of Defence R&D on Military Equipment Quality*, Defence & Peace Economics April 2006.

- (e) The quality of military equipment available for export by non-NATO countries is set to rise dramatically over the next 10 to 20 years. The rise of China is perhaps the clearest example, but China is not alone. By 2020 the MoD expects Chinese military equipment to be of the same quality of European equipment. An arms race is unhelpful, and the USA, as the manufacturer of the best military equipment in the world, is careful to sell (even to close allies) only what the purchasing nations could make for themselves or buy elsewhere. China faces a quite different set of political imperatives: it might become the major non-western arms-exporting nation before 2020.
- (f) If the UK does not increase investment in military equipment quality, or find a more efficient approach to investment, it will lose the quality advantage it currently enjoys and will be less able to exert influence. Consequently, to preserve the existing level of military capability, the UK will have to spend more. In fact, we have to do better just to maintain competitive advantage. This is the Government's dilemma; it is expected to deliver "security" with costs rising no more than inflation, but it faces underlying drivers more in line with GDP growth. The difference between Defence and government departments delivering a normal service is that Defence is about international armed competition (conflict), not delivering a monopoly service.
- (g) UK military equipment quality in 2020 will be predominantly determined by what the UK MoD is currently spending on R&D. With delays between R&D expenditure and military equipment quality being 10–25 years, we either invest now or forgo the option of maintaining UK's qualitative military advantage.
- (h) Defence requirements look set to continue to change as the uncertain strategic context unfolds, and this means a broad range of options need to be sustained for rapid application to problems as they arise. Failure to maintain access to capabilities will constrain the UK's ability to respond in time.

7. This analysis takes you to a substantially higher expenditure on UK military R&D in order to continue to have "smaller, smarter, forces", and the agility to respond to uncertainty. The amount of additional expenditure can be calculated by predicting who will be important exporters and how good their equipment will be. The "how much" question is very much one for debate, but if one accepts the arguments above, it is clear we are spending substantially too little on defence R&D.

8. In the opinion of QinetiQ, to maintain the option to have "smaller, smarter forces" the UK must reverse the long-term decline in defence R&D. This requires an increase in both near-horizon and far-horizon research. Research in both timeframes has declined over the last two decades. Work is underway jointly between MoD and Industry to consider the barriers and incentives to industrial investment for near-horizon research, but long-term investment must be the prerogative of Government. Whether the investment is made direct by Government, or indirectly through accepting higher profit margins on supply contracts to incentivise this activity, the equivalent of some £250 million is required to maintain our competitive position. This is not an affordable option for MoD within its current budget. It cannot realistically reduce support to Afghanistan now, to preserve a future option for a future Afghanistan, and has no way out.

9. This issue arises at a time when UK is seeking better ways to couple its highly successful academic base into its industrial base to enhance national competitive advantage. The government has substantially increased investment in academic research but, as the CBI Innovation study notes, it needs a greater focus on activity which couples science at low technology readiness levels into manufacture, across an "investment chasm". This is, of course, the zone on which much of the MoD's research is focussed, and a still greater fraction of the USA defence budget.

10. Defence is one of the few government departments with a strong capability to manage the risk inherent in applying advanced technology to immediate problems. In the USA, this strength is deliberately harnessed through companies active in several markets. Defence funds technology maturation and its early use drives down unit costs. The technology then finds its way into the wider industrial base through these multi-market suppliers, as it does in USA aerospace, computing, information technology and electronics. To reiterate a point, there is a means of making a UK necessity into a virtue.

22 December 2006

Memorandum from the Ministry of Defence

SUMMARY PROGRESS REPORT ON SIGNIFICANT DIS MILESTONES: AS AT 19 DECEMBER 2006

<i>DIS Commitment</i>	<i>Milestone</i>	<i>The Current Position</i>
<p>MARITIME (1) <i>We will immediately start negotiations . . . to achieve a programme level partnering agreement with a single industrial entity for the full lifecycle of the submarine flotilla.</i></p> <p><i>This will be matched by the implementation of a unified submarine Programme Management organisation within the MoD.</i></p>	<p>For the award of the contract for the fourth and subsequent Astute class submarines.</p>	<p>Ongoing</p> <p>Engagement with industry continues, and Industry has come to terms with the need to collaborate. We are now beginning to see some promising movement on a multilateral basis.</p> <p>A Joint Venture (JV) or Alliance would be acceptable subject to satisfactory arrangements and a commitment to continuous efficiency improvements.</p> <p>Achieved</p> <p>Since April 2006 submarine program management within MoD has been unified under Director General Nuclear, who is responsible for managing delivery of the submarine program from concept to disposal.</p> <p>Under DE&S, DG Nuc will be succeeded as an organisational unit by DG Submarines.</p>
<p>MARITIME (2) <i>For surface ship design and build, we aim within the next six months to arrive at a common understanding of the core load required to sustain the high-end design, systems engineering and combat systems integration skills . . .</i></p>	<p>Within six months from publication</p>	<p>Ongoing</p> <p>Good progress has been made in developing a coherent view of loading on the industry, which is an essential first step.</p> <p>We now need a more detailed skills analysis to ensure that we maintain the key capabilities we need. We will be working this out with the companies concerned in the first quarter of 2007.</p> <p>This complex analysis covers the surface ship, submarine and support programmes. We can then identify the Core Work Load which will sustain key skills and facilities (the Key Industrial Capabilities), both at platform and key equipment level.</p>
<p>MARITIME (3) <i>For surface ship support, we will start immediate negotiations with industry with the aim of exploring alternative contracting arrangements and the way ahead for contracting the next upkeep periods, which start in the autumn of next year. Key maritime equipment industrial capabilities will be supported by the production of a sustainability strategy for these key equipments by June 2006.</i></p>	<p>June 2006</p>	<p>Achieved</p> <p>The Department has moved forward quickly with the three dockyard companies (Babcock Support Services Limited, Fleet Support Limited and Devonport Management Limited) to put alternative contracting arrangements in place. To assist this process, competition policy has been suspended (an exclusion order to the 1998 Competition Act was tabled by Department of Trade and Industry on 8 March 2006 and came into force on 4 April 2006).</p> <p>Contracts were awarded for the five upkeep packages in October 2006 and work started shortly</p>

