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Defence Committee

Defence Procurement

Sixth Report of Session 2003–04

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Report, together with formal minutes

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The Defence Committee

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Summary

Six years ago the Ministry of Defence (MoD) introduced Smart Acquisition. Its objectives were to procure equipment faster, cheaper, better. On almost all counts, it has failed to deliver. In 2002–03 the top 20 defence equipment projects experienced in-year cost increases totalling £3.1 billion. They also suffered further time slippage—on average, they will be delivered a year and a half late. More cost increases and time slippages can be expected when the 2003–04 figures are published. This means that our Armed Forces are still not getting the equipment they need when they need it. Cost increases of this magnitude not only mean cancellations or further delays in the equipment programme, but can also lead to cuts elsewhere in defence.

The Chief of Defence Procurement—head of the Defence Procurement Agency—has found that only one of the seven principles underlying Smart Acquisition has been implemented in full. He has instituted a fundamental overhaul of the initiative. We will be looking for regular reports on its progress.

On specific projects:

- The ‘alliance’ arrangements for the Future Carrier programme are expected to work well. Further work is continuing to de-risk this project before going to the main investment approval point.
- The Joint Strike Fighter will operate from the Future Carriers, but issues relating to the weight of the aircraft need to be resolved and could impact on the expected in-service date and possibly on the overall programme.
- The in-service date for Eurofighter/Typhoon was finally achieved in 2003—54 months late. MoD wants the second tranche of aircraft, which have yet to be ordered, to be adapted to multi-role rather than the air-defence role. Officials’ belief that the required enhancements will have little impact on the total cost of the programme appears optimistic, unless there are plans to reduce the size of the third tranche.
- An assessment phase contract for the Future Rapid Effect System (FRES) is to be placed at the end of the year. Concern remains that the in-service date of 2009 is unrealistic.
- The main investment decision for the Watchkeeper Unmanned Air Vehicle is expected at the end of the year, but some slippage has already been experienced in the planned date for its initial operating capability.

The Defence Industrial Policy was launched in October 2002. Although it has led to an improved dialogue between industry and Government, practical implementation of its core principles remains patchy. The decision by the Secretary of State to purchase the Hawk trainer aircraft resulted in substantial exports for the UK, and has been cited by MoD as a good example of the Defence Industrial Policy working. But in taking that decision the Secretary of State had to override a formal recommendation from officials which does not appear to have included consideration of the wider factors set out in the Defence Industrial Policy, such as export potential or the likely effects on British industry.

These wider factors should be taken into account from an early stage in the procurement process, not left to the end as they seem to have been in this case.

Consolidation in the UK defence industry has continued. While ownership of UK defence companies by overseas companies can bring potential advantages, it also leads to longer term risks, in terms of security and the impact on competition, which should be fully considered. MoD must clarify what industrial capabilities and kinds of technologies it believes the UK's defence industry must be capable of providing in the future

Unfortunately, the expected waiver for the UK from the US International Traffic in Arms Regulations (ITAR) has yet to be secured, and protectionist measures in the US have re-emerged. These issues are potentially damaging to the UK and US defence industries and to the relationship between the two countries. The continuing failure to resolve them is unacceptable and must be addressed at the highest level.

1 Introduction

1. Since the introduction of annual defence equipment debates in 1998, we and our predecessors have undertaken annual inquiries to inform those debates. This is the sixth report in that series, and is aimed at informing the next debate which we expect to be held in the autumn. We have taken as our starting point a survey of fifteen major procurement projects whose progress we have monitored. Our aim in each inquiry has been to examine and report on a selection of the more significant of them, as particular programmes come to key points in their progress.

2. Last year we examined the Nimrod MRA4 maritime patrol and anti-submarine/anti-ship attack aircraft, and the Astute attack submarine programmes which had both experienced substantial problems. The contracts for both these major projects had to be re-negotiated because of difficulties stemming from poorly managed risk. We also examined the Future Carrier, Watchkeeper and Future Rapid Effect System programmes.¹

3. We have continued with our procurement monitoring exercise this year. In selecting our projects for tracking, we have retained many on our list from previous years. Our starting point, as with our previous inquiries, was to request a detailed memorandum covering these projects from the Ministry of Defence (MoD), which we publish with this report,² covering the following programmes:

- A400M military transport aircraft
- Advanced Short-Range Air-to-Air Missile
- Light Forces Anti-Tank Guided Weapon System
- Apache WAH 64 Attack Helicopter
- Type 45 Anti-Air Warfare Destroyer and its Principal Anti-Air Missile System
- ‘Meteor’ beyond visual range air-to-air missile
- Astute submarine
- Nimrod Maritime Reconnaissance and Attack Aircraft MK4
- ‘Bowman’ communications system
- Typhoon (formerly Eurofighter)
- ‘Watchkeeper’ Unmanned Air Vehicles
- Future Joint Combat Aircraft (Joint Strike Fighter)
- Future Strategic Tanker Aircraft

1 Defence Committee, Eighth Report of Session 2002–03, *Defence Procurement*, HC 694

2 Ev 80–107

- Future Rapid Effect System
- Future Carrier

4. Since the publication of last year's procurement report, there have been key developments on a number of the projects on our tracker list.³ These include:

- the signature for the Development and Production contract for the A400M military transport aircraft.
- the start of manufacture on HMS Daring, the First of Class Type 45 destroyer.
- the signature of the amended contracts reflecting the Agreements between MoD and BAE SYSTEMS on Astute and Nimrod.
- the achievement of the Bowman in-service date ahead of schedule in March 2004.
- the delivery of the first Eurofighter Typhoon and acceptance by the RAF.
- the selection of the AirTanker consortium as the preferred bidder for the Future Strategic Tanker Aircraft.
- the approval for the Future Rapid Effect System to go forward to the Assessment Phase.

5. In this year's inquiry, we have once again examined the progress of the Astute, Nimrod, Future Carrier, Future Rapid Effect System and Watchkeeper programmes. We also examined the progress on two fighter aircraft programmes—Joint Strike Fighter and Eurofighter/Typhoon.

6. Last year, in addition to specific equipment programmes, we examined the *Defence Industrial Policy*,⁴ a paper produced jointly by the MoD and the Department of Trade and Industry (DTI) in October 2002. We also took evidence from the then newly appointed Chief of Defence Procurement, Sir Peter Spencer and were impressed with his determination to make Smart Acquisition, launched as part of the Strategic Defence Review in 1998, truly agile and responsive to equipment customer needs. He appeared to share our view that Smart Acquisition needed to be periodically refreshed. This year we decided to revisit both of these key areas. We were particularly interested to examine the proposals for refreshing Smart Acquisition which are set out in the Defence Procurement Agency's 'A Stocktake of Smart Acquisition in the DPA—The agreed way forward',⁵ which Sir Peter forwarded to us in January 2004. With regard to the *Defence Industrial Policy*, we were keen to examine the progress made in implementing the Policy, since its launch some 20 months ago.

7. In undertaking our inquiry, we took oral evidence from representatives of the Defence Industries Council (Sir Richard Evans and Mr Nick Prest, Chairman and Vice-Chairman of the Council respectively,⁶ along with Mr John Howe, Vice-Chairman of Thales UK, and

3 Ev 80

4 Policy Paper 5: Defence Industrial Policy, Ministry of Defence, 14 October 2002.

5 Ev 65–76

6 Sir Richard Evans is also Chairman of BAE Systems, and Mr Prest is also Chairman and Chief Executive of Alvis.

Mr Simon Frost, Chief Executive Officer of Claverham). We also took evidence from Sir Peter Spencer, Chief of Defence Procurement, and Lord Bach, Minister for Defence Procurement (who was accompanied by Sir Peter Spencer and Lt General Rob Fulton, Deputy Chief of Defence Staff (Equipment Capability)—heads of the MoD’s ‘supplier’ and ‘equipment customer’ organisations respectively).

8. We received written evidence from a number of organisations in the defence sector including MoD,⁷ the Defence Industries Council,⁸ the Defence Manufacturers Association,⁹ Intellect,¹⁰ Northern Defence Industries Ltd,¹¹ the Defence Engineering Group,¹² and the VT Group.¹³ We are grateful to all those who contributed to our inquiry. We were assisted in our inquiry by our specialist advisers Mr Paul Beaver, Professor Michael Clarke, Rear Admiral Richard Cobbold, Professor David Kirkpatrick, Air Vice Marshal Professor Tony Mason and Brigadier Austin Thorp. We are also grateful to them.

7 Ev 77–107

8 Ev 111–114

9 Ev 129–130

10 Ev 115–118

11 Ev 120–122

12 Ev 108–111

13 Ev 122–123

2 Smart Acquisition

Procurement performance in 2002–03

9. The first indication that 2002–03 had been a particularly poor year in terms of procurement performance was provided in the Defence Procurement Agency (DPA) Annual Report and Accounts 2002–03, published in November 2003.¹⁴ In the foreword to the Annual Report and Accounts, Sir Peter Spencer, Chief of Defence Procurement, acknowledged that it had not been a good year for the Agency as measured by its corporate performance:

The agency.... failed to achieve its targets on programme slippage and cost growth.... overall performance was seriously damaged by major cost and time delays on a number of legacy¹⁵ projects.... In general, progress on newer projects [Smart Acquisition projects] has been better, although there have been some worrying delays and cost growth on those also.¹⁶

10. The DPA's Annual Report and Accounts provides details of performance against its Key Targets. Performance against the Key Targets relating to time slippage and cost variation was as follows:¹⁷

- Target: average cumulative slippage of in-service date not to exceed 12.1 months for 2002–03.

Outturn: 19.0 months for 2002–03. Average in-year slippage was 7.2 months.

- Target: average cumulative cost variation not to exceed 2.2 per cent for 2002–03.

Outturn: 8.1 per cent. Average in-year cost growth was 5.4 per cent.

11. A more detailed analysis of the problems experienced in 2002–03 was provided in the National Audit Office's (NAO) Major Projects Report 2003,¹⁸ published in January 2004, which covers the top 20 defence equipment projects in the Demonstration and Manufacture phase. The NAO reported:¹⁹

Projects have slipped an average of 18 months beyond their expected delivery dates, twice the average delay recorded in the Major Projects Report 2002. Legacy projects account for 114 months (79 per cent) of the 144 months slippage in the last year.

With the exception of two projects, the costs of which have been excluded because of their commercial sensitivity, total current forecast costs are £51.9 billion, an increase

14 Defence Procurement Agency, Annual Report and Accounts 2002/2003, HC 2

15 Legacy projects are those which started before the introduction of Smart Acquisition, launched as part of the Strategic Defence Review in 1998.

16 Defence Procurement Agency, Annual Report and Accounts 2002/2003, HC 2, p 3

17 *Ibid.*, p 9

18 National Audit Office, *Ministry of Defence Major Projects Report 2003*, HC 195, Session 2003–2004

19 *Ibid.*, para 8

of £3.1 billion in the last year and some six per cent over approval. Legacy projects account for £2.7 billion (87 per cent) of the £3.1 billion cost increase.

12. We and our predecessors have, to some extent, become accustomed to the too familiar story of time slippage and cost increases on major defence equipment projects. **The performance of the Defence Procurement Agency in 2002–03 can only be described as woeful. On the somewhat optimistic assumption that no further slippage is experienced, major equipment projects will on average be delivered to the end user a year and a half late. The substantial in-year cost increases of some £3.1 billion will have a major impact on the current equipment plan and must inevitably lead to cancellations or cuts in equipment projects, or delays in ordering equipment. Such substantial cost increases are also likely to have an impact beyond defence procurement and result in cuts elsewhere. Given the recent pressures on our Armed Forces we believe such impacts would be unacceptable.**

13. As we noted in our recent report on the Defence White Paper,²⁰ we believe the UK's future security challenges require the existing scale of forces to be retained. Otherwise, the Armed Forces will be unable to operate without again placing unsustainable demands on service personnel. We also consider that a policy of reducing the existing number of platforms in advance of acquiring the new capabilities is potentially dangerous. We note that the settlement announced by the Chancellor on 12 July 2004 raised the Defence budget by £3.7 billion between 2004–05 and 2007–08, a real terms increase of 1.4 per cent a year. The increase is welcomed, but MoD needs to manage the budget effectively to ensure that the Armed Forces see the maximum benefit.

Assessment of the Defence Procurement Agency

14. Shortly after taking up the post of Chief of Defence Procurement in May 2003, Sir Peter Spencer consulted widely with industry, other Government Departments and within MoD to identify areas of the DPA's business which were working well and areas which needed further development. He also commissioned McKinsey & Co. to undertake an analysis in order to gain an independent assessment of where improvements were needed. Sir Peter wrote to the Committee in January 2004 and provided a copy of '*A Stocktake of Smart Acquisition in the Defence Procurement Agency—The Agreed way forward*' (subsequently referred to as '*Stocktake of Smart Acquisition*').²¹ This sets out the DPA's proposals for re-invigorating Smart Acquisition.

