House of Commons
Defence Committee

Defence Equipment 2009

Third Report of Session 2008–09

Report, together with formal minutes, oral and written evidence

Ordered by the House of Commons
to be printed 10 February 2009
The Defence Committee

The Defence Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Ministry of Defence and its associated public bodies.

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The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at: www.parliament.uk/defcom

Committee staff

The current staff of the Committee are Mike Hennessy (Clerk), Richard Ward (Second Clerk), Karen Jackson (Audit Adviser), Sara Turnbull, (Inquiry Manager), Richard Dawson (Senior Committee Assistant), Christine McGrane (Committee Assistant) and Stewart McIlvenna (Committee Support Assistant).

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Summary

The mission of the MoD’s (Ministry of Defence’s) Defence Equipment and Support (DE&S) organisation is to equip and support our Armed Forces for operations now and in the future. Support to current operations in Afghanistan and Iraq has taken priority. Both DE&S and industry must be congratulated for their performance in providing equipment and supplies to our Armed Forces involved in these two operations.

The Urgent Operational Requirement (UOR) system remains highly effective in enabling vital equipment to be provided quickly to the two theatres to meet rapidly changing threats. However, we are concerned at the extent to which UORs represent a partial failure to equip our forces for predicted expeditionary operations, and at their effects on the core budget in future years. The procurement of 700 new armoured vehicles announced at the end of October 2008 is a welcome and clear sign of the Government’s commitment to protecting our Service personnel.

The performance of DE&S in delivering equipment and supplies to the two theatres, often in very challenging environments, has been impressive. However, given the ageing transport aircraft fleet, there are pressures on the airbridge. The A400M aircraft programme—to provide new tactical and strategic airlift—is running some two years late. Once the extent of the delay to the A400M programme is confirmed, the MoD needs to decide whether it considers the programme to be so delayed that abandonment would be preferable, and to take timely decisions either to procure or lease other airlift assets so that a capability gap in air transport does not develop.

DE&S’ performance in procuring longer-term equipment declined significantly in 2007–08. The forecast costs for the 20 largest defence projects increased by £205 million and the forecast delays increased by some 100 months in the year. The targets for cost and time for 2008–09 will be missed. Supporting current operations is likely to have been a factor behind the decline in procurement performance as some key DE&S staff have been transferred to work on shorter-term projects. There must also be cause for concern that the improvements promised by both the long-standing application of the principles of ‘smart procurement’ and the more recent formation of the DE&S organisation appear not to have materialised.

The new Secretary of State for Defence acknowledges that the MoD needs to deliver more equipment programmes to budget and on time. A new review will examine the progress in implementing procurement reforms, and make recommendations on how to secure better value for money in the delivery of equipment programmes. It will be vital for the MoD to implement the recommendations both quickly and fully and also learns the lessons from the failure of past reviews.

The Comprehensive Spending Review settlement for defence, announced on 25 July 2007, provided an additional £7.7 billion for defence by 2011, and a 1.5 per cent average annual real terms increase. Cost growth on equipment programmes has increased the pressures on the defence budget. Some commentators have suggested that an extra £1.5 billion a year is needed for the defence equipment element of the budget if the Defence Industrial Strategy...
is to be fully delivered. Claims by senior industry representatives that the equipment programme is in “limbo” and that the Defence Industrial Strategy is “on hold” suggest that funding issues are more acute than ever. The MoD acknowledged that Defence Inflation might be a factor and is undertaking analysis to demonstrate its impact. This analysis must be undertaken with a greater sense of urgency.

The Statement by the Secretary of State on 11 December 2008 acknowledges the pressures on the MoD’s budget and the need to rebalance the equipment programme. The MoD is to delay the entry into service of the two new aircraft carriers. The future carrier programme is likely to cost more in the longer-term as a result of the delay. It is deeply disappointing that it will be some time before the Royal Navy is operating the two new carriers with their full complement of new Joint Strike Fighter aircraft. The announcements in the Statement relating to the Future Lynx and other helicopter programmes are to be welcomed provided that sufficient numbers of aircraft are procured. Additional helicopter assets are much needed by our Armed Forces on operations and these programmes must be managed in a way which avoids any delays in bringing them into service.

The FRES programme has been a fiasco. The FRES Utility Vehicle no longer appears to be a priority. The Army will certainly not be getting the vehicle “in the early part of the next decade” as the MoD informed the Defence Committee in December 2006. This programme was poorly conceived and managed from the outset. The MoD has wasted both its and industry’s time and money. The MoD must decide what its requirements are for medium-weight armoured vehicles and identify lessons from the FRES Utility Vehicle programme.

Further announcements about the equipment programme may be made in spring 2009 following the completion of Planning Round 2009. Sufficient focus and funding is essential for the longer-term equipment programmes. The UK must have the equipment it requires for the types of operations it may face in 10, 15 and 20 years’ time. It is also crucial that the UK has the industrial capabilities, identified in the Defence Industrial Strategy, to manufacture and support a significant proportion of such equipment onshore, thereby retaining operational sovereignty. Industry needs clarity about future equipment requirements to enable it to make the necessary investment and such clarity was to have been provided in the updated version of the Strategy, which was originally expected to be published in December 2007. As is the case with many equipment programmes, the deadline for the updated Strategy was missed. There is now some doubt as to whether the updated Defence Industrial Strategy will appear at all. We condemn the failure to date to publish an updated version of the Defence Industrial Strategy and consider that its continuing absence increases the risk that the UK Defence Industrial Base will not be able to meet the future requirements of our Armed Forces.

Finally, the UK’s future military capability depends on the investment made today in Research and Development. The reduction in the amount spent on defence research was short-sighted. If the UK is to play a meaningful role in the world in the future, sufficient funding for defence research needs to be ring-fenced. The MoD must recognise the very high priority of research and reverse the cut in research spending; if not, the role which our Armed Forces can play in the future risks being substantially diminished.
1 Introduction

1. The Defence Committee has undertaken regular inquiries into issues relating to defence equipment procurement and the Defence Industrial Strategy (DIS). In our Report on *Defence Equipment 2008*, published on 27 March 2008, we examined: the first year of operation of the Defence Equipment and Support (DE&S) organisation (created on 1 April 2007 from the merger of the Defence Procurement Agency (DPA) and the Defence Logistics Organisation (DLO); the current and future issues facing DE&S and defence equipment procurement generally; and the progress on key equipment programmes. The Government response to our Report was published on 17 June 2008. Following the publication of the response, there have been several major announcements relating to defence equipment including:

- the announcement during the Defence Procurement debate on 19 June 2008 that the MoD was “undertaking a short examination of the equipment programme to look at our planning assumptions over the next 10 years”;
- the publication on 21 July 2008 of the Ministry of Defence Annual Report and Accounts 2007–08 showing that Public Service Agreement (PSA) Target 6—“Deliver the equipment programme to cost and time”—was only “partly met” and acknowledging that, over the year, “procurement performance declined”;
- the appointment on 5 October 2008 of Quentin Davies MP, as the new Minister for Defence Equipment and Support; and
- the Statement by the new Secretary of State for Defence on 11 December 2008 announcing the “key conclusions” from the short examination of the equipment programme, including the decision to delay “the In Service Date of the new carriers by 1–2 years”.

2. In this inquiry we once again examined the progress and performance of DE&S, but also broadened our inquiry to cover other key issues including: the announcements following the completion of the short examination of the equipment programme; the funding of defence equipment and support; and the progress with the DIS.

3. We held three oral evidence sessions for our inquiry: on 18 November 2008 we took evidence from senior representatives from the UK defence industry; on 25 November 2008 we took evidence from General Sir Kevin O’Donoghue, Chief of Defence Materiel (CDM) and head of DE&S, and DE&S officials; and on 16 December 2008, we took evidence from the new Minister for Defence Equipment and Support (the areas which the Minister leads
on are set out in Table 1 below), CDM, Lieutenant General Andrew Figgures, Deputy Chief of the Defence Staff (Equipment Capability), and Mr Amyas Morse, Defence Commercial Director. We received written evidence from a wide range of organisations and individuals. We are grateful to all those who contributed to our inquiry, including our specialist advisers.

Table 1: Areas which the Minister for Defence Equipment and Support leads on

<table>
<thead>
<tr>
<th>Min DE&amp;S leads on:</th>
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<tbody>
<tr>
<td>• Defence Equipment Programme through life</td>
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<tr>
<td>• Logistic support including:</td>
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<tr>
<td>• Defence Support Group</td>
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<tr>
<td>• Defence Storage and Distribution Agency</td>
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<tr>
<td>• Defence Industrial Strategy</td>
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<tr>
<td>• Acquisition Reform</td>
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<tr>
<td>• Performance Management of DE&amp;S including:</td>
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<tr>
<td>• Major Projects Report</td>
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<td>• National Defence Industries Council</td>
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<tr>
<td>• Defence Science and Technology including:</td>
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<tr>
<td>• Defence Technology Strategy</td>
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<tr>
<td>• DSTL</td>
</tr>
<tr>
<td>• QinetiQ</td>
</tr>
<tr>
<td>• Commercial Policy throughout the Department</td>
</tr>
<tr>
<td>• Atomic Weapons Establishment</td>
</tr>
<tr>
<td>• Defence exports including international aspects of defence equipment and support</td>
</tr>
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Source: Ministry of Defence

http://www.mod.uk/DefenceInternet/AboutDefence/People/Ministers/UnderSecretaryOfStateAndMinisterForDefenceEquipmentAndSupport.htm
2 DE&S progress and performance

Overview of DE&S

4. An overview of DE&S is provided in Table 2 below. DE&S is a Top Level Budget (TLB) area of the MoD. The mission of DE&S is “To equip and support our Armed Forces for operations now and in the future.”

Table 2: Overview of DE&S

<table>
<thead>
<tr>
<th>Defence Equipment and Support (DE&amp;S) equips and supports the UK’s armed forces for current and future operations. Employing approximately 25,500 people, with a budget of £13 billion, its Headquarters is located in Bristol with other sites located across the UK and overseas.</th>
</tr>
</thead>
<tbody>
<tr>
<td>DE&amp;S acquires and supports through-life, equipment and services ranging from ships, aircraft, vehicles and weapons, to information systems and satellite communications. As well as sustaining ongoing requirements including food, clothing, medical supplies and temporary accommodation, DE&amp;S is also responsible for HM Naval Bases, the joint supply chain and British Forces Post Office (BFPO).</td>
</tr>
<tr>
<td>DE&amp;S works closely with industry through partnering agreements and private finance initiatives in accordance with the Defence Industrial Strategy (DIS) to seek and deliver effective solutions for defence.</td>
</tr>
</tbody>
</table>

Source: Ministry of Defence

Inquiries undertaken by the Committee into DE&S

5. We have undertaken regular inquiries into defence equipment procurement. In our Report Defence Procurement 2006 published on 8 December 2006, we examined the performance of the DPA against its Key Targets and how the merger of the DPA and the DLO was progressing. In our Report Defence Equipment 2008 published on 27 March 2008, we examined the progress of DE&S in its first year of operation. The specific issues examined in this report included: the progress in implementing the Defence Acquisition Change Programme; the progress in implementing the Through Life Capability Management (TLCM) approach; the progress in improving DE&S staff skills (particularly engineering, project management, logistics, finance and commercial skills); the plans to reduce DE&S staff to 20,000 by 2012 (on 1 April 2007 when the DPA and DLO merged, DE&S had some 27,500 staff); new approaches to contracting, such as contracting for availability; the efficiency and value for money improvements expected from the merger (the merger was expected to generate annual net cash-releasing savings of some £250 million by 2010–11 and further savings were expected in the future from the collocation of most of DE&S business in the Bath and Bristol area); and the measuring and reporting of

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8 DE&S Business Strategy 2008-12, paras 1.1-1.2
9 http://www.mod.uk/DefenceInternet/MicroSite/DES/

**Overview of DE&S progress**


DE&S was established as a ‘fit for purpose’ organisation in April 2007, only nine months after the decision to merge was announced. Immediately after the merger, the DE&S Main Board began more detailed work to evolve the organisation from one that was ‘fit for purpose’ into one that was agile and effective, which led to the new ‘Blueprint’ for the organisation to be delivered by 2012 by the PACE (Performance, Agility, Confidence, Efficiency) Change Programme. Although it is still relatively early days, DE&S is settling down well as a key deliverable of acquisition change and as part of ‘Team Defence’. It has created a strong focus on improving it ability to deliver its mission […] Although DE&S has achieved much since it stood up in April 2007, progress has inevitably been faster in some areas than others. Business change has been more straightforward where operational pressures are less intense, and where the management team was already well established at the time of merger.13

7. The progress of DE&S, some 18 months after the merger, was referred to in some of the written evidence we received. Table 3 provides examples from the written evidence we received about the progress of DE&S.