<i>DIS Commitment</i>	<i>Milestone</i>	<i>The Current Position</i>
FIXED WING (1)	<i>... we will work with BAE Systems and the other companies in the defence aerospace sector so that it can reach the appropriate size and shape for demand ... we aim during 2006 to agree the way ahead—which will be challenging given the scope of the scale of the transformation that is required—and to implement it from 2007.</i>	Agreement of LTPA in 2006. Implementation from 2007 onwards
FIXED WING (2)	<i>... we intend to move ahead with a substantial Uninhabited Aerial Vehicle Technology Demonstrator Programme in 2006.</i>	In 2006
AFVs	<i>We will be working hard with BAE Systems ... to give effect to the long term partnering arrangement ... We intend to establish a joint partnering team within the early part of 2006 and to</i>	Early part of 2006

afterwards. These projects will be managed through the exploratory phase of the new Surface Ship Support Alliance (SSSA) announced by the Secretary of State on 14 February 2006. Discussions have started with the Dockyard companies on the workshare of the next batch of upkeep packages, which are due to commence in spring 2007, starting with HMS GLOUCESTER. In addition, MoD and the three dockyard companies signed a Memorandum of Understanding (MOU), a non legally-binding document, in September 2006.

Ongoing

We remain on course to reach agreement and implement a full Long Term Partnering Agreement (LTPA) by the end of 2007. Earlier this year the teams agreed the aims and objectives of a possible future LTPA—a framework for taking the project forward. We are now close to reaching agreement on the terms of a Foundation Contract aimed at de-risking the key component parts of the LTPA, provide confidence to both parties and inform detailed negotiations ahead. Over the coming months a key strand of this work will address the implications of any possible LTPA deal on the Company's supply chain and the wider defence fixed wing sector as we recognise that many of the underpinning skills and technologies reside across a wide range of defence aerospace companies.

Achieved

We awarded on 7 December a contract for a programme to build an experimental Unmanned Air Vehicle. "TARANIS", This is a jointly funded Technology Demonstrator Programme (TDP) between MoD and a BAE Systems led industry team comprising Rolls Royce, Smiths Industries and QinetiQ.

Achieved

An AFV Partnering Agreement between MoD and with BAE Systems Land Systems was signed on 15 December 2005 and a Joint MoD/BAES LS Partnering Team has been established in Andover.

<i>DIS Commitment</i>	<i>Milestone</i>	<i>The Current Position</i>
		<p>A Joint Business Plan has been developed that identifies the issues facing the Sustainment of industrial capability in the AFV Sector and proposes a strategy for addressing them.</p> <p>BAES LS have commenced rationalisation of their business in order to reduce their cost base and detailed transformation plans have been developed to enable them to move towards the through life capability management of the current AFV Fleet as required by the Partnering Agreement.</p> <p>Significant achievements include delivery of the FV 430 BULLDOG against challenging delivery schedules with very positive and encouraging user feedback received on current operations.</p>
HELICOPTERS	<p><i>We hope that by the Spring 2006, subject to value for money having been demonstrated, we will have reached agreement on a Strategic Partnering Arrangement (SPA) . . .</i></p>	<p>Spring 2006</p> <p>Achieved</p> <p>A Strategic Partnering Arrangement (SPA) and contractually-binding Business Transformation Incentivisation Agreement (BTIA) were signed with AgustaWestland (AW) on 22 June 2006 to drive forward business transformation across the full spectrum of the MoD/AW relationship.</p> <p>These agreements enshrine the demanding partnered relationship envisaged by the DIS and include challenging measures and targets to maintain effective business transformation both within AW and the MoD.</p> <p>The BTIA provides opportunities for the company to secure bonus payments for performance improvements and default payments, retained by MoD, if the company fails to improve performance.</p> <p>This balance of challenge and opportunity is key to driving the changes necessary across all our transactions with AW and ensuring the effective through-life support for those elements of our existing helicopter fleet for which AW have a Design Authority role.</p>
COMPLEX WEAPONS	<p><i>We [will establish] a multi-disciplinary team charged with working with all elements of the onshore industry to establish how we might together seek both to meet our ongoing requirements and sustain in an industrially viable manner the critical guided weapons technologies and through life</i></p>	<p>Mid-2006</p> <p>Achieved</p> <p>At Farnborough in July Minister(DP) announced the formation of Team CW, consisting of MBDA UK, Thales Air Defence Ltd, Thales Missile Electronics, Roxel and QinetiQ, and announced the intention to develop a Strategic Partnering Agreement (SPA) between the MoD and Team CW by the end of 2006.</p>