15. Given the poor performance in 2002–03, we were particularly interested in Sir Peter's assessment of the DPA, the factors which had contributed to the poor performance in 2002–03, and how well he thought Smart Acquisition had been working. Sir Peter told us that he found the underlying causes of poor performance to be 'endemic',²² and that 'Smart Acquisition reforms which have delivered a lot of benefit compared with the previous arrangements.... still have some way to go'.²³ He added that the 'result of the analysis

20 Defence Committee, Fifth Report of Session 2003–04, *Defence White Paper 2003*, HC 465-I, paras 74 and 79

21 Ev 65–76

22 Q 76

23 *Ibid*

demonstrated that we really had quite a lot to be concerned about'.²⁴ Most worryingly, he told us that of the seven principles underlying Smart Acquisition:

One had been implemented in full and is working extremely well, and that is the fund holding central military customer.... Of the other six, none of them had been implemented fully and in some cases had hardly been implemented at all.²⁵

16. We asked Sir Peter if he had been shocked by the scale of the time slippage and cost increases experienced in 2002–03. He told us that:

I was not shocked because I had seen emerging signs of this before I took up the post. I was fairly clear in my own mind that we either had a one-off problem with a year of bad results or we had something which was more fundamental.... although you could draw a conclusion that Smart projects were doing considerably better than so-called Legacy projects, there was also an argument that said that the majority of those Smart projects were at a rather earlier stage in their total cycle and that if you looked back on the projects which had completed, very often a lot of difficulties emerged as those projects had approached their original planned in-service dates, a point we had not arrived at on the Smart projects. That was a very clear warning not to assume that the forecasts to completion were going to be good for those youthful projects simply because they had been badged as “Smart”.²⁶

17. We were particularly concerned that some Smart Acquisition projects were starting to show signs of problems. Sir Peter told us that ‘they are indications that Smart Procurement in some of these projects has not been implemented as it should have been’.²⁷ In addition to bringing improvements to new projects, it was also claimed that Smart Acquisition would bring improvements to Legacy projects (those projects which started before the introduction of Smart Acquisition). We were dismayed to learn from Lord Bach, Minister for Defence Procurement that ‘there have been greater problems with the legacy projects than perhaps we had anticipated.... perhaps we overestimated then the effect Smart Procurement would have on dealing with those legacy issues’.²⁸

18. We asked Sir Peter if similar in-year time slippage and cost increases to those experienced in 2002–03 were expected for 2003–04. He said that, in his judgement, there would be a problem in 2003–04, but it was unlikely to be on the same scale as 2002–03. He added that, ‘it would be surprising if that were not the answer given that there is a systemic problem and it is going to take time to sort this out’.²⁹

19. We find it immensely disappointing that the Smart Acquisition initiative, launched some six years ago, has yet to deliver its aim of procuring equipment faster, cheaper, better. We are particularly concerned that it will still be some time before poor performance is reversed and the expected benefits from Smart Acquisition delivered.

24 Q 78

25 Q 81

26 Q 79

27 Q 84

28 Q 229

29 Q 80

We are forced to conclude that our Armed Forces have been let down by the organisation tasked with equipping them.

Failure to act earlier

20. The sorry picture outlined by Sir Peter, particularly the failure to implement the principles of Smart Acquisition, some six years after it was introduced, point to long-running problems. We asked Lord Bach when he had first become aware of the long-running problems within the DPA. He told us that he was not ‘naïve enough to think that everything was absolutely fine and rosy in the garden up until that particular point [when Sir Peter had completed his assessment of the DPA]’.³⁰ We asked him what had happened before Sir Peter had taken up post in May 2003. He said that ‘What I learned during those first two years, or nearly two years as it was before Sir Peter was appointed, was that Smart Acquisition principles were appropriate principles; putting them in effect was a good deal more difficult than the principles themselves’,³¹ and he added that ‘there comes a moment when a new face comes in to head the DPA and decides that something decisive has to be done, and I am delighted that Sir Peter has done that’.³² Lord Bach highlighted the changes to procurement that had taken place since the Strategic Defence Review in 1998 and stated that he was ‘absolutely content with the way in which things have gone’.³³

21. The Chief of Defence Procurement’s assessment of the Defence Procurement Agency identified long-running systemic problems and a failure to implement the principles of Smart Acquisition. We regret that both his predecessor and the current Minister for Defence Procurement failed to act earlier to address, what even the latter referred to as, ‘some things which have been endemically wrong for some time that we still haven’t sorted out’.³⁴

Areas to be addressed

22. Sir Peter provided us with an overview of his assessment of the DPA and of the implementation of Smart Acquisition. We were also interested in the specific areas where improvements were needed and the proposals for addressing them.

De-risking of projects

23. Sir Peter told us that major MoD procurements include the management of huge uncertainties and that ‘whether or not we actually invest enough time in de-risking before we make a major capital investment’³⁵ generally determines whether a project does or does not go astray. Historically, MoD has spent as little as two per cent of the total procurement budget for a project on the assessment phase—the average figure considered best practice is

30 Q 208

31 Q 209

32 *Ibid*

33 Q 211

34 Q 208

35 Q 81

some 15 per cent,³⁶ although this figure would vary depending upon the specific project. In its Major Projects Report 2003, the NAO found that the average Assessment Phase expenditure as a percentage of the total procurement expenditure for the 10 Assessment Phase projects (Smart Acquisition projects) in the Major Projects Report 2003 was 4.4 per cent,³⁷ and concluded that some projects which have recently passed through Main Gate (the approval point between the Assessment Phase and the Demonstration and Manufacture Phases) had been insufficiently de-risked and had consequently incurred early cost increases and delays.³⁸

24. A good example of successful de-risking was the 2087 sonar radar where some 14.8 per cent of the budget was spent in putting a prototype to sea and making certain that all the risks, such as those relating to maturing individual technologies and system integration, were understood.³⁹ Sir Peter told us that ‘when you look at the reasons given for cost overruns it is because we did not understand the technological risks’.⁴⁰

25. John Howe, Vice-Chairman of Thales UK, also highlighted concerns about risk reduction during the Assessment Phase. He told us that:

if there is one error, if you like, which has led consistently to setbacks, disappointment and difficulties in procurement, it is because the whole community—industry, the MoD and, if I may say, at the political level and the press—has conspired to be optimistic about the cost of military capability and has conspired to neglect the degree of risk that is involved in major defence projects where one is actually buying equipment that does not yet exist and it is what McKinsey’s I think called a conspiracy of optimism in their work on Smart Procurement. I think we still suffer from it. The figures still show that there is insufficient investment by the customer in risk reduction in the early stages of projects before they reach their main stage of approval and that fact, I think, has led us into a lot of the difficulties that individual projects have run into.⁴¹

26. We asked Sir Peter what changes he was proposing to make to the Assessment Phase, and he told us that, in future, ‘the assessment phase will have more resources devoted to it and compared to the way it had been done previously it will take longer and we will not through thick and thin hold on to a pre-declared date for making a main gate decision come what may and regard it as a sign of failure if we do not make it’.⁴² Lord Bach stressed that ‘if there is one message I want to get across today.... it is our commitment, my commitment, to ensuring that we keep the assessment phase of projects going and do not move too quickly to main gate before de-risking design and design maturity have actually occurred’.⁴³

36 Q 103

37 National Audit Office, *Ministry of Defence Major Projects Report 2003*, HC 195, Session 2003–2004, para 2.13

38 *Ibid.*, para 2.15

39 Q 104

40 Q 154

41 Q 14

42 Q 156

43 Q 186

27. Spending more money and time on the Assessment Phase will require a shift in the current culture within the DPA and MoD. However, there are signs that some changes are taking place, although the impetus for doing so appeared to have come from industry. Sir Richard Evans, Chairman of BAE SYSTEMS, told us that on the Future Carrier programme the original aim had been to go through Main Gate in March 2004. However, BAE SYSTEMS and Thales UK had advised the MoD that there had been insufficient de-risking. He said that ‘additional funding had been found to keep pre-main gate funding running forward and that will enable a lot more work to be done’.⁴⁴

28. It comes as no surprise that a key underlying cause of poor performance, in terms of delivering projects to time and cost, has been MoD’s failure to invest enough money and time to sufficiently de-risk projects in the Assessment Phase. This is a concern which we, our predecessors, and the National Audit Office, have highlighted over the past 20 or so years. MoD now proposes to spend more money and time in the Assessment Phase. We welcome this intention, but given past failures to address this longstanding problem we are still to be convinced that it will be implemented in practice.

Trade-offs

29. One of the key principles of Smart Acquisition is the routine trade-off between performance, time and cost. However, Sir Peter told us that this is another principle of Smart Acquisition which ‘we have not been applying properly’⁴⁵ and that ‘Performance, time and cost trade-off... was very patchy’.⁴⁶ He said that:

you should have a three-dimensional trade here so that you understand what the cost drivers are and the time drivers and, in conjunction with your military customer, if things start to get difficult and something has come out of the woodwork which you were not anticipating, you say “we need to fall back here” and plan B is that we do a little bit of this because we could add that at some later stage in the life of the equipment if it is really that important.⁴⁷

30. We explored why trade-offs had not been applied and identified two reasons. Firstly, individuals with ‘vested interests’ in a project. Lord Bach told us that ‘In any organisation people sometimes have a vested interest in what it is they have set up and what it is they want, and are reluctant to compromise that for what they may see as not particularly good reason’.⁴⁸ In terms of addressing this problem, he told us that ‘we really have to be... more strict and strong about insisting that trade-offs take place in order to achieve the results we want’.⁴⁹

31. The second reason why trade-offs have not been applied related to insufficient information. General Fulton told us what is needed is ‘the visibility of what it means—

44 Q 32

45 Q 79

46 Q 81

47 Q 79

48 Q 247

49 *Ibid*

visibility for my people on “If you trade this performance then it can come in at this cost and this time”. I think what we have not always had up until now is that full cost/time/performance visibility to enable us to do it’.⁵⁰ He accepted that the ‘customer’ was one of those responsible for the patchy use of trade-offs. This had been widely recognised and he considered that now ‘we are doing better’.⁵¹

32. It is, again, very disappointing that another principle of Smart Acquisition—the routine trade-offs between performance, time and cost—has not been implemented as intended. Without such trade-offs, time slippage and cost increases occur. We expect the Defence Procurement Agency and MoD to address the reasons which have, to date, limited the use of trade-offs, and to monitor the use of such trade-offs.

Through life management/whole-life costs

33. Whole-Life Costing is an important concept underpinning Smart Acquisition—one of the key principles of Smart Acquisition is that investment decisions should reflect the whole-life cost implications rather than focussing solely on procurement costs. Whole-life costs are the cost to MoD of equipment throughout its life from concept to disposal. The importance of whole-life costs was emphasised by Sir Peter who told us that ‘I talked about the cost of acquisition and said you obviously have to factor in not just the initial cost of acquisition, it is very important we do it on a through-life management basis and we are looking at the whole life costs’.⁵²

34. Industry also considered it important for MoD to use Whole-Life Costing. Simon Frost, Chief Executive Officer of Claverham, told us that, in the case of bids from overseas defence companies, ‘if big investments are being made in those countries’ industries, they are hard-headed people and they will get their money back and the way they get their money back usually is in the cost of support’.⁵³ He stressed the need for MoD, in relation to such procurements, to ‘look very carefully at what the life cycle cost in reality is going to be’.⁵⁴

35. Further progress is needed before this key principle of Smart Acquisition is implemented. The Defence Manufacturers Association considered that, ‘with regard to through life management.... there is clearly much still to be done before a really effective approach is found in the MoD to the challenge of funding and managing projects on this basis. Investment up front in procurement to achieve real support costs savings downstream is still a strong aspiration rather than a reality at present’.⁵⁵

36. The NAO recently reported⁵⁶ that MoD had made some progress in producing whole-life cost data and intended to use the data as a strategic planning tool at an individual project level and at a capability level. However, the data currently being produced needed

50 Q 248

51 *Ibid*

52 Q 110

53 Q 20

54 *Ibid*

55 Ev 130

56 National Audit Office, *Ministry of Defence Major Projects Report 2003*, HC 195 Session 2003–2004, Appendix 7

to be refined before it could be relied upon to support decision-making. The Defence Engineering Group also highlighted the NAO's concern that the through-life cost data so far assembled were currently immature and unable to support decision-making. They also considered that a through-life approach to any project was inhibited by the 'bureaucratic divisions of responsibility and budgets between the various MoD stakeholders involved'.⁵⁷

37. Whole-Life Costing is another key principle of Smart Acquisition which has yet to be implemented. While we acknowledge that some progress has been made in this area, we expect MoD to ensure that the whole-life cost data currently being produced is refined further so that it can support decision making.

Decision making in MoD

38. A key aim of Smart Acquisition was to address a long running criticism that the process for acquiring defence equipment took too long and was too complex. A change introduced under Smart Acquisition was to rationalise the equipment approvals process. The number of points at which a major equipment programme was approved for continuance was cut from four to two. This concept of Smart Acquisition fits every procurement into a contractual strait jacket. A more flexible system might lead to better results in some cases. Despite the reduction in the number of approval points, industry remained concerned about continuing delays in MoD's decision making. John Howe told us that he considered that:

the slowness of the approvals process and the extent to which companies exist in a state of uncertainty for some time while they are waiting for decisions, a process which is often very expensive because bids have to be sustained, that is one of, I think, the industry's legitimate criticisms of the approvals process.⁵⁸

39. In its written submission,⁵⁹ the Defence Manufacturers Association said that, at present, the single largest complaint from its member companies was excessive delays in MoD decision making which were both expensive and frustrating. Examples of projects where there had been delays included: the Future Rapid Effect System; the Airfield Service Support Project; and Armoured Vehicle Training Systems. The latter was said to be 'years late' and currently undergoing a third round of best and final bidding. These concerns were also echoed by Northern Defence Industries Ltd, who pointed to the 'time bidding takes both in bid preparation and the long lead times before orders are placed and fulfilled'.⁶⁰ This was a particular problem for Small and Medium Enterprises: during that timescale there was a real risk that such companies could be faced with financial pressures so that they were unable to maintain the necessary capability, or even went out of business.

40. In terms of addressing these concerns, Sir Peter told us that 'the Investment Approvals Board and the Ministerial Steering Group.... are very supportive in bringing forward ideas

57 Ev 108

58 Q 65

59 Ev 130

60 Ev 121

which are going to streamline those arrangements so there is much more confidence when we put the proposition forward that it is going to go through in an acceptable timescale'.⁶¹

41. Delays in MoD decision-making result in a great deal of uncertainty and expense for defence companies. For some companies, particularly smaller ones, there is a risk that such delays can lead to them going out of business. We expect MoD, to consult with industry on this matter, and to push forward with its efforts to identify and implement quicker decision making processes.