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12 Defence Committee, Seventh Special Report of Session 2007-08, Defence Equipment 2008; Government response to the Committee’s Tenth Report of Session 2007-08, HC 555

Table 3: Examples from the written evidence received about DE&S progress

<table>
<thead>
<tr>
<th>Organisation</th>
<th>Comments about DE&amp;S progress</th>
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<tbody>
<tr>
<td>EADS UK</td>
<td>“remarkable progress has been achieved merging the DPA and DLO organisations in the midst of difficult circumstances strategically and financially”.(^\text{14})</td>
</tr>
<tr>
<td>Unite Amicus Section</td>
<td>“Unite believes Defence Equipment and Support (DE&amp;S) is not achieving the objectives for which it was created”.(^\text{15})</td>
</tr>
<tr>
<td>VT Group</td>
<td>“Structural changes take time to bed down; more importantly, it is necessary to build a new culture and set of behaviours to support the new structure…. VT is sensitive to the fact that any assessment of DE&amp;S’ performance must be set in the context of the MoD’s current budgetary challenges and the pressure of supporting simultaneously deployed operations in Afghanistan and Iraq. DE&amp;S is in effect running in parallel two very different procurement processes”.(^\text{16})</td>
</tr>
<tr>
<td>Serco</td>
<td>“We welcomed the formation of DE&amp;S, and are greatly encouraged by early progress in improving relations between the MoD and industry and improvements to the procurement process which, ultimately, serve to strengthen support to operations”.(^\text{17})</td>
</tr>
<tr>
<td>Defence Industries Council (DIC)</td>
<td>“MoD deserves praise for the expeditious way the transformation was managed and executed. Although the process remains to be completed we recognise and support the efforts that have been made to embed Through Life Capability Management (TLCM) in the heart of the organisation’s structures and processes. We believe the department is heading in the “right direction” even if many remain impatient for greater progress”.(^\text{18})</td>
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8. While the evidence received has generally welcomed the progress made to date following the merger, some of the evidence commented on the impact of supporting current operations. The memorandum from the Defence Industries Council (DIC) states that:

However it is difficult to judge the overall success of the transformation in the current circumstances. DE&S has, quite rightly, focused considerable attention on support to operations and the overall impact of the MoD’s current financial and programme difficulties have slowed the decision making processes in many areas and slowed progress in the introduction of newer, longer term, acquisition approaches based on the principles of TLCM. Companies may therefore find it difficult to divorce some systematic improvements from the impact of programme delays and may be more conscious of the disruptions caused as a result of reductions and changes amongst their regular contacts in project teams. When the current programme difficulties are resolved it should allow the newly transformed organisation to demonstrate its true capabilities.\(^\text{19}\)

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\(^\text{14}\) Ev 66, para 1
\(^\text{15}\) Ev 67
\(^\text{16}\) Ev 70, para 3
\(^\text{17}\) Ev 74
\(^\text{18}\) Ev 75, para 1
\(^\text{19}\) Ev 75, para 2
9. At our evidence session on 18 November 2008 with industry representatives, we asked about the progress made by DE&S since the merger. Mike Turner, Chairman of the Defence Industries Council, said that he thought that the “MoD should be congratulated on the speed with which they did that [bringing together of the DPA and the DLO] and brought it into effect”. Ian Godden, Chief Executive of the Society of British Aerospace Companies (SBAC) considered that:

In terms of a merger of interest, it takes 18 months typically in any corporate entity or any government entity to put the two things together and develop. I think it has made the right move; it has progressed, et cetera. I think, however, in the organisation the issue is not so much a big budget issue but the fact that the pressure on the organisation on the very things we have talked about earlier, which are UORs, the whole concept of developing and revising the equipment review and so on and the issues around government policy on skills and technology, has acutely distracted the organisation from getting on with that programme. I think it has done excellently; it has worked hard at it, but it could be accelerated with a bit of stability in terms of what is happening to the overall picture. That is my observation of it.

Bob Keen, Head of Government Relations, BAE Systems, added that:

I would agree with all of that but I think it is worth saying that there is quite a lot of work going on to embed some of the through-life capability management principles into the way the new organisation does its business. There has been a good lead, from our perspective as a company, given by the capability area in MoD, the next stage of which is the establishment of a series of programme boards which will bring together the various stakeholders and interests in a particular capability area. I do not think we should ignore the work that has been going on, having established the organisation, to embed some of those principles into the way it operates. As Ian says, clearly that has been clouded by the general background against which they have been operating.

10. DE&S was created on 1 April 2007 following the merger of the Defence Procurement Agency and Defence Logistics Organisation. Some 20 months after the merger, DE&S appears to have made good progress and is considered to be “heading in the right direction”. The progress made has been achieved against a backdrop of supporting current operations in Afghanistan and Iraq. We commend the Chief of Defence Materiel and DE&S staff for their achievements to date.

11. While industry has generally welcomed the progress made to date by DE&S, it has also called for this progress to be accelerated and considers that the establishment of programme boards will be particularly beneficial. In its response to our Report, we expect the MoD to set out its plans for accelerating the progress achieved to date, the key changes it expects to see implemented in 2009, its plans relating to the establishment of programme boards, including the benefits expected from such boards.

20 Q 33
21 Q 34
22 Q 35
23 Ev 75, para 1
Performance in supporting current operations

12. The Ministry of Defence Annual Report and Accounts 2007–08 provides some statistics on the scale of the support being provided to current operations:

Between April and December 2007 we moved 45,000 tons of freight to Iraq and Afghanistan. In the same period the Defence Stores Distribution Agency made 300,000 issues in support of operations and 50,000 personnel were moved to theatre.24

13. We asked which specific issues about support to current operations were of most concern to CDM. He told us that:

Do the Forces in theatre and the Forces in contact have the right equipment? Is it the best equipment that we can give them? Is it properly integrated? Do they have the right amount of combat supplies, ammunition, food and so on? That is going well. I think the answer is: yes, they do. To answer your specific question: that is what I do worry about.25

I am happy—and this comes from the commanders in the field—that our Forces are the best equipped that they can be. I do not know if you saw Andy McNab over the weekend, if I can quote him, saying that the American infantry are looking to use the British infantry’s equipment. That is an interesting comment.26

14. On the issue of the transport assets available to the MoD, CDM said that the Ro-Ro ferries were good and had worked well and that it was fairly easy to take up shipping from trade “to get the sea line of communication out to Karachi or out to Iraq”. However, he considered that one of the highest risks was “strategic air”,27 and at the top of his wish list for supporting current operations would be “more strategic air”.28 We consider the issue of the airbridge below.

Airbridge

15. CDM emphasised at the evidence session on 25 November 2008 that the airbridge was “successful” with some 80% of aircraft leaving Brize Norton within four hours of the time they were planned to leave. However, he acknowledged that, while the airbridge was “workable”, it was “fragile”.29 The new Minister for Defence Equipment and Support appeared to see the situation with the airbridge as more serious. He told us that “we do find ourselves in a difficult situation with the A400M […] and we do have a big problem, we do have a big gap in the airbridge”.30
16. We examined strategic airlift and the issue of the airbridge in our Report Strategic Lift, published on 5 July 2007. We had been concerned to learn that the A400M transport aircraft programme, which is to provide new strategic and tactical airlift for our Armed Forces, had been delayed by 15 months. As a consequence of the delay the lives of ageing Hercules C-130K aircraft had to be extended. Some of the written evidence we received for this inquiry referred to the delays on the A400M programme and are set out in Table 4 below.

Table 4: References to the delays on the A400M programme in the written evidence received

<table>
<thead>
<tr>
<th>References to delays on the A400M programme</th>
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<tr>
<td><strong>EADS UK</strong></td>
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<tr>
<td>“While there remain challenges in some programmes, on A400M it needs to be recognised that this aircraft is designed to meet a seriously demanding and much needed requirement for the RAF and European air forces. It will provide a unique and very flexible capability; but it is consequently a very complex machine. For example, this aircraft will incorporate state-of-the-art systems and structure in addition to using power plants designed from scratch specifically to deliver the performance capability demanded by the customers. It was also designed to be as US ITAR restriction free as possible and to create a sovereign ability in Britain and Europe to design create and support serious tactical/strategic lift for our military customers. It is clearly not a straightforward civil Airbus product, and accordingly cannot be approached in the same manner as simply procuring a civil aircraft. We and our suppliers are working intensively with our customers to resolve outstanding issues as well as to mitigate the impact of any delays. We are confident of agreeing a robust way forward”.</td>
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| **Royal Aeronautical Society**            |
| “Our prediction that further slippage was likely was dismissed by industry spokesman as being too pessimistic. It gives the Society no pleasure to see that its misgivings have come to pass. The Society is concerned that a much-needed military capability, as well as a potentially valuable asset in world markets will be subject to further delay [...] There is little utility in detailing the reasons for the problems with the A400M, save to provide some support for EADS-Airbus’ claim that its commercial freedom to manage the programme has been compromised by the politics of collaboration. Airbus was employed to instill the kind of commercial discipline so often lacking in collaborative programmes. In accepting a fixed price contract, it was prepared to assume a large degree of risk. It now seems intolerable that Airbus must now pay the penalty for decisions forced upon it for national industry policy reasons and for the continued interference from several national procurement agencies [...] If anything, the experience to date with the A400M has re-enforced negative perceptions of European collaboration and there is a danger that firms with other options, particularly in the US, may look for alternative partnerships that could undermine a European defence industrial community that has delivered benefits, particularly technological, for both Europe and the United Kingdom”. |

17. In terms of the current assessment of the delay to the A400M programme, CDM said he was “working on an in-service date of at least two years’ delay”.

31 Defence Committee, Eleventh Report of Session 2006-07, Strategic Lift, HC 462
32 ibid, para 77
33 Ev 66, para 2
34 Ev 72, paras 11–13
35 Q 259
date was December 2011, a forecast in-service date slippage of 24 months. The Minister for Defence Equipment and Support told us that “we are sadly […] some way from an in-service date for the A400M”. An article in the Sunday Times on 11 January 2009 reported that the programme had experienced further delays and A400M aircraft “may not now be delivered until 2012 or later”.

18. CDM could not provide us with any more details about the likely in-service date as he was “waiting for the company to tell us what the new delivery schedule will be”. We pressed CDM on when he expected the delivery schedule from the company. He said that:

> I genuinely do not have a date, but I will be disappointed if it were more than a few months. Very disappointed […] there are a number of milestones (which I am not prepared to go into for commercial reasons) coming up, which I think will encourage the company to reach a view on the delivery schedule sooner rather than later.

19. The key date for the MoD was getting the delivery schedule from the company, in order to allow it to make the necessary decisions about other options to pursue. CDM said that the MoD was already considering “what we will do when we know what the schedule is going to be. So, yes, we have to get our plans together to see what we will do if, as you say, the A400M slides off further to the right”. We asked about the options being considered. CDM outlined these as follows:

> We have got a number of alternatives. We have got the [Hercules] C130Js which are fine; we have got the Ks which should be going out of service—we could extend them at a cost, that is one option; we could try to bring forward the A330s from the future strategic tanker aircraft—that is another option we are exploring; we could buy more C17s—that is another possibility. There are a number of options sitting on the table. There are also some commercial options as well—we could hire aircraft […] The key here is to find out what the schedule for delivery of the A400M is, and that is the challenge at the moment.

The Minister for Defence Equipment and Support confirmed that these were the options that the MoD were looking at and that there might be “one or two others”. He stressed that “the airbridge is an absolute critical imperative for us”.

20. It is extremely serious that the A400M transport aircraft programme, which is to provide much needed new tactical and strategic airlift for our Armed Forces, is now running two years late and further delays cannot be ruled out. We expect the MoD to
press the contractor for a new delivery schedule for the programme and examine closely
the assumptions and estimates in the schedule to ensure they are robust. Once the new
delivery schedule is confirmed, the MoD needs to act swiftly to take the decisions which
will prevent any capability gap emerging in the future relating to air transport. We
expect the MoD, in its response to our Report, to provide us with an update on the
forecast in-service date for the A400M programme and to update us on the action it is
proposing to take once the new delivery schedule has been received from the
contractor.