<i>DIS Commitment</i>	<i>Milestone</i>	<i>The Current Position</i>
	<i>support capabilities that we judge to be so important to our operational sovereignty . . . Our intention is that we should have a clearer way ahead by mid-2006.</i>	<p>Work to deliver this is making positive progress but it is now unlikely that we will be in a position to conclude negotiations, particularly relating to the finalisation of legally-binding performance measures and commitments, by that time.</p> <p>However, we have made significant progress in defining the agreement with the aim of delivering military capability, while sustaining indigenous industrial capabilities, achieving VFM, and delivering industrial transformation in the sector.</p> <p>Our work in examining options for the delivery and support of underwater weapons is making similarly positive progress.</p>
GENERAL MUNITIONS	<i>We will be taking forward Project MASS, with a view to making decisions on how best to sustain our required access to general munitions in the summer of next year . . . We are also actively pursuing partnering arrangements with other [non BAES] suppliers.</i>	<p>Ongoing</p> <p>We are working closely with BAES LSM to rationalise its general munitions manufacturing capacity at its Bridgewater and Chorley sites, to improve efficiency and transform their business model to create a viable future for general munitions production in the UK. Project MASS is progressing well towards its main decision point. We have agreed a partnering arrangement with Chemring Countermeasures for the future supply of pyrotechnics. A General Munitions and Energetics Technologies Steering Group has been established with industry to deliver DIS and DTS commitments effectively for all general munitions, warheads and rocket motors.</p>
RESEARCH AND TECHNOLOGY (1)	<i>We will [complete] the ongoing Science and Technology Capability Study . . . by Summer 2006.</i>	<p>Achieved</p> <p>Published as “Maximising the Benefit of Defence Research” on 3 October 2006.</p>
RESEARCH AND TECHNOLOGY (2)	<i>We will conduct further work better to understand the underpinning technologies that the UK must have . . . by Autumn 2006.</i>	<p>Achieved</p> <p>Completed with publication of the Defence Technology Strategy, as the output of this action was subsumed into that document.</p>
RESEARCH AND TECHNOLOGY (3)	<i>We will by mid-2006 update our Defence Technology Strategy</i>	<p>Achieved</p> <p>Completed. The Defence Technology Strategy successfully launched by Minister for Defence Procurement on 17 October 2006. Media and industry reception has been broadly positive.</p>
RESEARCH AND TECHNOLOGY (4)	<i>We will develop a better understanding of the innovation process and map out the technology trees for major capabilities, systems</i>	<p>Ongoing</p> <p>Final NDIC R&T sub-group report will be published early in 2007.</p>

<i>DIS Commitment</i>	<i>Milestone</i>	<i>The Current Position</i>
		<i>and platforms in a report, which we aim to produce by the Autumn of 2006.</i>
INTERNAL CHANGE (1)	April 2006	Achieved The Defence Values for Acquisition are being embedded across the Department and within industry. The DVfA underpins work to take forward DACP.
INTERNAL CHANGE (2)	First half of 2006	Achieved We have launched two Pathfinder programmes this year: Sustained Maritime Combatant Capability (SMCC) and the Sustained Armoured Vehicle Capability (SAVC) led by the MoD but with significant industrial input. Both are expected to complete their work for the April 2007 deadlines.
INTERNAL CHANGE (3)	April 2006	Achieved The DACP People, Skills and Behaviour (PS&B) workstream is focusing on cultural and behavioural change. An initial skills audit was completed in June 2006. Skills Champions have identified the skills gaps across the MoD and have developed Skills Growth Plans which will propose specific actions to reduce or remove these skills gaps. In June 2006 we appointed the Defence Commercial Director and established a single senior official responsible for leading on commercial policy and strategy and to act as head of profession and Skills Champion for the entire MoD commercial function. Options and opportunities for joint commercial skills training, particularly in the area of partnering, are now being actively explored with industry.
INTERNAL CHANGE (4)	October 2006	Achieved A package of HR Freedoms & flexibilities, including recognition and reward measures is being formulated to create the right incentives and behaviours within the new organisation and across MoD.

<i>DIS Commitment</i>	<i>Milestone</i>	<i>The Current Position</i>
INTERNAL CHANGE (5)	<i>The DPA will be piloting the operating framework during 2006, working in conjunction with the other areas of acquisition to ensure consistency and alignment.</i>	During 2006
		Achieved The DPA has completed development work regarding the Project and Programme management element of the operating framework, drawing on industry best practice. Over the coming months the Acquisition Operating Framework (AOF) structure will be subject to a number of design reviews. Initial role out of the AOF has been brought forward from September 2007 to April 2007 to align with DACP targets.
INTERNAL CHANGE (6)	<i>We will review—so that we are in a position to make judgements about this by May 2006—the extent to which the current process and organisational construct supports, encourages, hinders or obstructs the delivery of excellence in acquisition. This would allow us to commit to changes that are required this side of the summer recess.</i>	May 2006
		Achieved The EAC report was published in July 06 and implementation is progressing well. The report made a wide ranging set of recommendations. It is being implemented through the Defence Acquisition Change Programme.
INTERNAL CHANGE (7)	<i>We are looking forward to discussing further with Industry—in the first instance through the commercial policy sub-group of the NDIC early in the New Year—our ideas about alternatives to competition as a means where appropriate of assessing value for money, with a view to developing a concrete action plan for taking them forward.</i>	Early in 2006
		Ongoing Interim guidelines have been established for a through life approach, and action taken to put in place a joint MoD and industry code of conduct. A Key Supplier Management initiative has been developed with a comprehensive analysis of market drivers and behaviours planned to start in January 2007.
INTERNAL CHANGE (8)	<i>We will start with immediate effect, to deliver on our revised policy of providing industry with a better and longer term understanding of our future plans.</i>	Immediately
		Achieved Besides the increased openness in the DIS itself, we have already run several briefings to industry setting out more detail of our forward plans. Lessons identified from these have informed guidelines on the conduct of information release to embed the revised policy into normal business, and these will be discussed with industry early in the new year.