Contracting arrangements

42. Problems experienced on a number of equipment projects, for example on the Astute and Nimrod programmes, have highlighted shortcomings in the contracting arrangements used by MoD. Several of the submissions we have received from industry also highlighted the need for new approaches to contracting:

- The VT Group stressed the need for both industry and government to take full advantage of the opportunities provided by new business models being introduced in the commercial sector. They pointed to the UK offshore oil industry where a new partnering approach to project delivery had been developed and 'typically resulted in savings of 20%'. They also considered that new incentive structures which enhance supplier profitability through profit sharing schemes needed to be considered.⁶²
- Intellect, the trade association which represents the interests of the IT, telecommunications and electronic industries in the UK, also highlighted the need to manage contracts in a more coherent way—'this means contracting with new commercial arrangements'.⁶³
- QinetiQ Group plc referred to the approach in the United States, where more flexibility had been introduced through greater use of competitively placed IDIQ (indefinite deliverable, indefinite quantity) contracts which permit the customer to buy as required from a limited selection of suppliers.⁶⁴

43. Sir Peter told us that MoD was looking at 'much better contractual arrangements which will deliver better outcomes, not only for the Ministry of Defence but also for our suppliers',⁶⁵ and he also referred to the arrangements used in the petro-chemical industry.⁶⁶ MoD was also looking at partnering arrangements, not only in terms of providing services, but also partnering arrangements in terms of having less taut contracting arrangements than had been used in the past. These included target cost incentive arrangements, whereby a target is identified and contractors have an incentive to beat the target as they share in the cost under-run with MoD and get a higher percentage return as profit. Such

61 Q 160

62 Ev 122–123

63 Ev 117

64 Ev 119

65 Q 103

66 Q 171

arrangements, were ‘not always easy to set up but in the main.... they lead to much more harmonious relationships and much better outcomes’.⁶⁷

44. We consider it essential that the Defence Procurement Agency’s approach to contracting, and procurement generally, aligns with best practice. Although action is now being taken, we find it surprising that, some six years after Smart Acquisition was introduced, the Agency has only recently made concerted efforts to identify best practice elsewhere and reflect this in its own arrangements. We would expect a major procurer, such as the Defence Procurement Agency, to be constantly abreast of best practice elsewhere and to update its arrangements accordingly. We recommend that the Agency do so in future.

Direction from senior management

45. Integrated Project Team leaders within the DPA are tasked with delivering defence equipment projects to time, cost and specification. To do this, they require a clear understanding of what they are expected to deliver to the end user—the Armed Forces. We were concerned to hear from Sir Peter that ‘there was a misunderstanding across the Ministry of Defence as to what project leaders were expected to deliver’.⁶⁸

46. Sir Peter explained that the misunderstanding arose from the way in which time and cost estimates on projects were approved.⁶⁹ He said that the approvals for time and cost estimates were at the 90 per cent confidence level—the latest acceptable or highest acceptable. The understanding among many DPA staff was as long as you achieved that you had been successful. However, Sir Peter noted that MoD actually plans on the 50 per cent probability.⁷⁰ He provided the following example in relation to time:

to say you had a project which was expected to run for five years and you approved it at six years because you allowed one year as the contingency or risk differential in time, people were tending to say “as long as that comes in in six years that is successful” but everyone else had planned on five. So the front line commanders were expecting new equipment to arrive, the Principal Personnel Officers were training people up for the new equipment, the Defence Logistic Organisation were expecting to run down some old equipment and get it out of service, so we had this sort of repetition of the cycle.⁷¹

In other words, MoD and the Armed Forces planned on the basis of 50 per cent probability of delivery at five years, but DPA was allowing itself to plan the procurement against a 90 per cent probability of delivery at six years, and was doing so without apparently realising that it was out of step with the customer.

67 Q 104

68 Q 79

69 The Business Cases for projects seeking approval (for the two approval points—Initial Gate and Main Gate) are required to include 10 per cent, 50 per cent and 90 per cent confidence figures for time and cost, which are derived from Three-Point-Estimating.

70 Q 79

71 *Ibid*

47. A widespread misunderstanding about what project leaders are expected to deliver, signifies to us a failure by DPA senior management to set clear direction. The organisational changes being introduced at the DPA include the creation of three Operations Directors ‘to provide the challenge and the advice and support to ensure that programmes are on track’.⁷²

48. The NAO’s Major Projects Report 2003, refers to the difference in how Legacy and Smart Acquisition projects are measured—‘Legacy projects are measured against a 50 per cent approval; Smart Acquisition projects are measured against a 90 per cent approval’.⁷³ Sir Peter told us that there is to be a change in the reporting of performance. Whereas in the past the DPA had been reporting against the 90 per cent estimates [for Smart Acquisition projects] they are ‘now going to report movement against the 50 per cent estimates because that measures the heart of the problem in terms of getting defence right’.⁷⁴

49. It is unsatisfactory that Legacy projects are measured against a 50 per cent approval while Smart Acquisition projects are measured against a 90 per cent approval, and we therefore welcome the move to reporting project performance against the 50 per cent estimate for all projects. This should eliminate any misunderstanding among project leaders as to what they are expected to deliver. Time will tell if the new organisational changes at the Defence Procurement Agency provide the clear direction to project leaders which has been lacking to date. We recommend that the Agency’s senior management monitor the effectiveness of the new organisational arrangements in this regard.

Internal review process

50. Given the scale and extent of the problems highlighted by Sir Peter, it appears astonishing that they had apparently gone unnoticed until his arrival in May 2003. Our concern was also shared by Sir Peter who asked, in respect of the substantial problems experienced on a number of projects, ‘why did they suddenly come out of a clear blue sky? Somebody must have known.’⁷⁵ Smart Acquisition is not a straightforward process. We have previously expressed doubts over some of the claims made for it. Nonetheless, we were surprised at the apparent extent of the failings identified by Sir Peter, and that they had been so little recognised before his arrival.

51. We found it worrying that Sir Peter has effectively had to introduce an amnesty for the DPA’s Integrated Project Teams whereby they have been asked to provide ‘honest forecasts’⁷⁶ and told that ‘If you have got some things you need to get off your chest, this is the year to do it’.⁷⁷ There appears to us to have been a cultural problem within the DPA

72 Q 89

73 National Audit Office, *Ministry of Defence Major Projects Report 2003*, HC 195 Session 2003–2004, Appendix 1, para 2

74 Q 102

75 Q 89

76 Q 80

77 *Ibid*

which prevented problems from being disclosed. Simon Frost, Chief Executive of Claverham, referred to a ‘fear culture’⁷⁸ in the DPA.

52. It is of real concern that the DPA’s internal review process failed to pick up on the problems experienced on projects. We note that a more rigorous process of assurance, in terms of examining the status of projects at all stages of their cycle, is to be introduced. In future, once a project is in its Demonstration and Manufacture Phase, there will be a performance review process held on a quarterly basis against a standardised set of parameters which are, in the main, to be independently verified by experts on site who will then provide that independent assurance both to the Integrated Project Team leader and to the Operations Directors.⁷⁹

53. A combination of what has been called a ‘fear culture’ at the Defence Procurement Agency and an ineffective internal review process has resulted in problems on projects being hidden and going undetected. The Chief of Defence Procurement must ensure that there is a culture change at the Agency which encourages problems on projects to be disclosed. We also expect senior management at the Agency to have accurate and timely information on the status of projects. The proposed new assurance arrangements should, therefore, be introduced as a matter of urgency and regularly reviewed to assess their effectiveness.

Defence Procurement Agency change programme

54. Details of the change programme identified to re-energise Smart Acquisition are set out in the ‘*Stocktake of Smart Acquisition*’.⁸⁰ The areas where changes are being introduced are:

- Project review and assurance
- Project reporting
- Financial management
- Key supplier management
- Changes in the Equipment Programme
- Joint working with the Defence Logistics Organisation
- People and skills
- Organisation

55. Sir Peter told us that while organisational, personnel and cultural changes were needed, the most important were the process changes.⁸¹ Details of how the recommendations from the ‘Stocktake’ are being taken forward are set out in a memorandum provided by MoD.⁸²

78 Q 14

79 Q 96

80 Ev 65–76

81 Q 83

82 Ev 77–80

In terms of the improvements in procurement performance that are expected, the memorandum states that the changes are designed to improve the DPA's ability to deliver military equipment to agreed performance, cost and time parameters.

56. The impact of the changes are to be measured through year-on-year improvement in results against the DPA's Key Targets—performance against which is currently validated by the NAO. As part of the new arrangements, the DPA has proposed a revised set of Key Targets. Sir Peter told us that the revised Key Targets 'are tougher and more representative of the work we are doing'.⁸³ The targets for cost and time slippage will no longer be limited to the top 20 projects, but will cover 65 per cent of the value of the work managed by the DPA.⁸⁴ A new target will address the delivery of assets by value against the delivery schedule for the DPA as a whole. There will also be targets covering more conventional commercial efficiency performance parameters, which are measures of productivity.⁸⁵

57. The new Key Targets for the Defence Procurement Agency should provide a better measurement, and be more representative, of the work that it undertakes. We welcome the addition of a new target covering asset delivery, which should ensure that the Agency focuses its attention on delivering to the front line—something which has often been lacking in the past. We consider it important that the National Audit Office continues to validate the performance of the Defence Procurement Agency against the new set of key targets, particularly as the targets for cost and time slippage will now cover a much larger number of projects.

58. The changes set out in the '*Stocktake of Smart Acquisition*' are to be implemented over the next 12–18 months and are being driven by a small project team.⁸⁶ Sir Peter told us that Lord Bach had been extremely supportive both in terms of what he had needed to do at the DPA, and what needed to be done in the relationships between the DPA and other parts of the MoD on the one hand, and with industry on the other. Lord Bach chairs a monthly meeting, which effectively oversees the implementation plan of the 'reinvigoration of Smart Acquisition'.⁸⁷

59. The new organisational structure for the DPA was established on 1 April 2004.⁸⁸ Key milestones for the change management programme are set out in the '*Stocktake of Smart Acquisition*',⁸⁹ together with outline success measures covering the five main areas—improved agency performance, improved people management, improved business processes, improved project maturity at Main Gate, and improved organisational effectiveness.

60. We support the changes set out in '*A Stocktake of Smart Acquisition in the Defence Procurement Agency—The Agreed way forward*'. But they appear to us to go well beyond a 're-invigoration' of Smart Acquisition. Instead, they represent a fundamental

83 Q 98

84 Qq 98–99

85 Q 102

86 Ev 77

87 Q 82

88 Ev 79

89 Ev 75

overhaul of an initiative which, after some six years, had not been implemented as intended. We plan to monitor both the progress in implementing the changes and the improvements which are expected. In order to do so, we recommend that regular reports on the implementation of Smart Acquisition are provided to Parliament.

Savings from Smart Acquisition

61. MoD's Annual Report and Accounts 2002/2003 states that 'Smart Acquisition improvements are estimated to have produced reductions of some £2bn in the cost of MoD's planned equipment programme between 1998 and 2008. Smart Acquisition is now an integral part of MoD business and it is no longer possible to attribute savings directly to Smart Acquisition'.⁹⁰ No explanation of how this figure has been calculated is provided.

62. The fact that only one of the seven principles of Smart Acquisition has been implemented in full, must cast doubt on the scale of the savings which MoD have estimated Smart Acquisition has delivered. We asked whether MoD had quantified the cost to the taxpayer of the non-application of the other six principles. Lord Bach told us that 'It would be impossible to quantify that cost.... Perhaps some of those 7 principles should have been put into effect more clearly before Sir Peter arrived. I accept that. Whether that has cost the taxpayer any quantifiable amount of money I would somehow doubt'.⁹¹

63. **MoD estimates that Smart Acquisition has resulted in savings of £2 billion. However, given that the Chief of Defence Procurement has acknowledged that only one of the seven principles of Smart Acquisition had been implemented, we have no confidence in the reliability of this estimate. Indeed the programme of Smart Acquisition was created and named by government, but does not necessarily define the ultimate standards in defence procurement. Success in defence procurement should be measured by objective standards and not just by reference to the seven principles that the MoD has itself adopted. In future, we expect estimates of savings resulting from Smart Acquisition, or indeed resulting from other MoD initiatives, to be independently validated.**

90 Ministry of Defence, *Annual Report and Accounts 2002/2003*, HC 1125, para 129

91 Q 220

3 Progress on key projects

Astute and Nimrod

64. In last year's report on defence procurement⁹² we examined the problems on the Astute attack submarine and Nimrod MRA4 maritime patrol and anti-submarine/anti-ship attack aircraft programmes. The contracts for both these major projects had to be renegotiated because of difficulties stemming from poorly managed risk. MoD provided memoranda⁹³ for both projects which update the positions. Since we last reported, amended contracts reflecting the Agreements between MoD and BAE SYSTEMS have been signed.