21. We consider that the Government has no choice but to consider the options referred
to by the Chief of Defence Materiel. We call on the Government to set out its most up-
to-date thinking on these options and to say whether it considers that there is a real risk
that the entire A400M project might be so delayed that abandonment would be
preferable. The costs and benefits attributable to any such decision should be clearly
explained.

22. We sought confirmation that A400M aircraft will have a full Defensive Aids Suite
(DAS) when they enter service. The Minister for Defence Equipment and Support
confirmed that they would, but added that DAS would only be fitted for “the ones that we
are employing in theatre”. We pressed further on this matter and asked whether the MoD
might be procuring some A400M aircraft without a full DAS on the basis that these aircraft
would not be flying into dangerous areas. We were surprised to learn from the Minister
that the MoD “need to take that decision nearer the time”. He added that:

I have just given you the general principle and it is a very important general
principle. In so far as we were clear that some A400Ms would not need to fly into
theatre maybe we would not need to fit the defensive aid suites, but we would have to
take a view as to whether it would be sensible to have some aircraft, maybe just for
training purposes, where we did not need that. It is a decision we have not taken
yet. 47

23. On the issue of whether the A400M aircraft would be fitted with a fuel inertion system
and with explosive suppressant foam, the Minister said that, as with DAS, “the same
principles apply in all three cases because obviously the three cases are very analogous and
the same issue arise”. 48

24. We asked whether the Chinook helicopters which had just been made available to go to
Afghanistan would have a fuel inertion system. General Figgures explained that:

They have the pannier tanks, the piano hinges and they have got self-sealing tanks so
the business of catastrophic failure through fire would appear not to be the same as
on a large fixed-wing aircraft; there is a balance of risk there, but we constantly
review where to strike that balance. If we felt as a result of this constant assessment
that it was necessary to do it we would have to do it, although again we may not do it

45 Q 382
46 Q 383
47 Q 384
48 Q 387
in quite the same way. Currently we believe we have reduced the risk sufficiently through the self-sealing tanks and the fact that they are on panniers outside. When you have an enforced landing the tanks fall off and so reduce the danger of a catastrophic fire.\textsuperscript{49}

25. We asked General Figgures what made him think that the decision on the Chinook helicopters regarding a fuel inertion system was the right one. He said that it was:

Because I am certainly conscious of the requirement to review this and carry out the necessary risk assessments and carry out the necessary trials to see that we have reduced it to as low as reasonably practicable.\textsuperscript{50}

26. The Minister for Defence Equipment and Support has assured us that all the A400M transport aircraft which will be deployed into theatre will be fitted with a full Defensive Aids Suite, a fuel inertion system and explosive suppressant foam. Given that risks to aircraft are not restricted to operational theatres, we consider it surprising that a decision has yet to be made on whether the A400M aircraft not earmarked to be used in operational theatres will be fitted with all three systems. The safeguarding of our Service personnel should be paramount and the equipment they operate should have the maximum protection available. We note that the MoD considers that the risk of catastrophic fire on Chinook helicopters with pannier fuel tanks is low. We look to the MoD to ensure that its assessment about such risks is robust and is re-examined on a regular basis.

\textit{Urgent Operational Requirements}

27. Equipment needed for current operations is acquired through the Urgent Operational Requirement (UOR) process. We have examined the UOR process in a number of our inquiries. In our report \textit{UK land operations in Iraq 2007}, published on 3 December 2007, we noted the MoD’s assessment that the UOR process was working well in “rapidly delivering to the front line the battle-winning capability required by our Armed Forces”.\textsuperscript{51}

28. The written evidence received for this inquiry has generally praised the UOR process. The memorandum from the VT Group states that “There is a widespread consensus that the Urgent Operational Requirements (UOR) process is very effective in delivering quickly much needed equipment and support to the frontline”.\textsuperscript{52} At our evidence session with industry representatives, Mike Turner said that the MoD should be given “great credit on UORs. They have responded to what the lads need out in Iraq and Afghanistan in a magnificent way and so has industry”.\textsuperscript{53} At our evidence session with CDM and DE&S officials, we asked whether the UOR process was still operating effectively. CDM confirmed that it was “working successfully”, although he acknowledged that

\textsuperscript{49} Q 388  
\textsuperscript{50} Q 390  
\textsuperscript{51} Defence Committee, First Report of Session 2007-08, \textit{UK land operations in Iraq}, HC 110, para 72  
\textsuperscript{52} Ev 70, para 3  
\textsuperscript{53} Q 62
improvements could always be made.\textsuperscript{54} Dr Tyler, Chief Operating Officer, DE&S, provided further details regarding UORs:

This is practically our top focus in ensuring the delivering of UORs. Earlier this year we established a UOR programme office whose specific remit was to look across all of our areas of UOR activity, and make sure that we were continuously trying to improve delivery. Indeed, the numbers for this year so far have improved on last year’s numbers. Last year we were delivering 67 per cent of our projects at their 50 per cent forecast; and 86 per cent at their 90 per cent; and this year we have improved—79 per cent of them being delivered at their 50 per cent forecast; and 89 per cent at their 90 per cent forecast, so we are on an improving trend. One of the things that is an increasing challenge for us is the technical complexity and scale of some of the UORs, the sophistication of them. Some of the pieces of equipment we are putting in under UORs previously would have been small core, programme projects in their own right; but of course what we are having to do is get them into theatre very, very quickly.\textsuperscript{55}

29. We note that the Urgent Operational Requirement process has continued to prove highly effective in enabling vital equipment to be provided in quick time to our Armed Forces in Afghanistan and Iraq.

30. On 29 October 2008 the Secretary of State announced that further protected vehicles, some 700 new vehicles, are to be procured as Urgent Operational Requirements for operations in Afghanistan and Iraq. The Statement says that:

£500 million of funding has been allocated from the reserve towards this protected mobility package, which is expected to cost over £600 million in total. Defence will fund a part of the package in acknowledgement of the longer-term benefit to core Defence capability these vehicles offer beyond our current commitments.\textsuperscript{56}

31. We welcome the announcement on 29 October 2008 that a substantial number of protected vehicles are to be procured as Urgent Operational Requirements. The protection of our Service Personnel against continuously evolving threats must be the top priority. In its response to our Report, we expect the MoD to provide us with an update on its progress in acquiring these new vehicles and a breakdown of the procurement costs, including details of how much is to be funded from the MoD’s budget. We also expect the MoD to provide us with details of which of the vehicles are expected to provide “longer-term benefit” beyond the current operations in Afghanistan and Iraq.

Costs and funding of Urgent Operational Requirements

32. In our Report \textit{Ministry of Defence Annual Report and Accounts 2006–07}, published on 28 January 2008, we set out the costs of UORs in the period 2002–03 to 2006–07. These costs are set out in Table 5 below and also include the costs for 2007–08.

\textsuperscript{54} Q 135
\textsuperscript{55} Q 135
\textsuperscript{56} HC Deb, 29 October 2008, Cols 28-30WS
Table 5: Spend on UORs in the last six years

<table>
<thead>
<tr>
<th>Financial year</th>
<th>Approval cost (£ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002–03</td>
<td>0.500</td>
</tr>
<tr>
<td>2003–04</td>
<td>0.180</td>
</tr>
<tr>
<td>2004–05</td>
<td>0.130</td>
</tr>
<tr>
<td>2005–06</td>
<td>0.260</td>
</tr>
<tr>
<td>2006–07</td>
<td>0.790</td>
</tr>
<tr>
<td>2007–08</td>
<td>1,600.57</td>
</tr>
<tr>
<td>Total</td>
<td>3,460</td>
</tr>
</tbody>
</table>

Sources: Ministry of Defence

33. The Ministry of Defence Annual Report and Accounts 2007–08 states that:

The Urgent Operational Requirement (UOR) process is continuing to deliver; rapidly acquiring and delivering theatre-specific, battle-winning capability required by our Armed Forces at the front line. From April 2007 to March 2008 over 220 UORs were approved to a value of £1.6bn, bringing the overall total of UOR approvals to some £3.5Bn since the beginning of operations.

The MoD expects to spend £1,065 million on UORs in 2008–09 for the operations in Afghanistan and Iraq.

34. The change in the funding of UORs was announced on 22 November 2007 by the Rt Hon Baroness Taylor of Bolton, at the time Minister for Defence Equipment and Support. She acknowledged that when UK Armed Forces were deployed on operations, they faced challenges that “could not have been anticipated in the initial planning” and in those situations it was necessary to procure equipment quickly, utilising the UOR process, to counter those challenges. However, she said that:

much of the new equipment that we have developed because of problems in the theatre will be incorporated into mainstream planning. That is normal and right […]

The new approach with the Treasury means that, in the three years of the Comprehensive Spending Review, the reserve will continue to pay all additional costs of operations up front and will pay outright for UORs up to a mutually agreed total. Beyond that, the MoD and the Treasury will split the cost 50:50, with the MoD having to repay its share two years later, by which time there could have been
adjustments in the programme. The Treasury will give an extra £200 million in 2010–11 to ensure that the new arrangements are cost-neutral to defence.  

The Minister emphasised that the suggestion that the Treasury was “clawing back” more than the £2 billion already spent on UORs was not correct as the “only difference is the new arrangements for the future”.  

35. In our inquiry into the Ministry of Defence Annual Report and Accounts 2006–07, we sought further details about the new arrangements for funding UORs. In our Report Ministry of Defence Annual Report and Accounts 2006–07, we concluded that “The arrangements appear far from straightforward and we will be interested to see how they work out in practice when they are implemented. We look to the MoD to ensure that the new arrangements do not, in any way, undermine the success of the UOR process seen to date”.  

36. In November 2007 new arrangements for the funding of Urgent Operational Requirements (UORs) were announced. These new arrangements mean that, once the cost of UORs in a year have exceeded an agreed total with the Treasury, the MoD will have to contribute to half of the costs exceeding the agreed total and repay this two years later to the Treasury. In its response to our Report we expect the MoD to provide us with details of how the new arrangements have operated in practice, including its estimate of how much of the spend on UORs in 2008–09 will be funded from the MoD budget. We also expect the MoD to set out which of its programmes or activities will need to be re-prioritised in order to fund the cost of the UORs in 2008–09 which fall to the MoD’s core budget.  

37. While we are satisfied with UOR process, we remain concerned that the extent of UORs represents at least a partial failure by the MoD to equip adequately its forces for expeditionary operations which were anticipated by the Strategic Defence Review a decade ago.

Recuperation of equipment

38. In our Report Defence Equipment 2008, we examined the issue of repairing, refurbishing, supporting and storing equipment returning from current operations. The relevant paragraphs from this Report are reproduced in Table 6 below.

62 HL Deb, 22 November 2007, Col 997
63 HL Deb, 22 November 2007, Col 997
65 ibid, paras 155
Table 6: Recuperation of equipment—extracts from Defence Equipment 2008 Report

<table>
<thead>
<tr>
<th>Recuperation of equipment</th>
</tr>
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<tbody>
<tr>
<td>53. We examined support for operations in our UK land operations in Iraq 2007 report. One of the concerns raised in our report was:</td>
</tr>
<tr>
<td>that equipment returning from operational theatres—whether it was procured through the routine acquisition process or as UORs—will require substantial expenditure to repair, refurbish, support and store, and it appears that no provision has been made for this in the MoD’s budget.</td>
</tr>
<tr>
<td>54. The Government Response to this report states that:</td>
</tr>
<tr>
<td>In order to maintain equipment capability and avoid degeneration, we may repair and overhaul military vehicles used on operations more often than would routinely have been planned for in through-life costing assumptions. But the precise impact of activity on current operations and the subsequent costs of recuperation to a balanced force are complex issues, which depend on a range of factors. We have therefore initiated a substantial study to provide a detailed assessment of these issues, including the costs relating to operational usage, which will help to inform future equipment and financial planning.</td>
</tr>
<tr>
<td>55. We asked whether the recuperation of equipment would be funded as a cost of operation or whether it came out of the core budget. Lieutenant General Applegate said that:</td>
</tr>
<tr>
<td>Some of that funding does come out of contingency funding in order to maintain it. I am less sanguine about the cost of recuperation…. in other words, at a time when we do not need that equipment on the operation, or the operation is closing down, or we are trying to reconstitute a reserve, is there sufficient money to prepare for a contingency task in five years’ time? That is an issue which the department is looking at in this [Planning] round.</td>
</tr>
<tr>
<td>56. We note that the MoD has initiated a study to assess the impact of current operations on equipment, such as vehicles, and the subsequent costs of recuperation. We see the costs of recuperation as a cost of operation to be funded from the Reserve and not from the defence budget which is already under substantial pressure. In its response to our report, we expect the MoD to set out the terms of reference for this study and, once the study is completed, to provide us with a copy of it.</td>
</tr>
</tbody>
</table>

Source: Defence Committee

39. The Government response to our recommendation regarding the study to assess the impact of current operations on equipment stated that:

Our examination on the impact of current operations on equipments is in an early stage. No terms of reference have been set. When the study has been completed, the results will be made available to the Committee.