Letter from the Secretary of State for Defence to the Chairman

UK MARITIME INDUSTRIAL STRATEGY

As the first anniversary of publication of the Defence Industrial Strategy approaches, I wanted to update you on the situation regarding the future of the UK maritime sector, particularly in respect of industrial consolidation.

The progress that has been made toward industrial consolidation in the maritime sector has been disappointing. The lack of substantive progress is a direct reflection, I believe, not only of the complexity of the task but also because industry is enjoying a period of high workload from MoD's current shipbuilding and submarine programmes and does not feel a strong sense of urgency to implement the necessary changes. Industry needs to be realistic about MoD's future orders because beyond the very healthy programme prospects of the next five to 10 years, and after the peak of activity on the new aircraft carriers, the market will get smaller. I am determined to press home the need for managed reform with industry in order to improve efficiency and productivity and avoid a very difficult situation in 10 years time.

Maritime industrial facilities in the UK in both the submarine and surface ship sectors remain fragmented. What we are seeking from industry are innovative proposals that deliver performance improvement benefits to the MoD and the tax-payer, from an industry with a well-motivated leadership and with an incentive framework which drives a dramatic improvement in the efficiency of the business. Efficiency improvements would also greatly improve the prospects for export-led work on a commercial basis.

Industry has recently begun to show signs that it is coming to terms with the need to collaborate, and we are now seeing some promising movement on a multilateral basis. However, we are clear that financial engineering and mergers and acquisition activity will not achieve this on its own. The challenge is to ensure that consolidation results in improvement in performance. We will encourage and support proposals which add value, truly transform the business and deliver the substantial performance improvement the sector needs.

Fundamental to the success of this Maritime Industrial Strategy is the shipyards' ability to work together. The progress which has been made by the Future Aircraft Carrier Alliance has shown how industry can do this, and I see this as a "road test" for the behaviours we are seeking within a wider shipbuilding and ship support collaboration. Fundamental also, is the way in which MoD operates and provides leadership as the customer. With this in mind, I am reforming the way in which the MoD operates, how it is led and how it transacts with industry. From April 2007, MoD's new Defence Equipment & Support organisation will take the best practices from the DPA and DLO to create a single entity responsible for procuring, maintaining and sustaining military equipment capability. The MoD is also improving its financial planning, in particular by ensuring that new equipment and its in-service support costs are planned more coherently. The recently appointed new Commercial Director will lead in shaping the Department's relationship with industry and our future strategic commercial arrangements.

I am keen that these issues are clearly understood by all those with an interest in the UK maritime industry. My aim is to communicate clear and consistent messages to all; the management of the companies concerned, the Trades Unions; those within the MoD and the Armed Services; across Government; and in Parliament. I would be happy to explain further should you wish, and to meet to discuss if you would find that helpful.

16 November 2006

Letter from the Secretary of State for Defence to the Chairman

Thank you for your letter of 15 December about the signature of the Memorandum of Understanding (MoU) with the US government on the next phase of the JSF programme.

The MoU came into effect on 31 December 2006 and I enclose a copy for your information. A copy will also be placed in the Libraries of both Houses. I should explain, however, that the MoU sets out the general framework and the nature of the specific assurances provided by the US are contained in a separate highly classified bilateral supplement to the MoU. This supplement, which the Department has spent the last year negotiating with the US, details the specific areas of information which are critical to the delivery of operational sovereignty. Due to the nature of the arrangements set out in this supplement and its classification, I am not able to release it to the Committee.

In signing this document, the Department has had due regard to the roles it requires industry to play in delivering operational sovereignty. The assurances contained within the supplement provide for the transfer of the information required for UK industry to deliver those aspects of support and upgrade that we have set out as essential to delivering operational sovereignty throughout the life of the JSF programme. Within the JSF Industry team, agreements are also in place that recognise the key role to be played by UK companies in the programme, not only in delivering operational sovereignty for the UK but also to provide support services for the nine partner nations aircraft which will total around 3,000 aircraft.

As Lord Drayson testified to the Committee on 19 December, this agreement will provide us with the technology which we need to achieve our operational sovereignty requirements. The important thing as we move ahead is to maintain the forward focus in terms of the technology transfer as we go through the development of the aircraft.

6 January 2007

Supplementary memorandum from the Ministry of Defence

HCDC FOLLOW-UP QUESTIONS

(Q) The DMA considers that without a real increase in the MoD's research investment many of the aspirations in the Defence Technology Strategy will remain unfulfilled. How much defence research investment does the MoD think is needed to deliver the aspirations set out in the Defence Technology Strategy?

(A) The Defence Technology Strategy is affordable within the current research budget provided that both MoD and industry invest to develop and sustain the necessary technology base. The Defence Commercial Director will work with the Defence Industries Council to develop research funding models which allow a better match of risk and return for industry, and provide a basis for joint funding of technology development. The key tasks are prioritising research spend—DTS sets out MoD's views on priorities—and ensuring that MoD bridges the “Valley of Death” described by the NAO by improving exploitation and alignment of technology and industry strategies.

The Government has set a target to raise the national investment in R&D to 2.5% of GDP by 2014 and has increased its own national R&D spending to meet this target. UK industry needs to play a part in this endeavour. The DTS brings clarity to MoD's R&D priorities and requirements for up to 20 years in the future and will give industry a better understanding of the areas that MoD will invest in.

(Q) Does the MoD expect the proportion of defence equipment contracts which are let competitively to drop in the future and, if so, by how much [the DIS states that over the past four years some three-quarters of the MoD's contracts, by value, had been let competitively].