65. On Astute, the current forecast cost is £3,498 million compared to £2,578 million approved at Main Gate and £3,600 million reported in last year's memorandum. The current in-service date is January 2009 compared to the date of June 2005 approved at Main Gate. On Nimrod, the current forecast cost is £3.5 billion compared to £2.8 billion approved at Main Gate and £3.4 billion reported in last year's memorandum. The current in-service date is 2009 compared to the date of 2003 approved at Main Gate.⁹⁴

66. We asked Sir Richard Evans, Chairman of BAE SYSTEMS, whether the revised arrangements on the Astute and Nimrod programmes were working as expected. Sir Richard told us:

There is a much improved partnership in the context of the management of these programmes and, as a result of that, there is a lot of stability where both of these programmes are currently to budget and to time against the revised contract terms.⁹⁵

Both programmes had been recently reviewed and Sir Richard told us that on the basis of these reviews 'both of these programmes are looking good'.⁹⁶ He was confident that both programmes would be delivered within the new arrangements.⁹⁷

67. On Astute, Sir Richard highlighted concerns about retaining submarine design skills and sought from MoD an early indication as to whether there will be orders beyond the third boat. He emphasised that 'It needs to be agreed between the two of us and then we need to agree how we are going to make sure that those resources are maintained'.⁹⁸ On Nimrod, Sir Richard said that there was a lot of stability in terms of the design configuration and he was confident that the first aircraft would be flown in the middle of the year.⁹⁹

92 HC (2002–03) 694

93 Ev 91–94

94 *Ibid*

95 Q 40

96 *Ibid*

97 Q 41

98 Q 43

99 Q 40

68. In July 2004, we visited BAE SYSTEMS at Barrow, where the Astute submarines are being built, to learn about the progress on the programme. We were told that, while some risks had still to be addressed, the company was confident that the in-service date for the first submarine would be met. However, given the problems experienced on the programme, we were surprised to discover that there was only a relatively small MoD team based at Barrow.

69. On the Nimrod programme, MoD acknowledges that risks and challenges remain. However, ‘the development and manufacture of the first three Nimrod MRA4 aircraft to be used in the flight trials programme is well under way and we are making good joint progress towards first flight this summer’.¹⁰⁰ Under the restructured contract, design and production have been separated as far as possible to ensure that technology is adequately de-risked. MoD has, however, approved low risk production activities where these helped maintain essential skills and product knowledge as well as preserving the schedule.¹⁰¹ At a briefing from representatives of the BAE SYSTEMS’ workforce at Woodford, where work on Nimrod is being undertaken, we were told that in order to protect the in service date of 2009 and to retain the required skills, a decision regarding production and location was needed this year.

70. We are pleased to learn that good progress is being made on both the Astute and Nimrod programmes, and that the contractor is confident of delivering the programmes in accordance with the revised arrangements. On Astute, MoD and the contractor need to identify a way forward which ensures that vital submarine design skills are retained, particularly given that the Astute submarines are likely to require major refits in the future. We recommend that MoD sets out in its reply to this report its assessment of what it needs, particularly in terms of Defence Procurement Agency staff of sufficient seniority, at Barrow, where the submarines are being built, to ensure that it is kept fully abreast of developments on this previously troubled programme. On Nimrod, MoD needs to ensure that a decision on the programme is announced in a timescale which will ensure that the in-service date is met and that the skills of the current workforce are not lost.

Future Carrier

71. Last year, we concluded that ‘There is significant merit in the novel ‘Alliance’ arrangement for the Future Carrier programme. There may be some very difficult issues to iron-out, which may yet defeat the MoD. But we welcome the way the Alliance model is trying to avoid some of the pitfalls of the Nimrod and Astute programmes. We welcomed Lord Bach’s assurance that the discussions with France on a possible co-operation with its carrier programme would not be allowed to jeopardise the UK Carriers’ in-service dates’.¹⁰² The Government’s response to our report, published in October 2003, noted that ‘the

100 HC Deb, 21 June 2004, cols 1177–1178W [Commons written answer]

101 Ibid

102 HC (2002–03) 694, p 50

current intention remains to place a Demonstration and Manufacture contract in Spring 2004'.¹⁰³

72. In its memorandum on the Future Carrier,¹⁰⁴ MoD stated that the UK will procure two large aircraft carriers from around 2012 which would operate the Short Take Off and Vertical Landing (STOVL) variant of the Joint Strike Fighter, the Maritime Airborne Surveillance and Control (MASC) capability and other aircraft in a variety of roles. Stage 3 of the Assessment Phase formally started on 5 September 2003 and ran until 31 March 2004. However, work is continuing to develop the carrier design to a high degree of maturity, and MoD is discussing the alliancing strategy for the Demonstration and Manufacture Phases with the two companies—BAE SYSTEMS and Thales UK. The programme remains on target to meet the in-service dates of 2012 and 2015. The current estimate of cost for the carriers is around £3 billion. The memorandum notes that there is agreement between the UK and France, at ministerial level, that industry to industry co-operation represents the best way forward for any UK/France co-operation on aircraft carrier issues.

73. John Howe, Vice Chairman, Thales UK, told us that good progress has been made by the team in continuing with the design and that 'The work that is going on at the moment to complete the design and to assess the risk associated with that is essential before the Ministry takes the big decision'.¹⁰⁵ As already noted (paragraph 27), the Chairman of BAE SYSTEMS told us that the partnership had advised the MoD that there had been insufficient de-risking, and additional funding had been found to keep pre-main gate funding running to enable further work to be done.

74. On the issue of risk assessment, Sir Richard Evans added that:

As yet, there simply has not been sufficient work done to get us to the point where anybody, and by that I mean anybody on the industrial side or anybody on the procurement side, could realistically today make a full assessment of risk. If it were the case that you could make that assessment of risk then this programme would have gone through main gate and, as I have said previously, it has not done. I suspect there is probably realistically at least another year's worth of work to be done before we begin to see whether the scale of risks here can be managed and how they can be managed.¹⁰⁶

75. However, Sir Richard considered that the two companies between them had the capability to deliver the project assuming that no extraordinary risk was identified.¹⁰⁷ Sir Peter Spencer confirmed that the project was still at the de-risking phase and told us that 'all parties agree that it will be mutually beneficial for us to recognise that having spent about five per cent of the budget to date on the assessment phase that there are strong arguments to continue to mature our understanding of the design of the system integration

¹⁰³ Defence Committee, Fourth Special Report of Session 2002–03, *Defence Procurement: Government's Response to the Committee's Eighth Report of Session 2002–03*, HC 1194, para 27

¹⁰⁴ Ev 105–107

¹⁰⁵ Q 32

¹⁰⁶ Q 37

¹⁰⁷ Q 44

aspects and of the supply chain aspects'.¹⁰⁸ This de-risking was likely to continue until at least the end of this year, but Sir Peter did not think that this would lead to delays—it would provide a better understanding in order to set the time and cost targets.¹⁰⁹ Sir Peter told us that at the moment the plan was to come in on these already declared in-service dates, but he said that these would normally be set at the Main Gate decision and when the proposal had been de-risked.¹¹⁰

76. A number of reports in the press suggested that the expected costs of the two carriers could be nearer to £4 billion, compared with MoD's estimate of £3 billion. Sir Peter told us that MoD had 'very good metrics, independently verified, of what we know this carrier can be built for',¹¹¹ and added that a key issue was how MoD was going to go to contract, as a contract which rewarded people for delivering below the target price changed the whole dynamic of the relationship between the client and the supplier.¹¹²

77. We were pleased to learn that the alliance which had brought the BAE SYSTEMS and Thales teams together had been working 'very satisfactorily'.¹¹³ However, Sir Richard Evans was concerned that what was actually developing was 'some sort of procurement committee.... chaired by a procurement officer from the Ministry of Defence who will have a balancing vote on the committee'. He was particularly concerned about who would be responsible for the different risks and questioned whether a committee could adequately deal with the management of a programme of this scale.¹¹⁴ Sir Peter did not wish to comment on the revised arrangements for the alliance, because negotiations with the potential suppliers were taking place. However, he said that MoD had benchmarked against best practice in the petro-chemical industry, and he had looked at the way a similar alliance operated at Heathrow's Terminal Five. He said that the alliance on the Future Carrier was not developing into a 'committee'.¹¹⁵

78. In terms of the discussions taking place between MoD, BAE SYSTEMS and Thales UK on the revised alliance arrangements, Sir Peter told us that there was agreement on the great majority of the detail.¹¹⁶ Lord Bach added that 'proposals in relation to the phases of this procurement are with the rest of Government and it is hoped that we can make an announcement on that very soon indeed. As far as when an alliance strategy is set up, that might take a little bit longer'.¹¹⁷

79. With regard to the French carrier programme, Sir Richard Evans did not expect BAE SYSTEMS to participate to any significant extent.¹¹⁸ John Howe did not think it would be a

108 Q 165

109 Q 167

110 Q 168

111 Q 170

112 Qq 170–171

113 Q 38

114 *Ibid*

115 Q 165

116 Q 272

117 *Ibid*

118 Q 47

question of the French doing a lot of work on a British carrier or the British doing a lot of work on the French carrier. However, he considered that ‘there must be an advantage in the two programmes talking together at the industrial level’.¹¹⁹

80. We consider it vitally important that defence equipment programmes, particularly of the scale of the Future Carrier programme, are properly de-risked and we support the sensible decision to continue with the Assessment Phase on this programme. Publicly announcing the expected costs and in-service dates for the Future Carrier programme before the risks had been properly assessed was a mistake from which MoD must learn. We are pleased to learn that the ‘alliance’ discussions are progressing well and expect MoD to reach agreement on the revised arrangement as soon as possible.

Joint Strike Fighter

81. MoD’s memorandum stated:¹²⁰

The Future Joint Combat Aircraft (FJCA) will replace the capability currently provided by the RN’s Sea Harrier and the RAF’s Harrier GR 7/9 in the second decade of this century. The aircraft will be operated in a joint force, from both the new aircraft carriers and land bases.... The Short Take Off and Vertical Landing (STOVL) variant of the US-led Joint Strike Fighter (JSF) has been selected to meet the requirement and the UK is currently engaged in the System Development and Demonstration (SDD) phase of that programme, as the Level 1 collaborative partner.

The spend on the project to 31 March 2004 was £342 million. Overall aircraft numbers, which have yet to be determined, will drive the cost of the programme. The overall cost of the programme is expected to be in the region of £7–£10 billion.¹²¹

82. We were concerned to learn that, as development has progressed, the work to mature the design to meet weight targets necessary to achieve desired performance levels has proved much more demanding than expected and that the problem appeared to be greater on the STOVL variant of the Joint Strike Fighter. The US Marine Corps, who are also acquiring the STOVL variant of the Joint Strike Fighter, were expected to slip their forecast in-service date from 2010 to 2012.¹²²

83. General Fulton told us that MoD were ‘keenly interested’¹²³ in the issue of the weight problem on the STOVL variant of the Joint Strike Fighter. He had visited Lockheed Martin and said that they were optimistic that the aircraft would perform to its specification.¹²⁴ In terms of the impact on the UK in-service date for the aircraft, General Fulton told us that ‘at the moment we do not know until the programme formally tells us whether they are able to solve the problem and by when’.¹²⁵ Sir Peter Spencer said that it should not

119 Q 47

120 Ev 99

121 Ev 100

122 *Ibid*

123 Q 280

124 *Ibid*

125 Q 283

necessarily be assumed that that there would be a delay of two years for the UK,¹²⁶ because ‘we will ideally slipstream them by two to three years’.¹²⁷ Lord Bach expected the weight problem to be solved and did not believe that it would have an impact on the design and construction of the Future Carriers.¹²⁸

84. It is vital that when the Future Carriers enter service they have their offensive airpower capability, which is to be provided by the STOVL variant of the Joint Strike Fighter. However, it is unclear whether the weight problems currently affecting this variant of the Joint Strike Fighter can be solved to achieve the required performance and, even if they can, how this might affect the planned in-service date. We note that the Minister for Defence Procurement expects the problems to be resolved—this is an issue which we plan to monitor closely.

Eurofighter/Typhoon

85. MoD’s memorandum stated:¹²⁹

Typhoon (formerly Eurofighter) is an agile fighter aircraft that will serve as the cornerstone of the RAF’s future fighting capability. It will bring a significant increase in our air superiority capability as it replaces the Tornado F3 while its multi-role capability will allow Typhoon also to fulfil the ground attack roles now performed by the Jaguar.

The in-service date for Typhoon (defined as the date of delivery of the first aircraft to the RAF) was achieved in 2003—some 54 months late. The current forecast cost of Typhoon is £19,018 million, compared to £16,670 million approved at Main Gate. Typhoon is being produced in three tranches. Contracts for the production of the first tranche of 148 aircraft, of which 55 are for the RAF, were signed in 1998. Future production orders would commit the UK to 89 and 88 aircraft for tranches two and three respectively.

86. The NAO’s Major Projects Report 2003 noted that the second tranche of Eurofighter/Typhoon aircraft was expected to be ordered ‘around the end of 2003’.¹³⁰ However, at the time of our inquiry, the order for the second tranche had still to be placed. Sir Peter Spencer said the delay was because MoD had only recently received a proposition from industry addressing the issue of the price.¹³¹ MoD also needed a proper understanding of what it was going to get for the money, and a proper understanding of the de-risking of the technology as the development contract was completed.¹³²

87. Sir Richard Evans told us that the UK wished to make changes to the international contract for Typhoon and that the principal change was to introduce a new variant of the aircraft and to introduce that variant at tranche two. He added that there was ‘some truth

126 Q 284

127 Q 285

128 Q 286

129 Ev 95–97

130 National Audit Office, *Ministry of Defence Major Projects Report 2003*, HC 195 Session 2003–2004, p 151

131 Q 177

132 Q 178

in the speculation in the press regarding our view on the pricing of those changes which are very different from the views of the Ministry of Defence'.¹³³ In terms of the new variant of the aircraft, Sir Peter Spencer told us that the 'need for the aircraft to be adapted for multi-role capability comes as a direct result of us incrementally moving towards the performance which is now needed in defence.... what we need more of now is air-to-ground'.¹³⁴ However, he told us that the pricing of tranche two production was entirely separate from the enhancement programme to make it multi-role as there was little need for any physical change to the aircraft because that adaptability had been built into the basic design. The enhancements required were largely the software enhancements to the mission system of the aircraft which would be loaded into the aircraft's computer systems.¹³⁵ However, some commentators have suggested that there will be a need to add new systems and modifications for air to ground operations, including target acquisition, weapon delivery and communications.