40. Given that the Government response was published on 17 June 2008, we asked CDM about the progress with the study. He said:

That work is in hand; it is in hand in the equipment capability area; we are looking at the costs; we are looking at the timescale; and it is not yet ready to report.

67 Defence Committee, Seventh Special Report of Session 2007-08, Defence Equipment 2008: Government response to the Committee’s Tenth Report of Session 2007-08, HC 555, para 10
68 Q 110
Rear Admiral Paul Lambert, Capability Manager (Precision Attack) and Controller of the Navy added that:

"We are still in the middle of looking at this. There will be a debate on the costs and where those costs fall. We are in no position yet to say precisely where we are… it is a continuous investigation on the equipments; how quickly they are being burnt up; and what the issues are on recuperation etc. It is a continuous process."\(^6^9\)

41. We were concerned that the heavy usage of equipment on current operations would lead to equipment wearing out more quickly than planned and capability gaps arising as a result. However, to our surprise, Rear Admiral Lambert said that he had looked at this issue, and helicopters and aircraft were “not being burnt up any faster than we had predicted”.\(^7^0\)

42. We sought clarification as to whether the recuperation work would be funded from the Reserve as an additional cost of operation, or from the MoD’s budget. We found the response from CDM of concern:

"I do not think we have discussed that yet. I can see it being quite difficult to discuss. Until we know the costs—which we do not yet—it is quite difficult to have a discussion about who is going to pay for it. We are not there yet."\(^7^1\)

43. We pressed CDM further on this matter. Unfortunately, we were still unclear about which budget would bear the cost:

"The cost of repairing vehicles that are required to be repaired, replacing and buying UORs, the cost of those operations is covered by the contingency Reserve… What I thought we were talking about was, if one of these operations ceases and then everything comes out of theatre, if that were to happen, who then pays for the cost of doing whatever needs to be done to it? Bear in mind, a lot of it will have been brought up-to-date, brought up to the most recently required specification anyway, and that is paid for out of the contingency Reserve. We are talking about something which is a bit of an unknown here, and that is our difficulty [...] I thought your question was about when something stops everything comes out and is sitting there who pays for that to be recuperated? That is quite a difficult debate to have until we know how much has to be spent on doing what to it, and what the requirement is."\(^7^2\)

44. We are concerned that the MoD appears to have made little progress with regard to its examination of the impact of current operations on equipment. While the MoD appears to have robust data on the cost of equipment procured through the Urgent Operational Requirement process, it does not have information on the cost of recuperating equipment returning from current operations nor on the impact of those costs on other areas of its budget. Such costs must be substantial given the length of time that UK Armed Forces have been involved in current operations in Afghanistan

\(^6^9\) Qq 110-111
\(^7^0\) Q 112
\(^7^1\) Q 114
\(^7^2\) Q 120
\(^7^3\) Q 121
and Iraq. The MoD must identify accurately the costs to date of recuperating equipment and the likely future costs of recuperation. Without such information, there is a real risk that these costs will fall on the Defence Budget, which is already under pressure, rather than on the Reserve as they rightly should be.

45. On 17 December 2008 we announced that we were undertaking an inquiry into Readiness and recuperation for the contingent tasks of today. Issues which we plan to examine in this inquiry include the balance in priorities for recuperation between manpower, equipment, training and sustainability, and the likely costs of and timescale for the recuperation of the Armed Forces and how such recuperation will be funded.\textsuperscript{74}

**Equipment procurement performance**

**Procurement performance in 2007–08**

46. The MoD’s 2004 Spending Review Public Service Agreement (PSA) targets ran from 1 April 2005 to 31 March 2008. PSA target 6 was “Deliver the equipment programme to cost and time”. The Ministry of Defence Annual Report and Accounts 2007–08 provides the final assessment against the MoD’s six PSA targets. PSA target 6 was assessed as “Partly Met”\textsuperscript{75}. The Annual Report and Accounts states that:

> The Department invested about £6.7Bn in military equipment for the Armed Forces over the year, but procurement performance declined, failing to meet our in-year Public Service Agreement sub-targets for cost and time, and only partly meeting the overall target.\textsuperscript{76}

Details of the MoD performance against the three sub-targets underlying PSA target 6 are set out in Table 7 below.

**Table 7: MoD’s performance against PSA target 6**

<table>
<thead>
<tr>
<th>Sub-target</th>
<th>Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>At least 97% of Key User Requirements, for all Category A to C Projects that have passed Main Gate Approval, to be achieved.</td>
<td>100% of Key User Requirements achieved (99% in 2006–07, 97% in 2005–06)</td>
</tr>
<tr>
<td>On average, less than 0.2% in-year variation of forecast costs for Design and Manufacture phase of projects over £20M.</td>
<td>0.7% average increase in costs measured against estimated cost at beginning of year (0.0% in 2006–07, 0.2% in 2005–06).</td>
</tr>
<tr>
<td>No more than 0.4 months in-year slippage of forecast In-Service Dates for projects over £20M.</td>
<td>3.9 months average slippage (0.5 months in 2006–07, 0.7 months in 2005–06).</td>
</tr>
</tbody>
</table>

*Source: Ministry of Defence*\textsuperscript{77}

\textsuperscript{74} Defence Committee, 17 December 2008, Press Release Defence Inquiry into Readiness and Recuperation for the Contingent Tasks of Today


\textsuperscript{77} ibid.
47. The Ministry of Defence Annual Report and Accounts 2007–08 provides further details about the sub-targets relating to in-year cost growth and in-year project slippage which were not met:

both average in-year cost growth of 0.7% (£225M) and average project slippage of 3.9 months (164 in total across all projects) exceeded the tolerances established. The Department has therefore only partly met this Public Service Agreement target, in year and across the 2004 Spending Review period... The cost target is very susceptible to growth on only a few programmes. The key drivers were the Nimrod MRA4 (2.9% growth, £102M) and Meteor (Beyond Visual Range Air-to-Air Missile) (9.5% growth, £111M) projects. Much of the time slippage reflected low probability but high impact risks emerging during the test and trial phases towards the end of the programmes when the opportunities to mitigate issues are minimal, with the most serious being Naval Satellite Communications Terminals (19 months), and Terrier (27 months). Other significant contributors were General Service Respirator (22 months), Precision Guided Bombs (18 months) and SOOTHSAFER (16 months).78

48. The Nimrod MRA4 programme is one on which we have reported regularly. In 2007–08 the programme experienced in-year cost growth of £102 million—the forecast cost increase against approved cost at Main Gate now totals £789 million. The programme also experienced a further 3 months in-service date slippage—the forecast in-service date is now 92 months later than the approved in-service date at Main Gate.79 In spring 2008 “further potential cost increases were identified by BAE Systems on the procurement aspects of the Nimrod MRA4 programme”. The MoD informed us that work was underway to “scope the extent of these increase and identify potential mitigation measures”.80 We are concerned to learn that, once again, the Nimrod MRA4 programme has experienced further cost growth and in-service date slippage. In its response to our Report, we expect the MoD to set out the findings from its examination of the extent of further cost increases, to provide us with the latest position on the current forecast in-service date, and to outline the “mitigation measures” it has identified and what it expects these to deliver. We have not been satisfied by the explanations for these delays given by the MoD to date, nor by the Department’s assurances as to how performance would be improved. We will return to this matter in the future.

49. The National Audit Office’s (NAO’s) Major Projects Report 2008 was published on 18 December 2008.81 This report analyses the “cost, time and performance data for the military equipment projects in the year ended 31 March 2008”. The report covers the 20 largest projects where the main investment decision—Main Gate—has been taken by the MoD.82 The NAO’s examination found that “For the period of the Report, the forecast aggregate costs of the projects [Typhoon (formerly known as Eurofighter) was excluded

80 Ev 103, para 9
82 ibid, Summary, para 1
from the analysis because the numbers are commercially sensitive] increased by £205 million and there was an additional 96 months aggregate slippage”. The NAO found that the forecast cost increase was largely as a result of growth on the Beyond Visual Range Air-to-Air Missile (BVRAAM) and Nimrod MRA4 programmes. Nine of the 20 projects examined experienced in-service date slippage during 2007–08.\(^{83}\)

50. In its first year of operation, DE&S failed to meet its Public Service Agreement target to “Deliver the equipment programme to cost and time”. We note that the National Audit Office examined the procurement performance relating to the 20 largest projects and found that the aggregate forecast cost for these projects increased by £205 million and the aggregate in-service date slippage increased by eight years in 2007–08. We are concerned that DE&S has failed to control delays on equipment projects with almost half of the 20 largest projects experiencing in-service date slippage in 2007–08. We have not been satisfied with the explanations given by the MoD as to what it intends to do to rectify this decline in performance, and we will be returning to this matter in the near future.

**Procurement performance in 2008–09**

51. The MoD’s Defence Plan 2008–2012 reflects the outcome of the 2007 Comprehensive Spending Review and sets out the top level objectives which the MoD plans to deliver over 2008–2012. Departmental Strategic Objective (DSO) 3 is “Build for the Future”. Performance Indicator (PI) 3.1 under DSO 3 is “Procuring and Supporting military equipment capability through life”. There are three sub-objectives:

- average percentage forecast achievement of Key User Requirements [target of 97% for 2008–09];
- average in-year variation of forecast in-service date [target of 0.4 months for 2008–09];
- average in-year variation of forecast costs for Design and Manufacture [target of less than 0.2% in 2008–09].\(^{84}\)

52. The MoD’s Public Service Agreement Performance Report Quarter 1 2008–09 was published at the end of October 2008 and sets out the MoD’s performance against its DSOs for the period 1 April–30 June 2008. Only one of the three indicators under DSO 3, PI 3.1 is forecast as meeting the target. The MoD’s assessment of performance against the three indicators was as follows:

- “Forecast achievement of 100% of the Key User Requirements” [target—97%];
- “Average in-year forecast ISD slippage of 0.5 months” [target—no more than 0.4 months]; and
- “Average in-year forecast cost increase of 0.85%” [target—less than 0.2%].

\(^{83}\) ibid, Summary, para 3

\(^{84}\) Ministry of Defence, *Defence Plan including the Government’s Expenditure Plans 2008-2012*, Cm 7385, June 2008, pp 30-31
The report states that “in the first quarter of this financial year a number of risks to Time and Cost have been identified and options to recover these are being investigated”.

53. The MoD’s *Autumn Performance Report 2008–09* was published in mid December 2008 and sets out the MoD’s performance against its DSOs for the period 1 July–30 September 2008. Only one of the three indicators under DSO 3, PI 3.1 is forecast as meeting the target. The MoD’s assessment of performance against the three indicators was as follows:

- “Forecast achievement of 99% of the Key User Requirements” [target—97%];
- “Average in-year forecast ISD slippage of 1.4 months” [target—no more than 0.4 months]; and
- “Average in-year forecast cost increase of 0.3%” [target—less than 0.2%].

The report states that “in the second quarter of this financial year previously identified risks to Time and Cost have matured and are reflected in the deterioration of the reported performance”.

54. At our evidence session on 16 December 2008, we asked how the recent changes in the exchange rates had impacted on the cost of equipment programmes. The Minister for Defence Equipment and Support acknowledged that exchange rate fluctuations were an issue of concern. CDM outlined the MoD’s approach to managing exchange rate risk:

> We try to place contract where we can in sterling and then the contractor/industry bears the exchange rate challenge. Some of them are in euros and some of them are in dollars. You may have seen the second quarter report from the MoD for this year. There is a potential cost overrun/cost increase in projects and that is virtually all the exchange rate in this current year.

CDM said that the cost increases in the current year due to the exchange rate was about £60 million.

55. Financial Year 2008–09 saw the introduction of new Departmental Strategic Objectives (DSOs) which include a Performance Indicator under DSO 3 covering “Procuring and Supporting military equipment capability through life”. The MoD’s performance, six months into 2008–09, has been disappointing with average in-year forecast in-service date slippage and average in-year forecast cost increases both exceeding the targets set. The MoD considers that exchange rate changes account for most of the forecast cost increases reported in 2008–09. In its response to our Report, we expect the MoD to set out its estimate of how much it anticipates exchange rate changes will add to the cost of equipment programmes in 2008–09 and what action it is taking to minimise the risk of such cost increases.