(A) Over the past four years some three-quarters of the MoD's contracts, by value, have been let competitively. It will remain central to our acquisition strategy that competition should be considered in all procurements and pursued wherever it offers the potential to secure best long-term value for money. Procurement for non-warlike goods and services will continue to be conducted in accordance with the European Union Procurement Regulations. However, the Defence Industrial Strategy (DIS) recognised that there are occasions when competition may not be able to deliver the best long term value for money or sustain key UK defence industrial capabilities. We will not pursue competition beyond the point where it can offer long term advantage or where the cost of running a competition is demonstrably disproportionate to the benefits that might be achieved.

Whilst there has been a reduction in the total number of contracts let over the last four years as the market moves to longer-term arrangements, there has so far not been a significant drop in the proportion, by value, that are subject to competition. There is an underlying assumption that as DIS is more widely implemented the proportion of contracts let by competition may decline; however, in parallel the MoD will be seeking to work more closely in long-term partnering arrangements which would place a responsibility on primes to compete requirements at a sub-prime level wherever possible with full transparency of the value of work being offered across the supply chain.

(Q) How many long-term partnering arrangements were agreed in 2006, and in what areas? In which other areas are long-term partnering arrangements being considered?

(A) In June 2006, the MoD signed a Strategic Partnering Arrangement (SPA) and contractually-binding Business Transformation Incentivisation Agreement (BTIA) with AgustaWestland (AW). This represented a key early deliverable of the Defence Industrial Strategy and will incentivise and drive forward business transformation across the full spectrum of MoD business with AW. The SPA and associated BTIA will provide better value for money by improving speed of delivery, reducing costs and increasing operational availability. It will also help ensure a long term, viable and cost effective support of the MoD's helicopter fleet.

However, partnering is a broad term and there are many programmes which have elements of partnering. In addition to the above, in 2006 MoD entered into agreements for availability contracts for through-life support of major assets including the £450 million Merlin Integrated Operational Support contract let in March, the £200 million Chinook Through Life Customer Support contract let in February and the £1.52 billion Hercules Integrated Operational Support contract let in June.

In 2007, work will continue to progress other LTPAs:

Complex Weapons—positive progress is being made on a Strategic Partnering Agreement (SPA), but there remain areas where negotiation is needed. Speculation on a date for finalising this work is premature. The primary objective for MoD and industry is to develop and deliver a robust agreement.

Fixed Wing—MoD and BAES are working together to explore the viability of a long-term partnering agreement with the objective of sustaining a healthy fixed wing sector with industrial capabilities, skills and technologies crucial to our ability to support and upgrade our fleet over the next 30 years.

General Munitions—a Framework Partnering Agreement, that jointly addressed the Munitions Acquisition—the Supply Solution (MASS) procurement strategy and Framework partnering Agreement (FPA) issues, is under consideration. Currently we are exploring the commercial issues to provide assurance that a single source procurement strategy would be better value for money than other practical alternatives.

Armoured Vehicle Support Initiative (AVSI)—As part of the need to maintain reliability and availability of the AFV fleet and provide better value for money, MoD has a desire to secure future industry support and on-shore capability. One of the procurement options being considered is partnering with the Design Authority.

(Q) *How is the MoD addressing the concerns expressed by some sub-primes and suppliers that they will not get an opportunity to compete for the work underlying long-term partnering arrangements?*

(A) The MoD has acknowledged this concern and is taking a range of measures to ensure that sub-primes and SMEs will have the opportunity to compete for work in future.

MoD is working closely with Industry, at all levels, to ensure that best practice is applied in all our supply chains so that sub-primes and suppliers, including SMEs, are treated fairly. This includes:

- More in-depth understanding of the make-up of the supply chains in each Industrial Sector in terms of criticalities and vulnerabilities.
- Improved supply chain intelligence through direct links from MoD to the supplier databases maintained by relevant Trade Associations and the British Defence Equipment Catalogue.
- Review of the joint MoD and Industry Commercial Policy Group code of conduct on best practice supply chain management to reflect the means by which best value is realised from the supply chain, at all tiers.
- Our support for industry initiatives such as recently launched “21 Century Supply Chain” (SC21) initiative led by the SBAC

MoD works with industry to provide access and opportunity to compete for work in the Defence Supply Chain, in particular:

- The Defence Supplier Service provides a focal point for advice and guidance to companies interested in becoming defence suppliers.
- MoD’s Prime Contractors are encouraged to advertise their sub-contract opportunities in the Defence Contracts Bulletin which provides a gateway to new business opportunities for companies, large and small, who wish to compete for defence business.
- A wide range of shop window events are organised for SMEs where they can access the range of capabilities that the MoD is currently seeking to address.

In 2005–06 SMEs were directly awarded some 43% of all contracts placed by MoD, with a total value of almost £1 billion.

(Q) *How much will it cost the MoD to implement the DIS? Will the funding needed to support operations reduce the funds available to implement the DIS?*

(A) DIS implementation costs within MoD are estimated at being £23 million in the current financial year, and some £30 million for the coming financial year. These costs include dedicated sector teams taking forward sector implementation, specialist legal and financial advice as support to those teams, and the initial costs of the Defence Acquisition Change Programme. Recognising the criticality of DIS implementation to the future of the UK industrial base and the affordability of our equipment programme, each budget holder has found these costs within their existing budgets. Set against the £18.2 billion of contracts that MoD placed during the last financial year, this is a small investment for the future with the potential for major payoff.