88. General Fulton did not provide a figure for the cost of undertaking the required enhancements to make the aircraft multi-role, but said that in terms of the total cost to the programme 'it will not have added anything to the totality but clearly it has an impact on the profile of it'.¹³⁶ He told us that it was a more efficient use of resources to have fewer aircraft types that are able to fulfil more tasks,¹³⁷ and added that 'you would need to look at it in terms of whole life costs and in terms of operational flexibility and the overall number of aircraft that you need to own'.¹³⁸ However, Sir Peter Spencer and General Fulton's view of the cost of changing the aircraft to multi-role contrasted with Sir Richard Evans who told us that 'This is a hell of an expensive venture and it requires a very big amount of investment to be put in and this is not an investment that the other governments are willing.... to share'.¹³⁹

89. The Secretary of State has acknowledged that the second tranche aircraft is to be of a different kind from the first tranche and would provide an air-to-ground capability not originally envisaged when the aircraft was designed. He recognised that it was vital for the strike capabilities of the RAF that 'we secure tranche 2 aircraft.... that must be at an affordable price'.¹⁴⁰ MoD is committed to the tranche two purchase of 89 aircraft, but has stated that no decision needed to be made on tranche three until at least 2007.¹⁴¹ Lord Bach did not consider that the date for a decision on tranche 3 created any problems for BAE SYSTEMS at Warton, or in terms of keeping the expertise together.¹⁴²

90. We support the decision to adapt the second tranche of Eurofighter Typhoon aircraft to multi-role, as this will ensure that the UK gets the capability it needs in a

133 Q 52

134 Q 179

135 *Ibid*

136 Q 307

137 Q 305

138 *Ibid*

139 Q 53

140 HC Deb, 21 June 2004, col 1074 [Commons oral answer]

141 Q 308

142 Q 310

changed environment. However, we are concerned that there appears to be a wide disagreement between MoD and industry on how much the necessary enhancements will cost. We find it surprising that MoD considers that there will be little impact on the total cost of the programme, unless there are also plans to reduce the size of the third tranche. We expect MoD to conclude negotiations and place an order for the second tranche as soon as is possible.

Future Rapid Effect System

91. The Future Rapid Effect System (FRES) is intended to provide a capability to deploy an effective, combined arms land based force between the two existing extremes of heavy armour and light forces. It is anticipated that the capability will be provided by a family of medium-weight armoured vehicles that will replace the CVR(T) series, Saxon, and elements of the existing FV430 series.¹⁴³ MoD's memorandum notes that the Initial Gate investment decision had taken longer than expected, but was approved in April 2004.¹⁴⁴

92. Nick Prest, Chairman and Chief Executive of Alvis told us that 'in the armoured vehicle area... MoD has had particular difficulty in formulating its requirements, launching procurement programmes and then sticking to them',¹⁴⁵ and he referred to the various armoured vehicle programmes which had been cancelled such as TRACER and the Multi-Role Armoured Vehicle (MRAV). He noted that FRES was a project which had a number of different strands and that some of the problems of preparing for FRES had 'revolved around trying to disentangle those different elements of the project'.¹⁴⁶

93. Following the April decision, the Minister of State, Adam Ingram, announced¹⁴⁷ on 5 May 2004 details of the two year assessment phase for FRES:

The assessment phase will be led by a systems house, independent of product or manufacturing capability, selected for their programme management, risk management and systems engineering capabilities. The successful candidate will be selected via competition and a contract should be placed in late 2004. The systems house will provide an objective view of ideas and technologies, which may be applicable to FRES, and of the risks inherent in complex "system of systems" integration. It will exploit and build on previous work wherever possible. In addition, as part of an incremental acquisition approach, the assessment phase will include a range of risk reduction and technology demonstration work to examine the risks of relevant technologies and to determine if they are suitable for FRES, allowing the insertion of new technologies as they mature.

94. Nick Prest welcomed the announcement on the assessment phase, but noted that it had taken over two and a half years to launch this phase, which he considered 'unnecessarily long'.¹⁴⁸ He attributed the delays to: the time taken to formulate the business case and get it

143 Ev 103–104

144 Ev 103

145 Q 67

146 *Ibid*

147 HC Deb, 5 May 2004, cols 79–80WS

148 Q 67

through the approvals process; differing opinions on the procurement strategy; and problems in getting the required funding.¹⁴⁹ Northern Defence Industries Ltd referred to FRES as suffering ‘paralysis by analysis’.¹⁵⁰

95. We asked Nick Prest whether the in-service date for FRES of 2009–10 was achievable. He told us that buying off-the-shelf via a non-competitive route would probably provide the quickest in-service date, and a full development programme by full competition would be the longest route and that, depending upon which route MoD pursued, the in-service date could vary between ‘sometime perhaps not very long after 2009 and a date quite a long way after 2009’.¹⁵¹

96. Lord Bach considered a 2009 in-service date for FRES as realistic—‘we think it achievable otherwise we would not say it is’.¹⁵² However, General Fulton noted that the assessment phase will inform the extent to which it is realistic. What he was seeking from the assessment phase was answers to ‘trade-off’ questions.¹⁵³ He explained that what he wanted from FRES was ‘a single family of vehicles which would start with the simpler variants but would grow to some of the more complex variants. That is very much the way the United States are approaching their future combat system’.¹⁵⁴ General Fulton told us that he was faced with a number of demanding and conflicting parameters and the assessment phase would be expected to provide answers as to:¹⁵⁵

how many of these conflicting parameters can I have, in what timescale and at what cost. If that is an equation that just will not work then clearly we will have to look at what is the alternative and one of those would be to buy a stopgap and that would put FRES back to 2015/2020, maybe even 2025, and that is a pretty unattractive prospect to me.

97. We welcome the announcement that an assessment phase contract for FRES will be placed in late 2004, but remain concerned that the in-service date of 2009 will not be met—a concern shared by industry. This is another example, like the Future Carrier, where MoD appears to have announced an in-service date for an equipment before the assessment phase work required to substantiate that date has been undertaken.

Watchkeeper

98. MoD’s memorandum stated:¹⁵⁶

The Watchkeeper system will consist of unmanned air vehicles, sensors, and ground control stations. It will provide UK commanders in the land environment with a 24-hour, all weather, Intelligence, Surveillance, Target Acquisition and Reconnaissance

149 Q 68

150 Ev 120

151 Q 71

152 Q 311

153 *Ibid*

154 Q 313

155 Q 317

156 Ev 98

(ISTAR) capability, providing accurate, timely and high quality imagery to answer commanders' critical information requirements.

The programme is currently completing the Assessment Phase and proposals for the delivery of Watchkeeper have been received from Thales and Northrup Grumman. The current forecast cost of the Assessment Phase is £51.7 million. The main investment decision (Main Gate) is currently planned for later in 2004.¹⁵⁷ MoD's memorandum stated that the definition and timing of the in-service date for an initial operating capability for Watchkeeper would not be confirmed until Main Gate. Proposals have been solicited on the basis of delivering UAV capability to support a Medium Scale warfighting deployment by the 'end of 2006'.¹⁵⁸ Last year we were told that the initial operating capability was planned for 'early 2006',¹⁵⁹ it therefore appears that some delays are already being experienced.

99. We examined Watchkeeper in our report on the New Chapter to the Strategic Defence Review and concluded that:

The MoD's declared determination to "make sure we really do keep our forces equipped with the most up-to-date technology" does not sit with the lack of urgency in acquiring an effective networked UAV capability.¹⁶⁰

100. We are concerned that there are signs that Watchkeeper's initial operating capability is likely to be later than was being forecast last year. This appears to support the conclusion we drew last year—that MoD is still finding some difficulty in balancing increased procurement agility against decreased risk. If this is to be done successfully, it is important, in the assessing of bids, that the technical and Defence Industrial Policy issues are considered concurrently. Failure to do so may not only lead to unnecessary levels of risk but also to delays in the decision making process. We expect MoD to identify ways to restrict any further slippage in delivering the Watchkeeper capability.

157 Ev 98

158 *Ibid*

159 HC (2002–03) 694, para 97

160 Defence Committee, Sixth Report of Session 2002–03, *A New Chapter to the Strategic Defence Review*, HC 93-I, para 112

4 The Defence Industrial Policy

Progress in implementing the Defence Industrial Policy

101. The Defence Industrial Policy was launched in October 2002, after 18 months of discussion between the MOD, DTI and industry.¹⁶¹ The Policy covers four broad areas—Acquiring Capability for the Armed Forces; Market Access; Research and Technology; and the Future.¹⁶² There were six ‘Overarching Themes’:¹⁶³

- Provide required equipment at best value for money at a price we can afford
- Review policy and implementation
- Treat all defence suppliers that create value in the UK fairly, regardless of ownership
- Maximise economic benefit to the UK from defence expenditure
- Maintain close dialogue with industry
- Sustain an environment that enhances competitiveness of defence industry

102. We examined the Policy in last year’s Defence Procurement report and concluded:¹⁶⁴

We very much welcome the publication of the Defence Industrial Policy, bringing as it does a useful, though overdue, increase in transparency to this important area. The way its provisions and statements should be interpreted will inevitably have to be developed; by further debate and through “case law”. Indeed, in some areas, including the use of competition and open markets and in risk management (two of the perhaps more contentious of its themes), the Policy’s utility will be evident only with the passage of time.

First Review

103. The *First Review of the implementation of Defence Industrial Policy*¹⁶⁵ published in November 2003 set out the progress that had been made in the first year since the Policy was launched. The Minister of State, Adam Ingram, summarised the *First Review* as follows:¹⁶⁶

Since we launched the policy we have worked closely with industry to develop and pursue a joint implementation plan. We have completed a review of progress over the first year. During this time our close and productive relationship with industry

¹⁶¹ Speech by the Secretary of State at launch of the Defence Industrial Policy, 14 October 2002

¹⁶² Policy Paper 5: Defence Industrial Policy, Ministry of Defence, 14 October 2002.

¹⁶³ First Review of the implementation of Defence Industrial Policy, October 2003, www.mod.uk

¹⁶⁴ HC (2002–03) 694, para 23

¹⁶⁵ First Review of the implementation of Defence Industrial Policy, October 2003, www.mod.uk

¹⁶⁶ HC Deb, 13 November 2003, col 24WS [Commons written ministerial statement]

has developed further and we have agreed how we will take forward our common aims over the next few years.

The policy has been a significant driver in bringing together Government and industry, resulting in better communication and access to information. We both recognise that the policy is for the long-term and that it will take some time to measure the full effects on defence programmes and the industry that supports them. We remain committed to the policy and will continue to monitor its effectiveness and to develop best practice in this area among the MoD acquisition community. We will also continue to work to improve access to overseas defence markets and to maximise the benefits from our investment in research and technology.

Industry's view

104. From the written evidence we received, it was clear that the Defence Industrial Policy has been very much welcomed by the defence industry, and that industry was keen to see the Policy developed further and implemented in full. Indeed, the Defence Manufacturers Association considered 'the successful implementation of a DIP.... crucial to the future defence policy, security and strategic independence of the UK'.¹⁶⁷

105. A consistent message from the evidence we received from industry was that the main impact of the Defence Industrial Policy to date, was the improved dialogue between industry and government. John Howe, Vice-Chairman of Thales UK, told us that 'there is actually more dialogue between industry and Government than there was a few years ago'.¹⁶⁸ His view was echoed by the Defence Industries Council, who acknowledged that the Policy had 'intensified the dialogue between HMG and industry about the economic implications of defence'.¹⁶⁹

106. The Defence Manufacturers Association concluded that 'after some 20 months of the policy being launched no identifiable, tangible benefits have been delivered to date',¹⁷⁰ but acknowledged that the Policy was not expected to lead to significant changes in the short term. The Defence Industries Council considered the achievements to date to have been modest, noting that 'it is hard to point to examples of positive application of the Policy, and decisions could still be taken that would run counter to any coherent framework on industrial capability'.¹⁷¹

107. In several areas further progress was needed in implementing the Defence Industrial Policy, or the Policy needed to be developed further, or there were other concerns relating to the Policy. These included:

- The need to develop an Industrial Strategy
- The need to implement the Policy through the procurement process

167 Ev 129

168 Q2

169 Ev 112

170 Ev 129

171 Ev 112

- Consolidation in the UK Defence Industry
- Issues relating to open markets and access to technology
- Relations between MoD and industry

Industrial strategy

108. A common concern identified by industry was the need for clarification on what UK industrial capabilities and defence industry would be required in the future. This was emphasised by John Howe, who told us that:¹⁷²

there is still some way to go in one particular area which is clarity about what kinds of industrial capabilities and indeed what kinds of technologies are judged to be of crucial strategic importance in the long term. What kind of industry does the UK think it is important to have in the future? What kind of capabilities is it important to retain for strategic reasons? That is the area where I think we need to go on working to achieve more clarity.

109. Sir Richard Evans, Chairman of BAE SYSTEMS, also highlighted the need for industry to have ‘some clear indications as to what the long-term requirements are particularly in terms of where we are going to invest R&T for the future and we need that a lot more quickly identifying than appears to be the case at the moment’.¹⁷³ He considered that ‘we should.... identify those areas that are strategically important for us in the long term and together concentrate our joint resources into making sure that we stay in the premier league in those areas’.¹⁷⁴

110. The VT Group¹⁷⁵ considered that at the strategic level greater openness regarding long term government expenditure planning would be helpful. This would not be detailed information on individual programme budgets but more general data on for instance future expenditure in a general capability area. They considered that this would reduce uncertainty for industry and encourage more effective investment decision making.