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85 MOD Public Service Agreement Performance Report Quarter 1 2008-09, October 2008, pp 12-13
86 MOD Public Service Agreement Autumn Performance Report 2008-09, December 2008, pp 13-14
87 Q 324
88 Q 325
56. The DE&S Business Strategy 2008–12 states that DE&S “will play an active role […] using new acquisition approaches to reduce Demonstration and Manufacture timescales of projects by 50% from 2009 onwards”. In its response to our Report, we expect the MoD to set out what specific action it is taking to reduce the Demonstration and Manufacture timescales of equipment projects by 50% from 2009 onwards, a target set out in the DE&S Business Strategy 2008–12 and how such reductions will be measured and reported.

**Factors behind the decline in procurement performance**

57. We sought to identify the main factors behind the decline in procurement performance. The MoD acknowledges that supporting operations has had an impact—“one corollary of the focus on meeting the challenge of supporting current operations has been a downturn in our performance in managing the acquisition of new capability”. However, the MoD could not quantify the impact of supporting operations on procurement performance:

Supporting operations, not least through the procurement of equipment to meet Urgent Operational Requirements, has been the Department’s highest priority. Resources within DE&S have been prioritised accordingly. It is not, however, possible to assess to what extent, if any, this effort has impacted on our performance against the procurement targets.

58. Dr Tyler told us that there was “something of the order of 700–750 of our staff engaged in the UOR activity, and we are making sure that across our organisation we are balancing our resources across the whole of our current projects and support to ensure that the UORs are getting the priority”. Sir Bill Jeffrey, MoD’s Permanent Secretary, did not consider that supporting operations was a major factor behind the decline in procurement performance:

I would not overstate the knock-on impact on the rest of the business. There undoubtedly is some because certainly, when I visit Abbey Wood, I hear the same accounts of significant staff effort being devoted to the UOR process, but I do not think it is more in the end than a relatively small proportion of the total staff effort, so I would not jump to the conclusion that our longer-term investments are at risk because of this.

The MoD does not consider it possible to assess how, if at all, support to current operations has impacted on performance against its procurement targets. We consider that, while it would appear that only a small proportion of DE&S staff have been involved on Urgent Operational Requirement projects, support to current operations has had an adverse impact on its procurement performance, although we doubt that

89 DE&S Business Strategy 2008-12, p 15
91 Ev 88, para 7
92 Q 135
this factor alone is responsible for the state of parts of the equipment programme. DE&S staff involved in UOR projects have had to be transferred from longer-term equipment projects and, given the importance of UOR projects, more experienced project staff are likely to have been transferred. We would hope that as work supporting current operations begins to reduce, and staff are transferred back to the longer-term projects, that this will have a positive impact on procurement performance.

59. The MoD’s memorandum to our inquiry sets out the key factors which the MoD considers contributed to the decline in procurement performance:

The key factors for cost and time variation in Financial Year 2007–08 can broadly be grouped into three categories:

(i) decisions taken by the Department in the broader context of the defence needs (this would largely include elements of changed requirement; changed budgetary priorities; procurement strategy);

(ii) factors outside the Department’s direct control (this would largely include international contracting process and procurement strategy issues, accounting adjustments and re-definitions; inflation and exchange rates); and

(iii) factors reflecting the realisation of unplanned or low level/high impact risk for the Department and/or Industry (technical factors).

The MoD considers that “much of the in-year cost variation falls to factors either outside the Department’s direct control, with international factors being the single most significant element, or the realisation of unplanned low level / high impact risk”.44

60. We sought further details on the programmes where there had been unplanned low level / high impact risk. The MoD considers that “low probability but high impact risks are more likely to occur during the testing and evaluation phase of a project”. The MoD’s approach to reduce both time and cost risk is “greater emphasis […] being placed on investment prior to Main Gate decisions, the aim being to ensure greater technical, financial and commercial maturity of solutions”.45 In its memorandum, EDS (an HP company) referred to “a reluctance to spend the recommended 10–15% of the project budget during the assessment phase”.46 We looked at the data in the Major Projects Report 2003 and the Major Projects Report 2008 to see whether there was any indication that the amount spent on the Assessment Phase of a project had increased. We found that, in general, it would appear that the amount spent on the Assessment Phase had increased substantially.

61. We note that the MoD considers that a key contributor to cost increases or delays on equipment projects is “the realisation of unplanned or low level / high impact risk”. The MoD states that it was placing greater emphasis on investment prior to Main Gate to address this risk. In its response to our Report, we expect the MoD to set out, for the current projects which have passed Main Gate, the proportion of such projects where

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94 Ev 88, para 7
95 Ev 104, para 4
96 Ev 65
10–15 per cent or more of the forecast project budget was spent in the Assessment Phase.

**PACE programme**

62. The Ministry of Defence Annual Report and Accounts 2007–08 provides the following information about the DE&S PACE programme:

As called for in the Acquisition Change Programme, during 2007 DE&S conducted a post-launch business-led review to optimise the way the Armed Forces are equipped and supported. This led to the Blueprint: Future Operating Model in January 2008 setting out what DE&S should look like as a business and employer. This is now being implemented through the Performance, Agility, Confidence and Efficiency (PACE) programme, launched in March 2008. PACE will take DE&S beyond ‘fit for purpose’ to an operating model delivering ‘best for Defence’ outcomes contributing to an affordable and balanced Equipment and Support Plan with a significant reduction in acquisition cycle times and to greater agility in meeting the front line’s needs.97

On its establishment, DE&S comprised approximately 27,000 staff (of whom around 6,600 were military) based at sites across the United Kingdom and overseas. Its headquarters is at the Abbey Wood site near Bristol but its personnel are widely deployed across the Defence Estate and in industry providing support to the Armed Forces. Over the year however staff numbers were reduced to approximately 24,500 and a number of Integrated Project Teams were relocated to Abbey Wood under collocation plans already in train. The intention is that, where there is no business need for them to be based elsewhere, DE&S staff will to the maximum extent possible be consolidated within the Bristol acquisition hub in order to improve effectiveness and efficiency and provide a broader range of career opportunities. By 2012 it is planned that about 50% of the staff working for DE&S will be based at Abbey Wood out of a total workforce of around 20,000. This is being taken forward as part of the PACE programme.98

63. We examined issues relating to DE&S staff skills, and the shape and size of DE&S, in our *Defence Equipment Report 2008*.99 At our evidence session on 4 November 2008 for our Ministry of Defence Annual Report and Accounts 2007–08 inquiry, Sir Bill Jeffrey provided the following overview of the progress being made by DE&S in these areas:

In the so-called ‘Pace’ programme that Kevin O’Donoghue has put in hand, there are changes again associated with necessary reductions in manpower which will allow staff to be used more flexibly. Now, that is part of it. The other part, and this will take longer, but I think is heading in the right direction, is really what we were discussing earlier around the building of skills. Again, Sir Kevin can give you more detail than, I imagine, we can cover this morning, but, in terms of identifying groups of jobs where

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98 ibid, para 219
we expect particular levels of qualifications, the licensing of project managers, the building of commercial skills, it is inevitably something which will take time, but I think we are making progress.¹⁰⁰

64. The MoD’s memorandum provides details of the progress made to upskill DE&S staff, although the memorandum acknowledges that DE&S “must continue to develop and acquire skills needed for the future”. Skills Directors have been appointed for a range of disciplines and have drawn up skills plans to improve the skills capability in each of the functions. The memorandum states that the “Skills Directors […] are on track to meet Professional Posts targets to ensure key designated posts are filled by suitably qualified individuals”. We had been concerned that DE&S staff did not have sufficient time to complete their required training. However, 70% of DE&S staff met the “6+4” training days target in 2007–08 and the level of achievement in 2008–09 was considered to be at a higher level.¹⁰¹ The progress relating to the upskilling for the key acquisition disciplines is set out in Table 8 below.

Table 8: Upskilling across the key acquisition disciplines

<table>
<thead>
<tr>
<th>Acquisition discipline</th>
<th>Achievements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Project and Programme Management</strong></td>
<td>Project Management Level 3 Licence development commenced with a pilot of the Certificated Project Manager (CPM) qualification; 25 Professional Post holders are undertaking the pilot which will complete in March 2009. A total of 484 Project Management Licences (which are linked to the Association of Project Management) have been issued, including 80 at Level 2.</td>
</tr>
<tr>
<td><strong>Finance</strong></td>
<td>Over 55% of staff in DE&amp;S finance professional posts are qualified accountants. To improve the future position, the Training Accountant Development Scheme (TADS) has been increased and 22 new graduates commenced the development programme in September 2008. Existing TADS achieved 100% pass rate in the May 2008 CIMA exams, with two TADS achieving a mark that brought them into the “top 10 worldwide”. A further 39 have been accepted for Association of Accounting Technician training.</td>
</tr>
<tr>
<td><strong>Commercial</strong></td>
<td>Over 70% of DE&amp;S commercial professional posts are filled by individuals with the relevant Chartered Institute of Purchasing and Supply (CIPS) qualification. The target of 100% of Commercial Directors with MCIPS or on the Professional Development Programme is currently at 75%. The target of 100% is expected to be reached by 31 March 2009. The B2 conversion 2007/08 intake graduated in September 2008.</td>
</tr>
<tr>
<td><strong>Logistics</strong></td>
<td>New Defence Academy learning courses have gone live. Inventory Management Licences have been launched with 500 passes to date. Ten Supply Chain Management courses are being delivered.</td>
</tr>
<tr>
<td><strong>Engineering</strong></td>
<td>Twenty one DESG Graduates commenced the development programme and a further 51 have been given an offer of contract. Delivery of places achieved on Land Systems Post Graduate Certificate. Delivery of modular Aerospace Engineering Technology &amp; Systems Engineering awareness courses. Increase to apprentice recruitment, September 2008 intake expected to be in excess of 40.</td>
</tr>
</tbody>
</table>

Source: Ministry of Defence¹⁰²

¹⁰⁰ Defence Committee evidence session on 4 November 2008 for the MoD Annual Report and Accounts 2007-08 inquiry, Q 93, available at www.parliament.uk/defcom

¹⁰¹ Ev 89, para 10

¹⁰² Ev 89, para 10
65. The Secretary of State referred to DE&S skills during our evidence session on 12 November 2008 for our inquiry into the Ministry of Defence Annual Report and Accounts 2007–08. He said that the “new commercial director in the department has brought a wealth of private sector expertise and experience into play”. At our evidence session with industry representatives we asked about the issue of DE&S staff skills. Mike Turner told us that:

Amyas Morse has done an excellent job coming in as Commercial Director of MoD with the training programmes and bringing more commercial people in.

Ian Godden added:

I see it every day, secondments out to industry, secondments the other way, plus Amyas and his programmes, and that has had a big effect and will for the future.

66. We note that DE&S has made good progress in improving the skills of its staff across a range of key acquisition disciplines. We note also that the Defence Commercial Director has recently been announced as the new Comptroller and Auditor General, but we consider it essential that the MoD build upon the progress he and the Chief of Defence Materiel have achieved to date.

67. At the evidence session with industry representatives, Ian Godden referred to a training programme on the “value of time”:

The value of time is something that I know that Amyas Morse and the current MoD team are very keen to establish a programme on and to develop that timeliness in terms of decision-making, in terms of the risk/reward, getting to the risk/reward boundary as quickly as possible and agreeing that. I think those are programmes that would help, in addition to what Mike Turner has said.

68. Equipment programmes have often experienced delays at various points in their life cycle. We note that the MoD is looking at training programmes which focus on the “value of time”. In its response to our Report, we expect the MoD to set out what consideration it has given to such programmes and its future plans in this area.

**Streamlining of DE&S**

69. We examined the plans for reducing the number of DE&S staff to 20,000 by 2012 in our Report *Defence Equipment 2008*. In the Report we said that we remained to be convinced that improved economy, agility or responsiveness would follow from the planned reduction. At the end of September 2008, DE&S employed some 23,400 staff.