Funding to support operations should not effect DIS implementation although operational experience often drives future equipment requirements which may become part of the DIS. MoD attaches priority to operational needs, but recognises the need to strike a sensible balance between short term needs and the long term sustainment of an efficient and competitive industrial base.

(Q) In its first inquiry into the DIS, the Committee examined the issue of munitions and security of supply. What progress has been made with Project MASS? Has the MoD decided how best to sustain the required access to general munitions and, if so, what was the decision?

(A) Project MASS was charged with delivering a value for money and secure supply of general munitions. At Initial Gate in December 2004 approval was given to pursue a long term partnering agreement with BAES Land Systems Munitions (LSM), based on an integrated manufacture/supply/storage solution. The integrated solution failed to prove value for money, leading to a review of the way ahead. Subsequently LSM adopted a more radical modernisation agenda and produced a transformational proposal. This revised partnering arrangement offers a potential value for money solution, and is in accordance with DIS guidance on the retention of indigenous capabilities.

Currently we are exploring the commercial issues to provide assurance that a single source procurement strategy would be better value for money than other practical alternatives. We expect to identify the preferred procurement strategy early this year.

By the End of 2007 we aim to have made a firm investment commitment to proceed with MASS, to have completed any necessary performance/cost trade offs, and confirmed that the UK is not being disadvantaged in cost terms when compared to other nations who have a similar requirement.

A joint MoD/Industry General Munitions and Energetics Technologies (GMET) Steering Group has been established to facilitate cooperation on delivery of DIS and Defence Technology Strategy (DTS) objectives for all general munitions and the underpinning energetic materials technologies. Within this forum a draft General Munitions Industrial Strategy (GMIS) has been drafted and is being developed openly with industry.

In summary, no decision has yet been taken on how best to sustain the required access to general munitions but the ongoing work with Project MASS and the General Munitions Industry Strategy (GMIS) will provide the basis for this decision.

(Q) During its first inquiry into the DIS, the Committee was told that the Royal Ordnance Factory sites at Bridgwater and Chorley would not be closed until a secure alternative supply of the munitions existed. Have alternative suppliers been identified and, if so, how has the MoD assured itself that there is security of supply?

(A) Following the first inquiry into the DIS, BAES Land Systems Munitions (LSM) are now finalising the alternative supply arrangements to replace production at Bridgwater and Chorley. Most of the initiator production is being transferred to the Nobel Energetics site at Ardeer in Scotland. The high-value and high technology aspects of explosive manufacture are being transferred to the BAES LSM site at Glascoed in Wales, supported by considerable investment from the company. Raw materials for explosive manufacture will be imported from Holston in the US (run by BAES under a government-owned, contractor operated arrangement) and from Eurengo in France for some specialist products.

These proposed supply arrangements have been carefully scrutinised by MoD officials. The new manufacturing sites have been visited and inspected, contractual arrangements reviewed and supply chains assessed. Should the unforeseen happen and supply be interrupted from one source, BAE Systems will retain the technical ability to switch to the alternative (Holston or Eurengo), or draw on existing stockpiles. The Defence Ordnance Safety Group has been testing the quality of the new raw materials and, although not quite complete, results are excellent thus far. All of the companies being considered as new suppliers have excellent track records in meeting our production standards and quantity requirements. A top-down review of the site rationalisation programme was conducted in November 2006 and all sides were content to allow it to continue.

As has been previously stated, there are a number of existing agreements with our allies such as the "Implementing Agreement on Security of Supply" with France, Italy, Germany, Spain and Sweden or the US/UK Defense co-operation Memorandum of Understanding (MoU) which provide assurance on security of supply from these overseas suppliers. As an extra layer of protection and, due to the Department of Defense ownership of the Holston Army Ammunition Plant, officials have exchanged letters with the United States Armament Director to underline the importance of reliable supply between the various companies and to avoid any potential difficulties in the future.

New arrangements to rationalise the production of Insensitive Munitions (IM) (including 105mm, 155mm and 4.5 inch ammunition) at Glascoed are dependent upon the continued development and proving of the new High Volume Filling Facility: the company is working hard to rectify this situation.

As the Bridgwater site enters its final 12 months of production it faces considerable challenges in achieving its final production runs prior to closure due to legacy plant and equipment and the requirement to comply with new Health, Safety and Environmental regulations. The MoD is assured that the new arrangements will provide security of supply at least as great as that provided by Bridgwater and Chorley.

At the evidence session on 19 December 2006, the Committee asked for, or was offered, the following notes.

A DIS checklist for 2007 [Qs 4 and Q101].

To be provided to Committee by end of January

A table showing on a year-on-year basis, for the next 10 years, the forecast spending (the financial commitments) on equipment procurement and the funding (budget) expected to be available. A separate table showing the forecast spend by sector (sea, land, air) would be helpful [Qs 68–71].

FORWARD EQUIPMENT PLAN

The Equipment Plan (EP) is sub-divided into 11 capability areas which broadly match the way in which the Armed Forces operate. Examples of these capability areas include Above Water (AWE), Under Water (UWE), Ground Manoeuvre (Land Forces), etc Capability can generally be defined as “the ability to conduct defined tasks & effects within a given environment”.

Each of these capability areas manage a set of equipment projects where each projects has its own year-by-year funding line . There is a close relationship between the Directors of Equipment Capability who manage the capability areas and the Integrated Project Team Leaders and “Sector leads” in the Defence Procurement Agency (DPA) who have direct interface with industry.

The silt chart below sets out the Equipment Plan based (like the data in the DIS published in December 2005 on the outcome of the 2005 planning round), broken down by capability area, with a level of spend matched to our assumptions about the future level of resources available for equipment procurement, which may be adjusted by the outcome of the Department’s current planning round, and which in the longer term is dependent on the outcome of the Comprehensive Spending Review.