111. Lord Bach also agreed that the main area where the Defence Industrial Policy needed to be developed further was in producing an industrial strategy to sit alongside the industrial policy. He told us that ‘we need to further develop and state what technologies and industrial capabilities are of the greatest importance to us in maintaining existing capabilities, and which ones we expect to require in the long term’.¹⁷⁶ He told us that a meeting had taken place with the National Defence Industries Council at the end of May 2004 and that:

the NDIC supported fully our approach to an important development of an existing part of the policy, namely.... our emerging work on industrial strategy. We are

172 Q 2

173 Q 3

174 Q 9

175 Ev 123

176 Q 187

aiming to identify more explicitly the technical capabilities that we need to meet defence needs now and well into the future. We will assess the importance of sustaining these capabilities in the UK for national security, for technology, or for wider economic reasons. This is a complex undertaking that will take some time to do properly'.¹⁷⁷

112. We welcome the fact that MoD has recognised the importance of establishing an industrial strategy to sit alongside the Defence Industrial Policy, and that work is now in hand to take this forward. Such a strategy needs to provide industry with a clear picture of which industrial capabilities and technologies are considered to be of crucial strategic importance in the future. We recommend MoD take forward this work as a matter of urgency.

113. In terms of specific sectors within the defence industry which need to be retained, Sir Peter told us that:¹⁷⁸

The nuclear sector is very important in terms of supporting the submarine building programme for a nuclear steam raising plant. The surface shipbuilding sector is very important in terms of ensuring that we have actually got the capacity, the skills and the capabilities to deliver the very large programme which is planned for surface shipbuilding, but we have got a bit of a gap in the meantime, which is a worry, and the work is wholly aimed at how we keep those key skills in place and reassure the companies concerned that we are looking at this intelligently.

114. Sir Peter recognised that MoD had 'a responsibility to industry, as well as to the taxpayer, to make the most efficient use of those industrial assets'.¹⁷⁹ In terms of the criteria to be used to decide which sectors of the defence industry it was vital to retain, Sir Peter told us that:

We can all think of areas where we currently have industry and where the instinctive reaction is to say, "We need to keep it in being", in perpetuity perhaps, but we have to test those against some criteria. The first is, are they absolutely critical to national security. The answer for nuclear is self-evidently, yes.... Secondly, is it imperative for defence capability, in other words are we going to need to have these skills in the longer term to support the front line, in other words are we going to need to upgrade them through life and respond to urgent operational requirements during operations. Then there are the wider technical benefits for the nation, do we need these skills for wealth creation, and then there will be area employment issues.¹⁸⁰

115. We consider it critically important that MoD develop clear criteria for deciding which sectors of the defence industry it is vital to retain in the future. Issues such as security of supply, in particular to meet urgent operational requirements, should not be underestimated in making such decisions. Much equipment being procured today will be in-service for the next 20–30 years or more and will need to be upgraded and

177 Q 186

178 Q 122

179 *Ibid*

180 Q 125

maintained. The imperative of retaining the skills within the UK to undertake such work must be recognised. This applies across the range of equipment: from the highest level to the most basic of military requirements.

Implementing the Defence Industrial Policy through the procurement process

116. A common concern relayed to us was that the wider factors to be taken into account in acquisition decisions (which are set out in the Defence Industrial Policy) tended to be considered only at a very late stage in the procurement process. Sir Richard Evans, for example, told us that the policy is ‘a good start but it is absolutely not going to make progress until people implement it through the procurement process and, right now, there is insufficient evidence to say whether or not that is being done effectively across the board’.¹⁸¹

117. Lord Bach acknowledged that this was a legitimate concern, and told us:

I think there has been a tendency for it to be considered at a late stage. I think on occasions it is the sort of thing that has been left, as it were, to ministers to consider when the advice comes up to them from officials. I think that is changing... I do not think it should just be left to ministers at the end to consider these wider issues I think they should be part and parcel of procurement processes from the start’.¹⁸²

118. We are concerned that the wider factors to be taken into account in procurement decisions are still often being considered at a late stage in the process. We expect the Defence Procurement Agency to ensure that additional guidance or training is provided to its staff to address this issue.

119. In last year’s report on defence procurement,¹⁸³ we referred to the Advanced Jet Trainer Programme and the ‘unsolicited offer from BAE SYSTEMS to supply its Hawk 128 for that programme’. At the time, we understood that MoD was expected to decide whether to select the Hawk 128 or open up the programme to international competition. We considered the Hawk case to be an early test for the Defence Industrial Policy, not just in terms of taking account of the long-term prospects for competition, but also in terms of managing risk because the aircraft chosen for the Advanced Jet Trainer programme was then likely to be subsumed in the Military Flying Training System PFI programme.

120. MoD announced on 30 July 2003 that it was to purchase 20 Hawk 128 aircraft with options to buy up to another 24. MoD’s news release¹⁸⁴ announcing the decision noted that MoD had originally explored the possibility of a PFI arrangement with BAE SYSTEMS, but the terms proposed by the company did not offer value for money for the taxpayer.

121. Lord Bach told us that, in terms of specific examples of where the Defence Industrial Policy has had an effect on a procurement decision, ‘The one I would say it has certainly

181 Q 2

182 Q 197

183 HC (2002–03) 694, para 26–27

184 MoD news release, 172/03, 30 July 2003

had an effect on what was the Hawk decision'.¹⁸⁵ Sir Richard Evans also referred to the decision to procure Hawk trainer aircraft, and told us 'If this policy is going to be effective, we really should not be having situations where Secretaries of State are issuing ministerial directives to their departments in order to turn over recommendations that have been made'.¹⁸⁶ Sir Richard told us that the recommendation from the DPA to the minister was to acquire the Aermacchi aircraft rather than the Hawk, and that in coming to that recommendation there was 'absolutely no account taken of that additional value to the UK'.¹⁸⁷ He said that since the decision was taken, the Indian Government had placed an order for 66 Hawks which, had the decision gone against BAE SYSTEMS, would not have been placed. He said he could 'genuinely see us actually being able to sell 400 to 500 aircraft'.¹⁸⁸

122. Sir Peter Spencer would not comment on the detailed advice to ministers, but said that the suggestion that the advice from the DPA to ministers was to opt for the Italian Aermacchi bid was factually incorrect.¹⁸⁹ He considered the episode to have been a good example of the Defence Industrial Policy working 'because if you read the defence industrial policy it says, "We will address these issues upfront before we invite competitive tenders."' ¹⁹⁰

123. We believe that the decision by the Secretary of States to procure the Hawk trainer aircraft was a sensible one, which has resulted in substantial exports for the UK. Possible exports should always be a factor which is taken into consideration in making procurement decisions, and which should be considered at an early point in the procurement process.

Consolidation in the UK Defence Industry

124. The Defence Industrial Policy states that:

The UK defence industry embraces all defence suppliers that create value, employment, technology or intellectual assets in the UK. This includes both UK and foreign-owned companies.

Restructuring of the defence industry brings increasing commercial opportunities for UK companies, and economic and technological benefits through inward investment into the UK. The UK industry cannot grow by meeting domestic requirements alone, nor can all the technologies required by the Armed Forces be sourced from the UK. We will not constrain UK companies from expanding into new markets, except where national security clearly requires otherwise.¹⁹¹

185 Q 187

186 Q 2

187 Q 23

188 *Ibid*

189 Q 113

190 Q 115

191 Policy Paper 5: Defence Industrial Policy, Ministry of Defence, 14 October 2002, page 4

125. Sir Richard Evans told us that ‘although there has been a huge amount of consolidation that has taken place already, it is not going to stop where it is’.¹⁹² He considered that the US was likely to be the main predator and that if the process continued ‘the UK is simply going to become the American metal basher’.¹⁹³ However, Sir Peter did not think this was likely to happen.¹⁹⁴

Recent consolidation in the UK defence industry

126. At the time of our inquiry there were a number of proposed take-overs and reported take-overs of UK defence companies. These included an offer from General Dynamics of the United States for Alvis; an offer from Finmeccanica of Italy for GKN Westland; and reports that BAE SYSTEMS was considering selling its marine division.

127. Nick Prest, Chairman and Chief Executive of Alvis, pointed out that defence was now an international industry, and noted that Alvis had bought businesses in Sweden and in South Africa. He referred to the offer from General Dynamics for Alvis and told us that the reason why these developments were taking place was because companies believed that a bigger international spread in their business would give them access to a wider range of markets, and would enable them to draw on a wider range of sources of research and technology.¹⁹⁵ In the event, BAE SYSTEMS made a counter-bid for Alvis, and it was reported that General Dynamics had declined to revise or extend its offer.

128. We asked Lord Bach about the offer from Finmeccanica for GKN Westland—the UK’s only defence helicopter manufacturer. He told us that ‘These are private companies which are entitled, on the face of it, to engage in what transactions they wish to, subject to regulations and subject, of course, to our being satisfied over a number of very important issues, including security of supply’.¹⁹⁶ He added that ‘It really is time that we left behind the concept that what actually matters in the end is where the ownership of companies actually resides from one day to another, from one month to another. What matters is where the work is done; where the work is produced; where the technology is; and where the value is in the broadest sense’.¹⁹⁷ He added that [in relation to GKN Westland], ‘We will want to talk over matters which relate to much more than just security, but also relate to jobs, work that is promised for the future and what their intentions are.... we have to accept that it is a global defence market’.¹⁹⁸

129. We asked Sir Richard about the reports that BAE SYSTEMS’ naval shipyards might be acquired by a French company. He told us that there had been no discussion of any consequence about selling the naval shipyards to the French, and the French had not made any offers to buy the shipyards. However, he added that, if a proposal was put to BAE

192 Q 4

193 Q 5

194 Q 137

195 Q 12

196 Q 191

197 *Ibid*

198 Q 192

SYSTEMS and ‘we can see a way of more efficiently securing a long-term interest of this business, we will follow it’.¹⁹⁹

Ownership of companies

130. In terms of ownership of companies, Sir Peter would not comment on recent cases, but noted that the ‘Ministry of Defence is able to make representations on two principles, one is security and the Office of Fair Trading will be looking at competitive issues’.²⁰⁰ He added that ‘The whole process is becoming increasingly global. We need to be very clear about the principles which apply here and security of supply during future operations and over time is clearly a key concern of the Ministry of Defence’.²⁰¹ In his view:²⁰²

The restructuring will be inevitably.... a matter for the shareholders of the companies concerned, and there are limits as to the ability of the Ministry of Defence to alter any of that.... If hypothetically you get a change of ownership which gives a strong underpinning of a company to ride out the peaks and troughs of our own demand on industry because they are able to provide work from elsewhere, that can actually be very helpful as a component of nurturing the industrial base over time.

131. Lord Bach told us that ‘BAE SYSTEMS, and other British companies, have bought and purchased companies all over the world, particularly in the United States, and are absolutely entitled to do that. We also, in this country, are willing and happy to see companies that originated in other countries buy into the United Kingdom too’.²⁰³ However, on the issue of overseas companies acquiring UK companies, he told us that ‘Of course it is a concern’ but noted that ‘these companies that are owned abroad and invest heavily in the United Kingdom and create and sustain jobs here, sustain and create technology here, as far as we are concerned, and this must be commonsense in the global defence market, are to be treated as British companies’.²⁰⁴

132. We recognise that defence is a global industry and that consolidation in the defence industry can bring advantages, such as gaining access to a wider market. However, there are also possible disadvantages in that UK defence companies which are owned by overseas companies are more likely to be susceptible to job losses or cuts in investment if the parent company experiences problems. It is of real concern that in recent months, the UK’s only defence helicopter manufacturer has been taken over by an overseas company, and the UK’s main armoured vehicle manufacture was almost taken over by an overseas company. When overseas companies bid for UK defence companies, we expect MoD to consider fully issues of security and the impact on competition, and make the necessary representations where appropriate. It would be a terrible loss if the UK’s remaining defence companies merely became ‘metal bashers’

199 Q 55

200 Q 138

201 *Ibid*

202 Q 139

203 Q 190

204 Q 320

for overseas defence companies. We expect MoD and the DTI to stand ready to take action to counter this risk.

Open markets and access to technology

133. The Defence Industrial Policy states:

Protectionism is not a viable way forward, but we recognise that not all governments approach acquisition with similar openness. We will continue to press for freer access to overseas markets. We aim to improve the flow of defence information and technology access across borders, and to enable the UK defence industry to compete on merit in other markets.²⁰⁵

134. We examined the issue of open markets and access to technology in last year's report on defence procurement.²⁰⁶ We were happy to lend our weight to a campaign to address the lack of open markets in other countries and looked to ministers and their officials to maintain pressure for reciprocal treatment from other defence manufacturing countries. We concluded that 'The UK defence industry would suffer more than most from a retreat into protectionism. It is precisely because of the success abroad of UK firms that pressure must be maintained on the US and European countries to level the playing field'.²⁰⁷

135. In terms of the progress that had been made in opening up markets, Sir Peter told us that 'we have been working hard.... both in the United States and within Europe'.²⁰⁸ However, UK contractors were still experiencing difficulties selling to overseas markets. Sir Richard Evans told us that 'in defence terms, the UK is the only genuine open market in the world today.... For UK contractors to compete in America or to compete in many.... European countries is exceedingly difficult.... it is in everybody's interest that all the markets are as open as possible and that is how we generate real competition and get the benefits from it'.²⁰⁹

136. There are alleged to be signs that the defence market in France is changing—John Howe told us that 'as far as the French market is concerned, I would not argue that it is as open as the British market is, though it has been opening and the French part of Thales would argue that now they do have to win their business in competition which is much stiffer than it would have been a few years ago'.²¹⁰ However, it is not clear whether this meant international competition.