104 Q 55
105 Q 55
106 Q 61
108 ibid, para 77
109 Ev 88, para 9
This is a reduction of some 4,100 staff (15%) compared with the number in post when DE&S was formed on 1 April 2007. DE&S expects the number of staff to be some 23,300 at the end of March 2009. The memorandum from the MoD states that:

DE&S is currently reviewing its manpower requirements as part of the PR09 process. Based on current PACE (Performance, Agility, Confidence, Efficiency) manpower requirements, it is planned to reduce to a figure of around 20,000 by 31 March 2012 with resources re-prioritised where necessary to enable the effective delivery of our outputs.110

70. At our evidence session with industry representatives we asked about the streamlining plans. Ian Godden considered that:

My feeling is that it is right… On occasions it will conflict obviously, as any cost reduction exercise or any productivity improvement exercise would, at the same time as re-organising, and at the same time as fighting two wars. There is a lot of pressure on but I do not see the evidence that says that the cuts themselves are getting in the way of the programmes. I think those two are such that they can be combined.111

However, he added that:

All I know is that the uncertainty it creates is more the issue than the actual resources. I think the uncertainty of any reduction programme lives on and lives in the minds of people more than the actual resource issue itself…112

71. By 2012, DE&S plans to have reduced its staff by 25% compared to the number in post at the start of April 2007. At the end of September 2008 the number of staff had been reduced by some 15%. Given that procurement performance declined in 2007–08 and that DE&S is supporting two operations, we find it surprising that DE&S is pushing ahead with its streamlining programme. DE&S must monitor closely the morale of its staff and recognise the uncertainty that such programmes create. In its response to our Report, we expect the MoD to provide us with its rationale for reducing staff at a time when procurement performance has declined and when DE&S remains busy supporting two overseas operations. We also expect the MoD to provide us with details of the costs incurred to date, including redundancy and early retirement costs, as a result of the streamlining programme. The response should also set out how many consultants have been employed to undertake work previously undertaken by DE&S staff who have left under the streamlining programme, and the costs of these consultants.

**Review of defence acquisition**

72. At our evidence session on 12 November 2008 for our inquiry into the Ministry of Defence Annual Report and Accounts 2007–08, the Secretary of State told us that “we have

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110 ibid, para 9
111 Q 51
112 Q 52
to deliver more equipment on time, we have to deliver more equipment on budget". In his Statement to the House on 11 December 2008, the Secretary of State announced that:

I have also instituted a review, to be led by Bernard Gray, to examine progress with implementing the MoD’s acquisition change programme and make any further recommendations to secure better value for money in the delivery of major acquisition programmes.

73. We note that the Secretary of State has instituted a review to examine the progress in implementing acquisition reform and make recommendations for securing better value for money in the acquisition of major equipment programmes. There have been several such reviews over the last decade, yet major equipment programmes continue to experience cost increases and delays. It will be vital that the recommendations are implemented quickly and fully so that the expected benefits are delivered. We expect the MoD to provide us with a copy of the review once completed and to set out how the findings and recommendations in the review are to be taken forward.

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114 HC Deb, 11 December 2008, 67WS
3 Short examination of the Equipment Programme

Aim of the short examination of the Equipment Programme

74. During the Defence Procurement debate on 19 June 2008, the Minister for the Armed Forces announced that:

Our last planning round focused on the near-term issues facing the core equipment programme. We now need to take a closer look at our medium-term plans and concentrate them further on supporting operations, in line with our commitment in the national security strategy. That is why we are undertaking a short examination of the equipment programme to look at our planning assumptions over the next 10 years. The examination will take in the whole equipment programme, within the context of our basic defence policy. We are doing that because priorities can change, particularly as a result of our experience on operations.\(^\text{115}\)

75. The Ministry of Defence Annual Report and Accounts 2007–2008 states that:

Following the conclusion of Planning Round 2008 we are moving ahead over the summer with a further examination of the Defence Equipment programme. We are determined to do more to support our people at home and on the frontline. To do that, we need better to prioritise our spending plans. The examination of the equipment programme will focus on two issues above all: bearing down on cost increases to equipment programmes; and rebalancing the equipment programme to better support the frontline. The examination will be focused on identifying potential savings to the equipment programme in order to support the frontline and our people at home better. Any decisions on specific programmes will be announced as they are made.\(^\text{116}\)

Progress with the short examination

76. At our evidence session on 4 November 2008 for our Ministry of Defence Annual Report and Accounts 2007–08 inquiry, the MoD’s Permanent Secretary, Sir Bill Jeffrey, told us that the short examination would be completed “within weeks rather than months” and before Christmas 2008.\(^\text{117}\) The MoD’s memorandum provided the following update:

As Sir Bill Jeffrey told the Committee on 4 November, we hope to resolve the remaining issues arising out of our examination of the equipment programme over the next few weeks. We expect its results to provide an important input to our 2009 planning round, which will be completed in Spring 2009, but Ministers have

115 HC Deb, 19 June 2008, Col 1122
117 Defence Committee evidence session on 4 November 2008 for the MoD Annual Report and Accounts 2007-08 inquiry, Qq 113-114, available at www.parliament.uk/defcom
undertaken to inform Parliament of significant decisions affecting projects as soon as they are able to do so.\footnote{118}

77. The memorandum from the Defence Industries Council referred to the short examination and the need for speedy MoD decisions following the completion of the examination:

We understand MoD expects to report on the examination shortly and we are aware that individual companies have been asked to provide detailed inputs on possible consequences of programme decisions. We trust that the decisions to be taken are informed by these consultations, and that their industrial implications are understood fully. Industry would welcome an early read out of outcome of the examination and its implications for projects and programmes in the short term. Prolonged delays or paralysis in MoD decision making will have serious implications for the retention of industrial capabilities and company’s investment planning.\footnote{119}

78. At our evidence session with industry representatives, Mike Turner set out his expectations of the outcome of the short examination:

All the companies have been asked a number of questions about the impact of this, that and the other. Clearly there is a concern about jobs in the current climate, not surprisingly, but the feeling we get is that programmes will be stretched out; some will clearly have more favourable funding than others. We do not see any major programme cancellations in the current climate. We think the equipment examination will come to a conclusion in the next few weeks, but there will be no major changes. As I say, some programme will be more favoured than others, but with limited funding available what we want to do is work transparently with MoD to make the best of the situation we are in until we can get to a new situation.\footnote{120}

Dr Sandy Wilson, Chairman of the Defence Manufacturers Association, considered that clarity about the future equipment programme would be a longer-term issue:

The other thing about the equipment examination is that I think the Secretary of State stated that it would provide the basis for going into PR O9, so I do not think the equipment examination should be viewed as giving all the answers. I think we will then go into a period of many months of continued debate about options and we will see clarity emerge through the year in PR O9.\footnote{121}
Statement on 11 December 2008

Overview

79. On 11 December 2008, the Secretary of State announced the “key conclusions” from the short examination of the equipment programme. The first part of the Written Ministerial Statement is reproduced below:

Since May 2008 the MoD has been examining its equipment programme. The aims of the examination were to adapt to the rising cost of high-end defence equipment and to provide more support for current operations. The key conclusions I am announcing today help us meet these objectives; other aspects will be taken forward through our regular planning round, which will conclude next March.

The work to date will bring the defence equipment programme more closely into balance. Inevitably this has required a reprioritisation of investment to ensure that we deliver those capabilities of the highest immediate urgency, while continuing to invest in capabilities needed to respond to future threats. We remain committed to doing more for our people, here and on the front line—improving their support and welfare, pay, medical care, rehabilitation services and accommodation.

Support to current operations remains our highest priority. Among the top priorities of our operational commanders are the provision of the right mix of protected patrol vehicles and additional helicopter capability. The recent announcement of nearly 700 more protected patrol vehicles for Afghanistan, at a cost of over £700 million, is evidence of our commitment to meet their requirements. In addition to our core budget, the Government will continue to fund the net additional costs of operations from the Treasury reserve. Since 2001 we have received nearly £10 billion, over and above the core defence budget.

As well as the protected mobility package, we have agreed with the Treasury a budget of a further £635 million in 2009–10 for other urgent operational requirements, with any expenditure over and above that being met initially by the reserve, but repaid by the defence budget after two years.122

80. The Statement states that “we undertook to inform Parliament about the major decisions emerging from our examination of the equipment programme as soon as we were able to do so”.123 The key programmes / capabilities referred to in the Statement were: FRES; helicopters, including Future Lynx; Future Carrier; and MARS. We examine each of these below.

FRES programme

81. We have taken a close interest in the Future Rapid Effect System (FRES) programme. In our Report The Army’s requirement for armoured vehicles: the FRES programme124,
published on 21 February 2007, we examined the progress on the FRES Utility Vehicle (UV) programme. In the Report we concluded that:

The MoD’s attempts to meet its medium-weight vehicle requirement have been a sorry story of indecision, changing requirements and delay. It is high time the MoD decided where its priorities lay.

In the Report we noted “the expected In-Service Date for FRES has slipped from 2009 to “the early part of the next decade”.

82. We also examined the FRES programme in our Report Defence Equipment 2008. At the evidence session on 29 January 2008, the MoD appeared very confident about the progress on the programme and expected the decision on the UV design to be announced “very soon”.

83. The MoD’s memorandum provided the following update on the FRES UV programme:

On 8 May 2008, the MoD (Ministry of Defence) announced selection of PIRANHA V offered by General Dynamics (UK) Ltd as the preferred design for the FRES (Future Rapid Effect System) Utility Vehicle. Acknowledging that there were significant issues to be resolved during negotiations, the MoD took the step of making General Dynamics (UK) Ltd’s preferred bidder status provisional. Their conversion to full preferred bidder status was dependent upon the agreement of acceptable commercial terms followed by the successful completion of a package of work on risk reduction. As PUS said at the HCDC evidence session on 4 November 2008 we are still discussing exactly how to pursue the relationship with GDUK.

84. At our evidence session on 25 November 2008, we asked how the announcement at the end of October 2008 that 700 new armoured vehicles were to be procured impacted upon the FRES programme. CDM said that “there will still be a requirement for FRES; I am quite clear about that”. We asked if the MoD knew what its requirement for FRES was. CDM told us that “I think we are pretty clear we know what it is”.

85. Given the delays on the FRES UV programme, we have previously asked the MoD about the option of procuring a vehicle off-the-shelf to meet the requirement. We raised the issue again as to whether such a solution could provide the flexibility which the MoD needed. Dr Tyler said that:

What you do not want is buying a vehicle that, essentially, is role-specific or theatre-specific or operation-specific; what you want is a vehicle that has got the ability to be

126 ibid, p 3
128 ibid, Q 181
129 Ev 82
130 Q 237
131 Q 238
used across a whole range of applications and tailored according to the needs of that particular day by reconfiguration, adding new types of armour—hence the reason why you need weight margins—new types of electronic equipment in system and open architectures to fit different types of sensor. That is the sort of vehicle that you want for the future because you do not know what the future is going to be.\footnote{132}

He added that a vehicle such as Mastiff “does not come close to meeting the FRES requirement”.\footnote{133}

86. CDM considered that the requirements for armoured vehicles for current operations and for future requirements were quite different:

What we have now is a current operation which requires armoured vehicles. In my view, we have done exactly the right thing, which is buy the armoured vehicles as UORs, virtually off the shelf, added to them, and so on, and put them into theatre. That is absolutely right. What we now need to do is make sure that there is a medium-weight armoured vehicle out there for the Army that we can buy which will meet a number of contingent operations. That is what we are now doing.\footnote{134}

87. The Written Ministerial Statement on 11 December 2008 announced the following regarding the FRES programme:

Our examination of the equipment programme has, separately, considered the balance of investment and priority in the army’s armoured vehicle programme. We have concluded that, in the context of current operations, and bearing in mind the considerable recent investment in protected mobility, the highest priority should now be accorded to delivering the Warrior capability sustainment programme and the FRES scout vehicle as quickly as possible. Against that background, we have decided to restructure the FRES programme, giving priority to FRES scout over the FRES utility vehicle. Whilst this will mean a delay to the programme, we recognise the importance of the utility vehicle and are now looking at the best way to take this procurement forward. General Dynamics (UK) will have an opportunity to compete in any future utility vehicle competition.\footnote{135}

88. We found it extraordinary that, some seven months after announcing that General Dynamics UK (GDUK) had been selected as “preferred bidder status provisional” for the FRES Utility Vehicle, the MoD was now giving priority to the FRES Scout Vehicle. We sought clarification on what the specific issue had been on the FRES UV vehicle between the MoD and GDUK. The Minister for Defence Equipment and Support said that:

General Dynamics always made clear that they had a different concept than we did as to the role they wanted to play. We made clear that their concept was not ours and their concept was not the basis on which we were going to let the contract. They decided however to bid, making it quite clear that they had a different concept. The basic different concept, as you say, related to the fact that they wished to continue to