GLOSSARY TO TABLE

DAES (Directorate Analysis Experimentation & Simulation)—test and evaluation facilities (managed by QinetiQ)

GM (Ground Manoeuvre)—covers armoured fighting vehicles, engineer vehicles, weapons and ancillaries, along with dismounted close combat systems (weapons and clothing systems) for the soldier, sailor and airman up to Battlegroup level.

TA (Theatre Aerospace)—Responsible for the capability to achieve control and denial of theatre aerospace and effective operations in the air environment. Major equipment includes Typhoon, BVRAAM missile and the Advanced Jet Trainer.

SP (Special Projects)—Special Forces equipment

CBRN (Chemical, Biological Radiological & Nuclear)—DEC CBRN delivers a coherent CBRN defence capability for joint forces to be able to operate in a CBRN threat environment. Major equipments include General Service Respirator and biological detection systems.

ALM (Air Littoral Manoeuvre)—Responsible for those capabilities that move personnel and material in and around the land and littoral environments by ship and helicopter. Platforms include Chinook, Merlin, Attack Helicopter, Puma, Sea King, and Lynx aircraft together with HMS Ocean, HMS Bulwark and Albion and the new Landing Ship Dock Auxiliaries.

ELS (Expeditionary Logistics & Support)—Responsible for the delivery of logistics effects in the land environment for joint and combined operations. Major equipment includes Support Vehicle, Operational Utility Vehicle System(OUVS) and deployable accommodation.

ISTAR (Intelligence Surveillance Target Acquisition & Reconnaissance)—responsible for capabilities relating to the collection and delivery of Intelligence and targeting data. Major projects include Watchkeeper and Airborne Stand Off Radar (ASTOR)

CCII (Communication, Control & Information Infrastructure)—responsible for equipment programmes covering defence communications and battlefield systems eg Bowman and other tactical radios, SATCOM and Falcon

DTA (Deep Target Attack)—responsible for delivering of the capability required to attack surface targets . Major equipments include Tornado GR4, Harrier GR9, Joint Combat Aircraft, Stormshadow cruise missile, Tomahawk Land Attack Missile (TLAM), AS90 self-propelled howitzer, and MLRS.

UWE (Underwater Effect)—Submarines (including Astute), torpedoes, Nimrod MRA4 and Merlin ASW helicopters.

AWE (Above Water Effect)—AWE provides Control and Denial of the Above Water Battlespace. Major equipment projects include the future Aircraft Carrier (CVF), the new T45 Air Defence Destroyer and the Future Surface Combatant.

16 January 2007

Supplementary memorandum from the Ministry of Defence

MILESTONES FOR THE DEFENCE INDUSTRIAL STRATEGY, DEFENCE TECHNOLOGY STRATEGY AND DEFENCE ACQUISITION CHANGE PROGRAMME

	<i>Current Public Commitment</i>	<i>Proposed Public Milestones for 2007</i>
Maritime	<p>Submarine flotilla: start negotiations to achieve a programme-level partnering agreement with a single industrial entity for the full lifecycle. Complete in time for the contract for the fourth Astute class submarine, matched by the implementation of a unified submarine programme management organisation within the MOD.</p> <p>For surface ship design and build aim by June 2006 to arrive at a common understanding of the core load required to sustain the high-end design, systems engineering and combat systems integration skills.</p>	<p>Agree a route map to a Long-Term Collaboration Agreement between MOD and key Industrial Partners covering full submarine life-cycle by Summer 2007.</p> <p>Agree the core load required to sustain the high-end design, systems engineering and combat systems integration skills by Summer 2007.</p> <p>Achieve an affordable programme following robust industry commitments to consolidation and performance improvement by Summer 2007.</p> <p>Industrial restructuring for Surface Ships which delivers potential cost improvements</p>