137. The VT Group²¹¹ suggested that a new industry/Government approach to securing greater access to global defence markets should be developed and implemented. They considered that, by developing a common position on this issue, both industry and Government would be able significantly to strengthen their understanding of what trade

205 Policy Paper 5: Defence Industrial Policy, Ministry of Defence, 14 October 2002, page 4

206 HC (2002–03) 694

207 *Ibid.*, p 48

208 Q 108

209 Q 15

210 Q 19

211 Ev 123

barriers actually exist at present. This seemed to us to be something which should be taken forward.

138. In last year's report on defence procurement, we examined a number of issues relating to the United States—including the threat of a more protectionist approach and delays in securing a UK waiver from the US International Traffic in Arms Regulations (ITAR). The Government's Response²¹² to our report noted that 'On his recent visit to Washington, the Prime Minister secured an agreement with President Bush radically to improve the sharing of defence information and technology between our two countries. The Government is also working with the US Administration to secure a waiver for the UK from the US International Traffic in Arms Regulations'. Sir Peter acknowledged that 'this Committee has been extremely supportive of ministers and of the Ministry of Defence in discussing in the United States the general concerns about access to technology, and the results of that were the prospective Buy American legislation which was passed last year was a good deal less problematic than it might have been'.²¹³

139. Despite the efforts that have been made by ministers and the MoD, it was disappointing to learn that little progress has been made and that the issue of protectionism in the US has re-emerged. At a UK/US Defence Industry Seminar held in London on 2 June 2004, Lord Bach raised his concerns about protectionism in the US and noted that, in contrast to European moves to reduce market barriers, there were some in the US who wished to move in the opposite direction—to close off opportunities for cooperation and to erect barriers in the marketplace. Lord Bach told the audience that this would 'undoubtedly harm the UK both in capability and industrial terms, and will also damage US industry with which we have a close relationship and from which we acquire important elements of our national capability'. He said:

Last year we had to deal with the implications of the Defense Authorizations Bill which sought to introduce overt protectionist measures to US defence procurement. It seems like we have escaped from that damaging proposal only to be confronted with another. It's got a new name—4200, new wording and a new strategy. But its supporters and its intentions are the same. And I have no doubt that once again we will need to expend time and effort in countering these proposals.... I am encouraged to learn that the US Administration has expressed its opposition to this language in the House version of the bill.... We have seen some concrete actions from the Administration. For instance we agreed the terms of the ITAR Waiver in May last year. Delivery of the waiver is now long overdue and the frustration that we feel and the messages that it sends are counter-productive. I note that the House version of the 2005 Defense Authorizations bill also includes language which, if enacted, will further impede the introduction of an ITAR waiver. Again I am pleased to see that this language has been opposed publicly by the US Administration'.

140. A recent article in a defence journal²¹⁴ claimed that the UK Government 'has threatened to ban US contractors from significant defense work here if protectionist

212 HC (2002–03) 1194, para 10

213 Q 142

214 *DefenseNews*, 28 June 2004

measures proposed by the US House Armed Services Committee Chairman Duncan Hunter become law.’

141. We are dismayed that a waiver for the UK from the US International Traffic in Arms Regulations (ITAR) has still to be secured and that the introduction of protectionist measures in the US have re-emerged. In addition to the potential damage to both the UK and US defence industries, there is a real risk that the close relationship between the UK and US could be harmed. We note that the US Administration has provided support to the UK on these matters, but it is essential that that support is translated into real results. We again lend our support to ministers and the MoD in addressing these issues.

142. On the issue of problems with access to technology, Sir Richard Evans cited the example of the Joint Strike Fighter. He told us that ‘I think the JSF is a classic example. It is no good when you have signed up and paid your cheque over then trying to go back to negotiate the release of technology’²¹⁵ He pointed out that in the case of the Joint Strike Fighter there would probably be two or three major updates throughout the programme and these will be undertaken by Lockheed in the US and not in the UK.²¹⁶

143. We raised this concern with Sir Peter Spencer who told us that the issue of access to technology was an extremely sensitive area for the United States. He said that a Bilateral Defense Acquisition Committee has been set up.²¹⁷ This is a senior forum between the United States Department of Defense and the United Kingdom Ministry of Defence and its terms of reference include to ‘Develop and co-ordinate efforts to improve information and technology exchange including the timely release of classified and sensitive information’²¹⁸ He added that ‘we have identified the specific areas which need to be followed through, including the Joint Strike Fighter.... So far as access to technology which is needed by British Aerospace to discharge its responsibilities as subcontractor to Lockheed Martin on Joint Strike Fighter, we have been getting there’.²¹⁹ He said that ‘We need to know that we can operate this thing effectively in operations, not join a queue and get the thing fixed six months later’.²²⁰

144. The issue of access to technology on the Joint Strike Fighter was also raised by Lord Bach at the UK/US Defence Industry Seminar on 2 June 2004. He noted that ‘We had a difficult start to exchanging the necessary data and technical information on this programme, but a concerted effort at the most senior levels on both sides has delivered success’. However, some reports in the media have suggested that there was continuing concern among the collaborative partners on the project about US restrictions on information sharing.

145. Information transfer delays, on programmes such as the Joint Strike Fighter, can prevent co-operating industrial partners from fulfilling their contractual obligations.

215 Q 16

216 Q 43

217 Q 142

218 HL Deb, 10 June 2004, cols 49–50WA [Lords written answer]

219 Q 142

220 Q 143

We note that a Bilateral Defense Acquisition Committee, involving the UK and US, has been established and that it is tasked with developing and co-ordinating efforts to improve information and technology exchange including the timely release of classified and sensitive information. We note that MoD considers that, on the Joint Strike Fighter programme, the necessary data and technical information is now being exchanged, and we expect MoD to ensure that this remains the case.

Relations between MoD and industry

146. The Minister of State, Adam Ingram has said that, since the launch of the Defence Industrial Policy, ‘our close and productive relationship with industry has developed further.’²²¹ However, in the run-up to our evidence session with the Defence Industries Council, a number of press articles had reported that the relationship between MoD and the UK’s largest defence contractor—BAE SYSTEMS—had reached an all time low.

147. We asked Sir Richard Evans about his company’s relationship with MoD. He considered it to be pretty robust but thought it would get quite a bit tougher given the issues presently under discussion.²²² However, he also believed that:

We need to put this behind us and have a fresh start on this.... I want it to be quite clear that in the context of my position and indeed Dick Olver, who is taking over from me in July, our objective is to have a proper and good relationship with the most important single customer that we have.²²³

We were interested in Lord Bach’s view on MoD’s relations with industry and, specifically, with its largest supplier. He told us that:²²⁴

I really do not think the fact that there is tension between industry, on the one side, and the Ministry of Defence, on the other, is necessarily a bad thing.... As far as BAE SYSTEMS are concerned.... The relationship is often satisfactory, and sometimes good or better.

He went on to say, ‘I actually accept what you said to Sir Richard—which was that it was important that all sides do their best to make sure that the relationship was a workable one, and one that got better rather than worse’.²²⁵ He considered that was happening.

148. For the Defence Industrial Policy to succeed, it is important that there is a constructive relationship between MoD and the defence industry. We are disappointed to learn that there have been difficulties in the relationship between the MoD and the UK’s largest defence contractor—BAE SYSTEMS. We note that both MoD and BAE SYSTEMS recognise the need to rebuild their relations, and we encourage them to push forward with their efforts to do so.

221 HC Deb, 13 November 2003, col 24WS [Commons written ministerial statement]

222 Q 51

223 Q 61

224 Q 189

225 *Ibid*

5 Conclusion

149. At a time when both our Armed Forces are over-stretched and the defence budget is under pressure, it is vital that defence equipment projects are delivered on time, and the costs of defence procurement are controlled. The aim of the Smart Acquisition initiative, launched as part of the Strategic Defence Review in 1998, was to procure equipment faster, cheaper, better, and there were some early indications that that this aim might be achieved. However, the scale of the time slippage and cost increases in 2002–03, suggest that the benefits expected from Smart Acquisition are still some way off. Most disappointing of all, it was the failure to implement the initiative, rather than initiative itself, which was at fault—only one of the seven principles of Smart Acquisition has been delivered in full, and some hardly implemented at all. A programme of measures to ‘re-invigorate’ Smart Acquisition has been identified, but its success will again depend upon how fully it is implemented. Crucial to this is the need for senior management of MoD and the Defence Procurement Agency to drive the programme forward and review its effectiveness—something which has been lacking to date in relation to Smart Acquisition.

150. The Defence Industrial Policy by comparison was launched only 20 months ago. It is hardly surprising that it has yet to deliver many tangible benefits. As well as pressing ahead with implementing the Policy, a key priority for MoD must be to push forward its work on producing an Industrial Strategy to sit alongside the Industrial Policy. Industry needs to know what kinds of industrial capabilities and technologies are likely to be required in the future, to reduce uncertainty and help it decide where best to invest.

151. The Defence Industrial Policy and Smart Acquisition should be seen as two complementary approaches to the same problem. The Defence Industrial Policy should provide a context for Smart Acquisition by giving greater clarity to industry about MoD’s priorities and a more consistent and coherent baseline from which MoD can develop its relationship with industry. Smart Acquisition should put flesh on the bones of that partnership by using protocols and procedures which are understood by both sides and which are therefore seen to be fair to both sides. Thus progress in one should reinforce progress in the other. But the reverse is equally possible. Failure to implement one could undermine the effectiveness of the other. Relations between MoD and industry would deteriorate as each believed the other had failed to live up to its undertakings. The annual cycle of cost overruns and time slippages in the procurement programme would be perpetuated.

152. It is therefore crucial that the Defence Industrial Policy does not experience similar implementation problems to those which have beset the Smart Acquisition initiative. We were concerned to hear that industry believed that little real progress had been made and that already they had doubts about the priority which MoD was giving to effective implementation of the policy. Although it will be some time before the impact of the Defence Industrial Policy can be fully assessed, we welcome the publication of an Annual Review of the implementation of the Policy. Neither the MoD nor the British defence industry can afford to risk the prospect that, in a few years time, a ‘Stocktake of the Defence Industrial Policy’ will find endemic problems of non-implementation on the scale that the Stocktake of Smart Acquisition has found this year.

Conclusions and recommendations

1. The performance of the Defence Procurement Agency in 2002–03 can only be described as woeful. On the somewhat optimistic assumption that no further slippage is experienced, major equipment projects will on average be delivered to the end user a year and a half late. The substantial in-year cost increases of some £3.1 billion will have a major impact on the current equipment plan and must inevitably lead to cancellations or cuts in equipment projects, or delays in ordering equipment. Such substantial cost increases are also likely to have an impact beyond defence procurement and result in cuts elsewhere. Given the recent pressures on our Armed Forces we believe such impacts would be unacceptable. (Paragraph 12)
2. We find it immensely disappointing that the Smart Acquisition initiative, launched some six years ago, has yet to deliver its aim of procuring equipment faster, cheaper, better. We are particularly concerned that it will still be some time before poor performance is reversed and the expected benefits from Smart Acquisition delivered. We are forced to conclude that our Armed Forces have been let down by the organisation tasked with equipping them. (Paragraph 19)
3. The Chief of Defence Procurement’s assessment of the Defence Procurement Agency identified long-running systemic problems and a failure to implement the principles of Smart Acquisition. We regret that both his predecessor and the current Minister for Defence Procurement failed to act earlier to address, what even the latter referred to as, ‘some things which have been endemically wrong for some time that we still haven’t sorted out’. (Paragraph 21)
4. It comes as no surprise that a key underlying cause of poor performance, in terms of delivering projects to time and cost, has been MoD’s failure to invest enough money and time to sufficiently de-risk projects in the Assessment Phase. This is a concern which we, our predecessors, and the National Audit Office, have highlighted over the past 20 or so years.²²⁶ MoD now proposes to spend more money and time in the Assessment Phase. We welcome this intention, but given past failures to address this longstanding problem we are still to be convinced that it will be implemented in practice. (Paragraph 28)
5. It is, again, very disappointing that another principle of Smart Acquisition—the routine trade-offs between performance, time and cost—has not been implemented as intended. Without such trade-offs, time slippage and cost increases occur. We expect the Defence Procurement Agency and MoD to address the reasons which have, to date, limited the use of trade-offs, and to monitor the use of such trade-offs. (Paragraph 32)
6. Whole-Life Costing is another key principle of Smart Acquisition which has yet to be implemented. While we acknowledge that some progress has been made in this area,

226 See previous Defence Committee Reports on Procurement, www.parliament.uk/parliamentary_committees/defence_committee.cfm and NAO Major Projects Reports, www.nao.gov.uk. Also see Ev 80–107.

we expect MoD to ensure that the whole-life cost data currently being produced is refined further so that it can support decision making. (Paragraph 37)