\footnote{132 Q 245}
\footnote{133 Q 249}
\footnote{134 Q 251}
\footnote{135 HC Deb, 11 December 2008, Col 66WS}
have the intellectual property and they wished to be responsible, if they got the
design contract, for the development and manufacturing, or at least to have a share
in that.\textsuperscript{136}

89. We could not understand why the MoD had allowed GDUK to bid if the company had
set out its position regarding intellectual property on the vehicle. The Minister told us that:

What we did was we gave them provisional preferred bidder status, and we made it
clear to them that we were making it provisional because confirmation of their status
was entirely contingent on our agreeing on commercial terms that would be
acceptable to us.\textsuperscript{137}

90. The Minister emphasised that negotiations had taken place during the summer, but the
two parties had failed to reach agreement:

Having postponed the commercial discussions, because that is the way the company
wanted to play it (and we saw no reason why we should not play it that way, and
everybody was being completely honest and transparent with everybody else) we
then tried, in good faith, to see if we could reach agreement with them commercially
in the course of the summer, and we failed to do that. Both sides, with no ill-will, in
total transparency and with good faith decided then that we did not have a basis on
which we could proceed commercially. That is the position we found ourselves in
last month.\textsuperscript{138}

91. We asked if the MoD was paying GDUK to keep its team together. The Minister said
that “going forward we have not made any commitments at all [...] we are considering
how to proceed with the utility vehicle now”.\textsuperscript{139} He stressed that the MoD was committed
to the UV programme and to providing “the British Army with a utility vehicle”.\textsuperscript{140} The
Minister acknowledged that the programme:

will not come forward in the timescale which it was originally intended to do [...] But we are not abandoning this project.\textsuperscript{141}

92. Given the number of different armoured vehicles which have been procured for current
operations and the different FRES vehicles which the MoD plans to procure, we asked
about the MoD’s strategy relating to armoured vehicles and, specifically, about the issue of
coherency. To our astonishment, the Minister told us that “the coherence lies in having the
widest possible suite of weapons for commanders in the field to choose from”.\textsuperscript{142} At our
evidence session on 25 November 2008, Dr Tyler was asked if, as a result of the armoured
vehicles procured as UORs, the vehicle fleet had become less cohesive and coherent. He
told us that “yes, I think that is the case”.\textsuperscript{143} We suggested to the Minister that surely the
widest suite of weapons destroys the coherence. The Minister outlined his understanding of coherence as follows:

Coherence is not something we pursue for its own sake, just for the sake of neatness and having a nice inventory that looks good on paper, coherence is what we want to have where the capabilities of the various vehicles are complementary so that you can move across a spectrum, going from heavier to lighter, going from greater firepower to less firepower, going from faster to not so fast, for difficult terrain, less difficult terrain, so that you have the widest possible scope for choosing the vehicle that you really need for that particular operation. That is what we are trying to give commanders in the field and that is what I mean by coherent so that each particular platform relates to the others in the sense that it is complementary, it is not if you like duplicating the capability of the other one, it is expanding the full range of capability available to us. 144

93. General Figges explained that, for the FRES family of vehicles, the MoD originally anticipated having one common chassis on which it would build “various subsystems to reflect the requirements for each function”. However, further work had suggested that two chassis types were needed to:

achieve our commonality and the logistic coherence […] through having common subsystems and this would be part of a network-enabled capability […] so we would have the common network which would be implemented right across these 'FRES' vehicles although they would have different chassis systems. We would attempt to have common generators where appropriate, we would have common radios, we would have common electronic counter-measures, we would have where appropriate to reflect the function of the vehicles common subsystems in terms of sighting and so on. So that is how we were going to achieve it, although because the chassis did not look precisely the same did not mean that we were going to give up this original idea but we were going to optimise it, there were trades and balances in this. 145

94. As to the question of whether the MoD knew what it required of FRES, General Figges stressed that “capability (which I plan) is a relative notion; you cannot stand still in time because the enemy has a vote in this… the fact that our original view with respect to FRES was that perhaps it had to be proof against kinetic energy rounds in preference to chemical and improvised explosive devices. Our experience in Iraq and Afghanistan has demonstrated that we have got to shift that balance.”146

95. The FRES programme has been a fiasco. In February 2007 we concluded that the MoD’s attempts to meet its medium-weight vehicle requirement had been a sorry story of indecision, changing requirements and delay. Two years later the story is, incredibly, even worse. We find it extraordinary that, some seven months after announcing General Dynamics UK as the provisional preferred bidder for the FRES Utility Vehicle, the MoD has announced that priority is now to be given to the FRES Scout Vehicle. Whilst we recognise that the MoD’s equipment requirements need to reflect changing

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144 Q 369
145 Q 370
146 Q 371
threats, that is no excuse for the MoD’s behaviour in this programme; they have wasted their and industry’s time and money. The FRES Utility Vehicle programme was, from the outset, poorly conceived and managed. The MoD must work out what its requirements are for medium-weight armoured vehicles and identify lessons from the saga of the FRES Utility Vehicle programme. In its response to our Report, we expect the MoD to set out the cost to date of the FRES Utility Vehicle programme and how it plans to take forward this programme in the future.

**Helicopters and the Future Lynx programme**

96. We have examined issues relating to helicopter support in our inquiries into current operations in Afghanistan and Iraq. At our evidence session on 25 November 2008, CDM told us that “helicopters—you can always use more helicopters”. The MoD’s memorandum provides details of the current UK military helicopter fleets, including the current planned out-of-service dates, and the UK military helicopter fleets expected to be operating in 2020. The Written Ministerial Statement on 11 December 2008 announced the following regarding UK military helicopters:

We have increased the number of helicopter airframes and hours available to our commanders in Afghanistan by around 60 per cent. over the past two years, and will make a further significant increase in helicopter capacity in Afghanistan over the next two years.

In addition to our planned battlefield helicopter procurements, we will be spending £70 million from the reserve to upgrade 12 Lynx Mark 9 helicopters with new engines, with the first aircraft available by the end of 2009. This will give commanders more helicopters able to operate effectively all year round in the hot and high altitude in Afghanistan, freeing up other aircraft for other tasks. Taken with the Chinook Mark 3 reversion, the additional planned Apache capability and the Merlins that we plan to move to Afghanistan once they have completed their mission in Iraq, this will deliver a significant increase in helicopter capability available to military commanders.

The new AgustaWestland Future Lynx helicopter will provide even greater operational capability when it comes into service, as planned, in 2014.

97. We welcome the announcement made on 11 December 2008 that the MoD will be further increasing helicopter capacity in Afghanistan over the next two years. Given our continuing interest in helicopter support for current operations, we plan to monitor closely the progress in delivering the commitments set out in the announcement.

98. The announcement on 11 December 2008 provided little detail about the Future Lynx programme. The MoD’s memorandum sets out the approved cost (£1.9 billion) and the approved in-service date (January 2014) at Main Gate. The current forecast cost has

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147 Q 134
148 Ev 86
149 HC Deb, 11 December 2008, Cols 66-67W5
increased by some £10 million since Main Gate, but the current in-service date remains the same. The memorandum sets out the key events and decisions since the programme was approved:

June 2006—F Lynx Contract awarded to AgustaWestland, along with the signing of the Strategic Partnering Agreement and the Business Transformation Incentivisation Arrangement.  

99. At our evidence session on 25 November 2008, we asked about the Future Lynx programme and whether an off-the-shelf solution would have provided the same capability at lower cost. CDM said that:

I do not actually agree with you that we could buy a helicopter which you could fly off the back of a ship and fly in the battlefield and have a common helicopter. I do not agree that we could buy that cheaper. 

100. We pressed CDM on the issue of whether Future Lynx was the ideal helicopter for the land environment. He considered it to be “exactly what is required”. We asked the Minister for Defence Equipment and Support whether Future Lynx was the solution which offered best value for money. He said that the programme was a “partnership programme”, and that under such an arrangement the contractor:

will work on reducing the risk, they will take some of the risk, we will take some of the risk, we will typically have a target price with incentives for doing better than that, penalties for doing worse than that, so that we share the risks right the way through. 

101. The Minister told us that he had looked at “competitive solutions”. He had asked whether Future Lynx was needed and whether there was an off-the-shelf solution which could meet the requirement. The Minister had commissioned a small study to look at the US Black Hawk helicopter and was surprised by how expensive this solution would have been. From this work the Minister:

was persuaded that we needed the same helicopter, the same basic structure of helicopter for the naval and battlefield roles… [and] was persuaded that actually we did have a good deal. 

102. On the issue of the number of Future Lynx helicopters that would be procured, the Minister said that the MoD would be buying about 60. He could not provide us with details about the in-service date for Future Lynx as he said the programme had not passed Main Gate. CDM confirmed that the programme had passed Main Gate, but the Minister then
told us that the contract had not yet been placed.\textsuperscript{157} We found this surprising given that the MoD’s memorandum states that the contract was awarded in June 2006.\textsuperscript{158} The Minister added that:

The point is that until we have gone through main gate we have not had the negotiations with the company, we have not fixed on the price, we have not fixed on the terms of the contract so we are in a very bad position in order to be able to say what it is. We are hoping it is 2014, January 2014.\textsuperscript{159}

103. Later in the evidence session the Minister referred to Future Lynx as a programme which the MoD had “brought forward”.\textsuperscript{160} We were surprised by the Minister’s statement given that Future Lynx was already in the Equipment Programme, and asked why the Minister had described it as a programme which had been brought forward. The Minister said that he had described it as such “for the simple reason that there was very considerable uncertainty about this programme, there were all kinds of rumours”.\textsuperscript{161} We pointed out that this uncertainty had been caused by the Government.

104. The MoD’s confirmation that some 60 Future Lynx helicopters are to be procured is to be welcomed. However, in his evidence to the Committee, the Minister for Defence Equipment and Support was unsure as to whether the programme had passed the main investment decision or whether the contract had been signed. This may have been what caused him to say that the programme had been brought forward. We recognise that the Minister had taken up post only two months before the evidence session, but we do note that this was one of the programmes referred to in the Written Ministerial Statement of 11 December 2008. In its response to our report, we expect the MoD to provide us with the latest forecast cost and in-service date for the Future Lynx programme. It is also difficult to judge on the evidence currently available whether these numbers are sufficient to meet all battlefield and maritime needs.

105. On 5 November 2008, we announced our outline programme of inquiries for 2009, which includes an inquiry into current and future helicopter capability.\textsuperscript{162}

\textit{Future Carrier}

106. We have examined the progress on the Future Carrier programme on a regular basis. In our Report \textit{Future Carrier and Joint Combat Aircraft Programmes}\textsuperscript{163}, published on 21 December 2005, we examined the progress in acquiring the two new aircraft carriers and considered that there was “a serious risk that the two carriers will not enter service in 2012 and 2015 as originally planned”.\textsuperscript{164} We also examined the progress on the Joint Combat
Aircraft programme. Under this programme, the Joint Strike Fighter (JSF), a US-led programme, has been selected as the aircraft to operate from the new carriers. The two new aircraft carriers and the aircraft to operate from them are core elements of the “Carrier Strike” capability.\footnote{Defence Committee, Second Report of Session 2005-06, Future Carrier and Joint Combat Aircraft Programmes, HC 554, para 2}


Last July, the Secretary of State for Defence announced that the MoD would be placing orders for two aircraft carriers to enter service in 2014 and 2016. The manufacture contract has still not been signed and the MoD could not tell us why. Further delays to signing the contract run the risk of slippage to the forecast in-service dates and cost increases.

We were disappointed to learn that Joint Strike Fighter (JSF) aircraft will not be available to operate from the first new aircraft carrier when it is due in service in 2014. The MoD plans to keep the Harrier GR9 aircraft in service until around 2018 and to operate these aircraft from the new carriers. The MoD originally planned to buy up to 150 JSF aircraft. We would expect the number of JSF aircraft to be determined by what the UK needs for its defence capability.\footnote{Ibid, p 4}

108. The MoD memorandum provides the following update on the Future Carrier programme:

3 July 2008—It was announced in Parliament that contracts valued at around £3bn had been placed with the newly-formed Joint Venture company (BVT) and the Aircraft Carrier Alliance for the construction of two 65,000 tonne aircraft carriers for the Royal Navy.

Sub-contracts (valued at approximately £400M) have been placed for the following:

(placed before contract signature) The modification of Rosyth dockyard, 80,000 Tonnes of Steel, Blown Fibre Optic Cable Plant, Reverse Osmosis Equipment, Aviation Fuel Systems Equipment, Manufacture of Aircraft Lifts.