<i>Current Public Commitment</i>	<i>Proposed Public Milestones for 2007</i>
<p>For surface ship support (SSS), start negotiations with the industry with the aim of exploring alternative contracting arrangements and the way ahead for contracting the next upkeep periods, which start in the autumn of 2006.</p> <p>Note: Currently it is anticipated that contracts for 12 upkeep/docking periods will be let.</p> <p>Key maritime equipment industrial capabilities will be supported by the production of a sustainability strategy for these key equipments by June 2006.</p>	<p>across the maritime programme Summer 2007.</p> <p>Validate the core load requirement against the surface build programme and rationalisation proposals for build capability by Autumn 2007.</p> <p>Throughout 2007 and early 2008, complete individual contract negotiations for the refits and docking periods (known locally as the "Gloucester X" upkeeps) due to commence between Spring 2007 and Spring 2008.</p> <p>By Spring 2008, subject to both approvals and consultation, establish the Surface Ship Support Alliance (SSSA).</p>
<p>Fixed Wing</p> <p>Commence negotiations with BAE Systems on the terms of the business rationalisation and transformation agreement required to facilitate the effective sustainment of the industrial skills, capability and technologies important to our ability to operate, support and upgrade our fast jet combat aircraft through-life. Work with the company during 2006 to agree the way ahead and to implement it from 2007.</p> <p>Move ahead with a substantial Uninhabited Aerial Vehicle Technology Demonstrator Programme in 2006.</p>	<p>Achieve signature of a Foundation Contract to establish the feasibility of and de-risk the proposed long-term partnering agreement (LTPA) by Early 2007.</p> <p>Reach a firm decision on the viability, shape and scope of the proposed LTPA by the End of 2007 and be positioned to place relevant supporting contracts as appropriate.</p> <p>Completed. TDP now underway.</p>
<p>Armoured Vehicles</p> <p>With BAE Systems give effect to the long-term partnering arrangement required to improve the reliability, availability and effectiveness through life of our existing AFV fleets. Establish a joint partnering team within the early part of 2006 and to establish a business transformation plan underpinned by a robust milestone and performance regime.</p>	<p>Agree a strategy for sustaining the current [and future] AFV fleet by Spring 2007.</p> <p>Implement the strategy for procurement of the FRES system by Spring 2007 including initiation of a competition to provide the FRES Utility Variant.</p>
<p>Helicopters</p> <p>By Spring 2006, subject to value for money having been demonstrated, reach agreement on a Strategic Partnering Arrangement (SPA) which will be focused on activities to sustain the design engineering skills and knowledge of UK military demands and safety standards within Agusta Westland necessary for them to provide effective through-life support to those elements of the in-service helicopter fleet for which they are the DA.</p>	<p>Continue to build upon early success with the SPA to improve efficiency and reduce dependency on UK Government contracts for its long-term viability. Ongoing.</p> <p>Reach decision on preferred bidder and transfer of responsibility for operation of DARA (RW and Components Business Units) and initiate action to place appropriate contracts and agreements by Summer 2007.</p>
<p>Complex Weapons</p> <p>Establish a multi-disciplinary team to establish how we might seek both to meet our ongoing requirements and sustain in an industrially viable manner the critical guided weapons technologies and through life support capabilities. Have a clear way ahead by mid-2006.</p>	<p>Issue the Complex Weapons Sector Strategy in Early 2007.</p> <p>Achieve Signature of a Complex Weapons SPA by Summer 2007.</p>
<p>General Munitions</p> <p>Take forward Project MASS, with a view to making decisions on how best to sustain our required access to general munitions in the Summer of 2007, building on the joint working arrangements enshrined in the existing Framework Partnering Agreement</p>	<p>Confirm the preferred commercial strategy for meeting this requirement in Summer 2007.</p> <p>Achieve contractual commitments in support of this before Spring 2008.</p>

	<i>Current Public Commitment</i>	<i>Proposed Public Milestones for 2007</i>
CBRN	<p>as reinforced by the recently agreed MOD/BAE Systems LS partnering principles.</p> <p>None declared publicly in 2006.</p>	<p>Complete the CBRN Industry Capability Matrix and share the findings with the Home Office in Early 2007.</p> <p>Continue to build on the concept of <i>Team CBRN</i> by creating a Joint Focus Group which delivers an Initial Gate Business Case for CBRN sector transformation by Mid 2007.</p>
Defence Commercial Director	<p>The appointment of the DCD has paved the way for changes in the way in which the MOD behaves as a customer and changes to the relationship between MOD and Industry.</p>	<p>Complete the review of our approach to SME in acquisition and implement necessary policy changes to improve SME engagement by Summer 2007.</p> <p>Issue proposed terms of business for major defence contractors wishing to work with MoD for industry consultation by Summer 2007.</p> <p>Issue best practice on contracting of long-term partnering agreements by Summer 2007.</p>
Defence Technology Strategy	<p>All previous public commitments have now been met.</p>	<p>Award contracts for funded Grand Challenge teams to be announced summer 2007. Final trials 2008.</p> <p>Award contract awarded for Competition of Ideas by Spring 2007.</p> <p>Publish Strategy to Stimulate Innovation. Summer 2007.</p> <p>Publish People Skills Roadmap. Summer 2007.</p> <p>Investment in S&E skills. Start scheme Summer 2007.</p> <p>Publish R&D Business Models for Investment. Autumn 2007.</p>
Transparency	<p>Defence Industrial Strategy Chapter A8 committed the department to significant increases in the quality and quantity of planning assumptions and data shared with Industry.</p>	<p>Complete the consultation process with Industry and issue formal guidance on Transparency in Early 2007.</p> <p>Following the outcome of the annual planning round, issue relevant planning assumptions to industry by Summer 2007.</p>
DACP	<p>The establishment of an integrated procurement and support organisation, removing barriers to integrated delivery of equipment and support.</p> <p>Unity of purpose and agility of the MOD customer.</p> <p>New departmental planning process—bringing together previously separate plans for equipment and equipment support</p>	<p>The DPA and DLO will be merged into a single organisation with a mission to equip and support our armed forces—Defence Equipment & Support (DE&S)—April 2007.</p> <p>A new Capability Planning Group (CPG) regime will be in operation using consistent processes and structures. Each group will bring together key stakeholders who will ensure the delivery of enduring military capability within their area of responsibility—April 2007, with the remainder of 2007 being used to test, develop and embed the new arrangements.</p> <p>Planning Round 2008 (starting Spring 2007) will be significantly different from previous years. Responsibility for programming equipment support costs will transfer from the DLO to the Sponsor and the Front Line TLB (FLTLB)s, thereby aligning programming responsibility with those organisations which have the ultimate responsibility for delivering coherent future</p>

<i>Current Public Commitment</i>	<i>Proposed Public Milestones for 2007</i>
Streamlining of decisions	<p>equipment capability (the Sponsor) and for integrating the DLoDs to deliver military capability (the User)—April 2007.</p> <p>Equipment support resources will be programmed in detail over ten years. Front Line Commands will programme the costs of support for in-service equipment for Years 1–4, and the Sponsor will programme the costs of support of all new equipment and for in-service equipment over Years 5–10—April 2007.</p> <p>A revised approvals process will be applied progressively to projects—April 2007.</p>

29 January 2007