7. Delays in MoD decision-making result in a great deal of uncertainty and expense for defence companies. For some companies, particularly smaller ones, there is a risk that such delays can lead to them going out of business. We expect MoD, to consult with industry on this matter, and to push forward with its efforts to identify and implement quicker decision making processes. (Paragraph 41)
8. We consider it essential that the Defence Procurement Agency's approach to contracting, and procurement generally, aligns with best practice. Although action is now being taken, we find it surprising that, some six years after Smart Acquisition was introduced, the Agency has only recently made concerted efforts to identify best practice elsewhere and reflect this in its own arrangements. We would expect a major procurer, such as the Defence Procurement Agency, to be constantly abreast of best practice elsewhere and to update its arrangements accordingly. We recommend that the Agency do so in future. (Paragraph 44)
9. It is unsatisfactory that Legacy projects are measured against a 50 per cent approval while Smart Acquisition projects are measured against a 90 per cent approval, and we therefore welcome the move to reporting project performance against the 50 per cent estimate for all projects. This should eliminate any misunderstanding among project leaders as to what they are expected to deliver. Time will tell if the new organisational changes at the Defence Procurement Agency provide the clear direction to project leaders which has been lacking to date. We recommend that the Agency's senior management monitor the effectiveness of the new organisational arrangements in this regard. (Paragraph 49)
10. A combination of what has been called a 'fear culture' at the Defence Procurement Agency and an ineffective internal review process has resulted in problems on projects being hidden and going undetected. The Chief of Defence Procurement must ensure that there is a culture change at the Agency which encourages problems on projects to be disclosed. We also expect senior management at the Agency to have accurate and timely information on the status of projects. The proposed new assurance arrangements should, therefore, be introduced as a matter of urgency and regularly reviewed to assess their effectiveness. (Paragraph 53)
11. The new Key Targets for the Defence Procurement Agency should provide a better measurement, and be more representative, of the work that it undertakes. We welcome the addition of a new target covering asset delivery, which should ensure that the Agency focuses its attention on delivering to the front line—something which has often been lacking in the past (Paragraph 57)
12. We consider it important that the National Audit Office continues to validate the performance of the Defence Procurement Agency against the new set of key targets, particularly as the targets for cost and time slippage will now cover a much larger number of projects. (Paragraph 57)
13. We support the changes set out in 'A Stocktake of Smart Acquisition in the Defence Procurement Agency—The Agreed way forward'. But they appear to us to go well

beyond a ‘re-invigoration’ of Smart Acquisition. Instead, they represent a fundamental overhaul of an initiative which, after some six years, had not been implemented as intended. We plan to monitor both the progress in implementing the changes and the improvements which are expected. In order to do so, we recommend that regular reports on the implementation of Smart Acquisition are provided to Parliament. (Paragraph 60)

14. MoD estimates that Smart Acquisition has resulted in savings of £2 billion. However, given that the Chief of Defence Procurement has acknowledged that only one of the seven principles of Smart Acquisition had been implemented, we have no confidence in the reliability of this estimate. Indeed the programme of Smart Acquisition was created and named by government, but does not necessarily define the ultimate standards in defence procurement. Success in defence procurement should be measured by objective standards and not just by reference to the seven principles that the MoD has itself adopted. In future, we expect estimates of savings resulting from Smart Acquisition, or indeed resulting from other MoD initiatives, to be independently validated. (Paragraph 63)
15. We are pleased to learn that good progress is being made on both the Astute and Nimrod programmes, and that the contractor is confident of delivering the programmes in accordance with the revised arrangements. On Astute, MoD and the contractor need to identify a way forward which ensures that vital submarine design skills are retained, particularly given that the Astute submarines are likely to require major refits in the future. We recommend that MoD sets out in its reply to this report its assessment of what it needs, particularly in terms of Defence Procurement Agency staff of sufficient seniority, at Barrow, where the submarines are being built, to ensure that it is kept fully abreast of developments on this previously troubled programme. On Nimrod, MoD needs to ensure that a decision on the programme is announced in a timescale which will ensure that the in-service date is met and that the skills of the current workforce are not lost. (Paragraph 70)
16. We consider it vitally important that defence equipment programmes, particularly of the scale of the Future Carrier programme, are properly de-risked and we support the sensible decision to continue with the Assessment Phase on this programme. Publicly announcing the expected costs and in-service dates for the Future Carrier programme before the risks had been properly assessed was a mistake from which MoD must learn. We are pleased to learn that the ‘alliance’ discussions are progressing well and expect MoD to reach agreement on the revised arrangement as soon as possible. (Paragraph 80)
17. It is vital that when the Future Carriers enter service they have their offensive airpower capability, which is to be provided by the STOVL variant of the Joint Strike Fighter. However, it is unclear whether the weight problems currently affecting this variant of the Joint Strike Fighter can be solved to achieve the required performance and, even if they can, how this might affect the planned in-service date. We note that the Minister for Defence Procurement expects the problems to be resolved—this is an issue which we plan to monitor closely. (Paragraph 84)

18. We support the decision to adapt the second tranche of Eurofighter Typhoon aircraft to multi-role, as this will ensure that the UK gets the capability it needs in a changed environment. However, we are concerned that there appears to be a wide disagreement between MoD and industry on how much the necessary enhancements will cost. We find it surprising that MoD considers that there will be little impact on the total cost of the programme, unless there are also plans to reduce the size of the third tranche. We expect MoD to conclude negotiations and place an order for the second tranche as soon as is possible. (Paragraph 90)
19. We welcome the announcement that an assessment phase contract for FRES will be placed in late 2004, but remain concerned that the in-service date of 2009 will not be met—a concern shared by industry. This is another example, like the Future Carrier, where MoD appears to have announced an in-service date for an equipment before the assessment phase work required to substantiate that date has been undertaken. (Paragraph 97)
20. We are concerned that there are signs that Watchkeeper's initial operating capability is likely to be later than was being forecast last year. This appears to support the conclusion we drew last year—that MoD is still finding some difficulty in balancing increased procurement agility against decreased risk. If this is to be done successfully, it is important, in the assessing of bids, that the technical and Defence Industrial Policy issues are considered concurrently. Failure to do so may not only lead to unnecessary levels of risk but also to delays in the decision making process. We expect MoD to identify ways to restrict any further slippage in delivering the Watchkeeper capability. (Paragraph 100)
21. We welcome the fact that MoD has recognised the importance of establishing an industrial strategy to sit alongside the Defence Industrial Policy, and that work is now in hand to take this forward. Such a strategy needs to provide industry with a clear picture of which industrial capabilities and technologies are considered to be of crucial strategic importance in the future. We recommend MoD take forward this work as a matter of urgency. (Paragraph 112)
22. We consider it critically important that MoD develop clear criteria for deciding which sectors of the defence industry it is vital to retain in the future. Issues such as security of supply, in particular to meet urgent operational requirements, should not be underestimated in making such decisions. Much equipment being procured today will be in-service for the next 20–30 years or more and will need to be upgraded and maintained. The imperative of retaining the skills within the UK to undertake such work must be recognised. This applies across the range of equipment: from the highest level to the most basic of military requirements. (Paragraph 115)
23. We are concerned that the wider factors to be taken into account in procurement decisions are still often being considered at a late stage in the process. We expect the Defence Procurement Agency to ensure that additional guidance or training is provided to its staff to address this issue. (Paragraph 118)
24. We believe that the decision by the Secretary of States to procure the Hawk trainer aircraft was a sensible one, which has resulted in substantial exports for the UK.

Possible exports should always be a factor which is taken into consideration in making procurement decisions, and which should be considered at an early point in the procurement process. (Paragraph 123)

25. We recognise that defence is a global industry and that consolidation in the defence industry can bring advantages, such as gaining access to a wider market. However, there are also possible disadvantages in that UK defence companies which are owned by overseas companies are more likely to be susceptible to job losses or cuts in investment if the parent company experiences problems. It is of real concern that in recent months, the UK's only defence helicopter manufacturer has been taken over by an overseas company, and the UK's main armoured vehicle manufacture was almost taken over by an overseas company. When overseas companies bid for UK defence companies, we expect MoD to consider fully issues of security and the impact on competition, and make the necessary representations where appropriate. It would be a terrible loss if the UK's remaining defence companies merely became 'metal bashers' for overseas defence companies. We expect MoD and the DTI to stand ready to take action to counter this risk. (Paragraph 132)
26. We are dismayed that a waiver for the UK from the US International Traffic in Arms Regulations (ITAR) has still to be secured and that the introduction of protectionist measures in the US have re-emerged. In addition to the potential damage to both the UK and US defence industries, there is a real risk that the close relationship between the UK and US could be harmed. We note that the US Administration has provided support to the UK on these matters, but it is essential that that support is translated into real results. We again lend our support to ministers and the MoD in addressing these issues. (Paragraph 141)
27. Information transfer delays, on programmes such as the Joint Strike Fighter, can prevent co-operating industrial partners from fulfilling their contractual obligations. We note that a Bilateral Defense Acquisition Committee, involving the UK and US, has been established and that it is tasked with developing and co-ordinating efforts to improve information and technology exchange including the timely release of classified and sensitive information. We note that MoD considers that, on the Joint Strike Fighter programme, the necessary data and technical information is now being exchanged, and we expect MoD to ensure that this remains the case. (Paragraph 145)
28. For the Defence Industrial Policy to succeed, it is important that there is a constructive relationship between MoD and the defence industry. We are disappointed to learn that there have been difficulties in the relationship between the MoD and the UK's largest defence contractor—BAE SYSTEMS. We note that both MoD and BAE SYSTEMS recognise the need to rebuild their relations, and we encourage them to push forward with their efforts to do so. (Paragraph 148)

Annex: List of Abbreviations

CVR(T)	Combat Vehicle Reconnaissance (Tracked)
DIP	Defence Industrial Policy
DPA	Defence Procurement Agency
DTI	Department of Trade and Industry
FRES	Future Rapid Effect System
HMG	Her Majesty's Government
IDIQ	Indefinite Deliverable, Indefinite Quantity
ISTAR	Intelligence, Surveillance, Target Acquisition and Reconnaissance
ITAR	International Traffic in Arms Regulations
JSF	Joint Strike Fighter
MASC	Maritime Airborne Surveillance and Control
MoD	Ministry of Defence
MRAV	Multi-Role Armoured Vehicle
NAO	National Audit Office
NDIC	National Defence Industries Council
PFI	Private Finance Initiative
RAF	Royal Air Force
RN	Royal Navy
R&T	Research and Technology
SDD	System Development and Demonstration
STOVL	Short Take Off and Vertical Landing
UAV	Unmanned Air Vehicle
UK	United Kingdom
US	United States

Formal minutes

Wednesday 14 July 2004

Members present:
Mr Bruce George, in the Chair

Mr James Cran
Mr David Crausby
Mike Gapes
Mr Mike Hancock

Mr Kevan Jones
Rachel Squire
Mr Peter Viggers

The Committee deliberated.

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

Paragraphs 1 to 152 read and agreed to.

Annexes [Summary and List of Abbreviations] agreed to.

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

Ordered, That the Chairman do make the Report to the House.

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

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

Ordered, That several memoranda be reported to the House.

[Adjourned till Wednesday 21 July at 2.30 pm]

Witnesses

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Wednesday 5 May 2004

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Sir Richard Evans, Chairman, BAE Systems, and Chairman, Defence Industries Council, **Mr Nick Prest**, Chairman and Chief Executive, Alvis, and Vice Chairman, Defence Industries Council, **Mr John Howe**, Vice Chairman, Thales UK, and **Mr Simon Frost**, Chief Executive, Claverham

Ev 1

Wednesday 12 May 2004

Sir Peter Spencer KCB, Chief of Defence Procurement, Ministry of Defence

Ev 20

Wednesday 20 April 2004

Lord Bach, a Member of the House of Lords, Minister for Defence Procurement, **Sir Peter Spencer KCB**, Chief of Defence Procurement, and **Lieutenant General Rob Fulton**, Deputy Chief of Defence Staff (Equipment Capability), Ministry of Defence

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Tony Purton	Ev 128
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List of unprinted written evidence

An additional paper has been received from the following organisation and has been reported to the House but to save printing costs it has not been printed. A copy has been placed in the House of Commons Library where it may be inspected by Members. Other copies are in the Record Office, House of Lords and are available to the public for inspection. Requests for inspection should be addressed to the Record Office, House of Lords, London SW1 (Tel 020 7219 3074); hours of inspection are from 9:30am to 5:00pm on Mondays to Fridays.

PIMS Associates Limited

Reports from the Defence Committee since 2001

Session 2003–04

First Report	Armed Forces Pensions and Compensation	HC 96–I & II (<i>Cm 6109</i>)
Second Report	Annual Report for 2003	HC 293
Third Report	Lessons of Iraq	HC 57–I, II & III (<i>HC 635</i>)
Fourth Report	Strategic Export Controls: Annual Report for 2002, Licensing Policy and Parliamentary Scrutiny	HC 390
Fifth Report	The Defence White Paper 2003	HC465–I & II

Session 2002–03

First Report	Missile Defence	HC 290 (<i>HC 411</i>)
Second Report	Annual Report for 2002	HC 378
Third Report	Arms Control and Disarmament (Inspections) Bill	HC 321 (<i>HC 754</i>)
Fourth Report	The Government's Proposals for Secondary Legislation under the Export Control Act	HC 620 (<i>Cm 5988</i>)
Fifth Report	Strategic Export Controls: Annual Report for 2001, Licensing Policy and Parliamentary Scrutiny	HC 474 (<i>Cm 5943</i>)
Sixth Report	A New Chapter to the Strategic Defence Review	HC 93–I & II (<i>HC 975</i>)
Seventh Report	Draft Civil Contingencies Bill	HC 557 (<i>Cm 6078</i>)
Eighth Report	Defence Procurement	HC 694 (<i>HC 1194</i>)

Session 2001–02

First Report	Ministry of Defence Police: Changes in jurisdiction proposed under the Anti-terrorism Crime and Security Bill 2001	HC 382 (<i>HC 621</i>)
Second Report	The Threat from Terrorism	HC 348 (<i>HC 667</i>)
Third Report	The Ministry of Defence Reviews of Armed Forces' Pension and Compensation Arrangements	HC 666 (<i>HC 115</i>)
Fourth Report	Major Procurement Projects	HC 779 (<i>HC 1229</i>)
Fifth Report	The Government's Annual Report on Strategic Export Controls for 2000, Licensing Policy and Prior Parliamentary Scrutiny (Joint with Foreign Affairs Committee, International Development Committee and Trade and Industry Committee)	HC 718 (<i>Cm 5629</i>)
Sixth Report	Defence and Security in the UK	HC 518 (<i>HC 1230</i>)
Seventh Report	The Future of NATO	HC 914 (<i>HC 1231</i>)

Government Responses to Defence Committee reports are published as Special Reports from the Committee (or as Command papers). They are listed here in brackets by the HC (or Cm) No. after the report they relate to.