An MoD Press Notice of 3 July 2008 states that “the carriers are expected to enter service in 2014 and 2016 respectively”.\footnote{“£3 billion contracts signed for largest ever UK warships”, Ministry of Defence, Defence News, 3 July 2008,}

109. The Written Ministerial Statement on 11 December 2008 announced the following regarding the Future Carrier programme:

\footnote{Ibid, p 4}
We have concluded that there is scope for bringing more closely into line the introduction of the joint combat aircraft and the aircraft carrier. This is likely to mean delaying the in service date of the new carriers by one to two years. We are in close consultation with the Aircraft Carrier Alliance on how this might best be done. Construction is already under way and will continue, the programme will still provide stability for the core shipyard workforce, including 10,000 UK jobs.170

110. We asked why, only six months after announcing the award of the contracts for the Future Carrier and the expected in-service dates, the in-service dates were to be delayed. We also sought clarification as to when the two carriers were now expected to enter service and whether the lives of the current carriers would have to be extended to meet any potential capability gap. The Minister for Defence Equipment and Support provided a lengthy response to our questions:

for whatever reason, the particular dates involved in the contract which was signed last July were ones which, when I looked at them, I realised could actually be extended with no loss to the defence capability of the nation at all. If you like, it was a kind of free hit. We find ourselves under a certain amount of financial pressure. The last thing I wanted to do was to delay programmes which are really essential in the short term, either for operational reasons or for other reasons, but this was an opportunity in fact to re-profile our spending plans in a way which involved no defence costs, but simply made the delivery date of the carriers rather more rational, and reduced the gap between both the launching and the in-service date of the carriers and the arrival of the JSF aircraft to fly on them, so that is the decision we took. As you rightly say, what we are doing now is extending it by roughly one year. We have not come up with a formal in-service date yet but we will no doubt be doing that fairly shortly. We have said that we are delaying the first carrier, the Queen Elizabeth, by about one year, so instead of an in-service date of 2014, it will be 2015 and, without me stating what the formal in-service date is, if I add one to 14 I have come up with an unambiguous answer that no-one will contest. Equally, the second carrier, the Prince of Wales, would be extended again by approximately two years, that would have been from roughly 2016 to 2018. The second question you ask is what does that mean for the existing three carriers. The Invincible is already at some notice in fact; Ark Royal will probably be withdrawn from service before too long, in the course of the next few years, and we will need to have Illustrious certainly remain in-service until it is quite clear that the Queen Elizabeth has passed her sea trials and that her aircraft complement, whether they are still Harriers or JSFs at that stage, are fully worked up and operational. The object of investing in two carriers—let me be clear about this—is to make absolutely certain that the country at any one time can launch one of them with a proper force of aircraft on her, so that is the important thing, and that we will always achieve. We are looking again at the issue as to whether or not it is sensible to extend Illustrious’s in-service period and, if so, whether that would involve cost of any kind or whether it would not, Illustrious’s to provide a slightly greater degree of overlap. I am quite confident that things can be done and the central principle will be preserved and conserved and respected: that

170 HC Deb, 11 December 2008, Col67WS
the country will always have at least one carrier with a full complement of aircraft which can be deployed in defence of the nation.\textsuperscript{171}

111. We were surprised to hear that delaying the in-service dates for the two carriers would result in “no loss to the defence capability of the nation at all” and pressed the Minister on this point. He remained of the view that there would be “no costs in terms of our defence capability”.\textsuperscript{172}

112. We find it very strange that, only six months after awarding the contracts to build the carriers and announcing the in-service dates, the MoD has decided to delay the entry into service of the two new aircraft carriers, the first by one year and the second by two years. We do not share the view of the Minister for Defence Equipment and Support that the delays to the in-service dates will result in “no loss to the defence capability of the nation at all”. In its response to our Report, we expect the MoD to set out its latest forecast of when the two carriers are expected to enter service.

113. The Minister could not provide us with an estimate of the cost of delaying the in-service dates for the two carriers. Industry had provided figures, but these were “purely internal estimates” and were “not robust”.\textsuperscript{173} On the cost of extending the life of HMS Illustrious, the Minister told us that:

In terms of any cost of continuing slightly longer with Illustrious, the point I made earlier on, that is not a matter which we have focused on yet and not a matter I think we need to focus on at this particular juncture.

We were surprised to hear that HMS Ark Royal was due to be paid off earlier, despite it being the newest of the three Invincible Class Carriers. The Minister’s evidence would seem to indicate that for a period prior to the introduction of the new Carriers only one Invincible Class Carrier will be in service, which represents a significant reduction in capability.

114. We are concerned that the MoD could not provide us with an estimate of how much the decision to delay the in-service dates for the Future Carriers will cost, as the estimates that the MoD has been given were not considered robust. We would expect DE&S to have the ability to produce robust estimates, given that one of its key roles is to be an intelligent customer. There will also be a cost in extending the life of either one or both of the existing Carriers, but the Minister for Defence Equipment and Support did not apparently consider this a matter of any importance. We consider that, while the delay to the entry into service of the two carriers may provide some short-term savings, the Future Carrier programme is likely to cost substantially more in the long-term. In its response to our Report, we expect the MoD to provide us with details of the additional cost of delaying the entry into service of the two carriers—both the additional contractual costs relating to the Demonstration and Manufacture phase and the costs of extending the life of either one or both of the existing Carriers currently in service.

\textsuperscript{171} Q 308
\textsuperscript{172} Q 314
\textsuperscript{173} Q 315
115. We asked how the delays to the in-service dates would be managed and the industrial implications of this. The Minister provided a lengthy response. He told us that there was “no question of completing the work on the existing schedule, and then just stopping everything and downing tools and everybody going away for six months’ holiday; nothing of that sort, no”.

According to the Minister, the decision to delay the in-service dates of the carriers “does not in any way cause any structural unemployment”. He assured us that there would be no job losses and that there would “not be any loss of specialist skills”. We asked if industry would be able to keep their teams together given that the programme was being stretched out. The Minister said that the industry teams will be kept together and that “the core skills will continue to be fully employed”.

116. The Minister once again claimed that there would be no defence costs to the nation:

I can repeat to you what we are trying to do is to produce a solution which makes sense in financial terms. It has no defence costs to the nation. We are not losing any defence capability. That is very important, and I have already made that point, and it also does not have industrial and employment costs.

117. The Minister for Defence Equipment and Support has assured us that the decision to delay the in-service dates of the carriers will not result in any job losses or loss of specialist skills. We remain to be convinced and will be monitoring the programme closely, in particular, the industrial implications of the decision to delay the entry into service of the two carriers. We are also puzzled as to why this decision was made so soon after Main Gate. The timing suggests that the decision had nothing to do with the carrier programme itself but with easing problems with other programmes identified in the short examination of the equipment programme. We expect from the MoD clarification of this change to plans so soon after Main Gate in response to this Report.

Joint Strike Fighter

118. In our Future Carrier and Joint Combat Aircraft Programmes inquiry, the MoD told us that “we anticipate buying up to 150 STOVL [Short Take Off and Landing] variants of the Joint Strike Fighter”. In our Defence Equipment 2008 inquiry we asked CDM how many JSF aircraft the MoD would be procuring. He told us that “it depends on what they cost”. At the time, the MoD did not know the unit costs or support costs for the JSF and CDM considered that “it would be foolish of me to suggest a number without knowing the price”. At our evidence session on 25 November 2008 we asked whether the MoD was

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174 Q 318  
175 Q 318  
176 Q 319  
177 Q 320  
178 Q 328  
179 Q 320  
180 Defence Committee, Second Report of Session 2005-06, Future Carrier and Joint Combat Aircraft Programmes, HC 554, Ev 42  
181 Defence Committee, Tenth Report of Session 2007-08, Defence Equipment 2008, HC 295, Q 158  
182 ibid, Q 159
any clearer about the unit cost of a JSF aircraft. CDM replied “No, I do not think I am, am I?”. Dr Tyler added:

We have got transparent visibility of the costing models that are being used in the United States, and in the programme office there, on the unit price of JSF. The information is confidential because we have not yet signed any production contracts with the company, but what we do get visibility of is the way that that cost is tracking with time. At the moment, it is reasonably stable... \(^{183}\)

119. Given that there was now some information on costs, we asked how many JSF aircraft the MoD was planning to buy. CDM told us that there “is still a decision-making process going on, we are looking at buying three, which are the Operational Test and Evaluation aircraft”.\(^{184}\) We asked how many would be acquired following the purchase of the three initial aircraft, but CDM said is was a case of waiting to see “what the Operational Test and Evaluation comes out with”.\(^{185}\) The MoD do not expect to make any commitments on the number of JSF it will buy until the “operational test and evaluation of JSF is complete in 2014”.\(^{186}\)

120. CDM did not believe that technology transfer, which would provide the UK with operational sovereignty, was an issue on the JSF programme. Technology was being transferred to the timescale that was originally agreed.\(^{187}\)

121. There have been reports that there was uncertainty about the future of the STOVL JSF programme. CDM did not think there was any uncertainty and said that the MoD was “going through a series of milestones”. He added that:

There is a programme to procure aircraft which goes out in the future. One of the great advantages of this procurement programme is that we do not have to buy them all up front to create an attrition reserve because we are a very small part of what the Americans are buying; we can buy them as we need them. So, I think, to say there is not a programme is not right. Decisions have not been made on the totality of the programme, would be fairer.\(^{188}\)

122. The MoD was not looking at the option of marinised Typhoon aircraft to operate from the carriers, nor had the MoD been having discussions with the French about buying French aircraft to operate from the carriers.\(^{189}\) We asked if the MoD would consider buying a non-STOVL version of JSF if the STOVL version was not available. Rear Admiral Lambert said that the “option that met the bill was STOVL”. CDM told us that the “carriers are not fitted for, but could be fitted for, the carrier variant” of JSF, if the STOVL variant did not proceed.\(^{190}\) Dr Tyler set out the position:

\(^{183}\) Q 276  
\(^{184}\) Q 277  
\(^{185}\) Q 278  
\(^{186}\) HC Deb, 17 December 2008, Col 765W  
\(^{187}\) Q 279  
\(^{188}\) Q 280  
\(^{189}\) Qq 281-282  
\(^{190}\) Qq 283-284
There is the conventional take-off variant; there is the carrier variant, which is for catapults and traps, and then there is the STOVL variant. Our choice is resolutely on the STOVL variant, and at the moment there is very, very strong support for that in the programme. Indeed, the STOVL part of the programme is going extremely well; it has already made several flights and it will be hovering for the first time very early next year. So, technically, that is absolutely on track. So our extant planning assumption is absolutely to buy the STOVL variants to go on the carrier. If there was some seismic change in the programme, like, for example, the Americans decided not to support the STOVL, then we may need to go back and revisit our planning assumptions, but there is no sign of that—in fact, to the contrary.\(^{191}\)

The future carriers were large enough to take the carrier version of JSF and one of the MoD’s assumptions on the carrier design was that the “flight deck needed to be of sufficient length that, should you wish to, you could convert”.\(^{192}\)

123. The Minister for Defence Equipment and Support told us that on the JSF programme “there is nothing specific that I am particularly worried about at the moment”,\(^{193}\) and that recent news “on that front is encouraging”.\(^{194}\)

124. We note that the MoD considers that the Joint Strike Fighter STOVL programme is progressing well and that it plans to procure three aircraft for Operational Test and Evaluation. We also note that the MoD considers that technology relating to the programme was being transferred to the timescale originally agreed. We plan to continue to monitor the progress of this key programme.

**MARS programmes**

125. The Major Projects Report 2008 provides the following information about the Military Afloat Reach and Sustainability (MARS) programme:

The Military Afloat Reach and Sustainability system will provide afloat logistic support to UK and allied maritime task groups at sea and their amphibious components operating ashore. Although not strictly a one-for-one replacement programme, new vessels will incrementally replace much of the existing Royal Fleet Auxilary flotilla, as ships enter and leave service respectively. The Military Afloat Reach and Sustainability capability is designed to support three distinct types of maritime task group: Carrier Strike, Littoral Manoeuvre and Maritime Security […] The Military Afloat Reach and Sustainability system will be in service until around 2047 and as such the solution will be designed to accommodate the requirements of current and known future force structures […]. The capability to be provided is essential to the evolving logistic support needs of the Royal Navy. The proposed procurement profile of Military Afloat Reach and Sustainability ships has been matched to this need, the initial focus being on the double-hulled Fleet Tankers
which are urgently required in order to comply with International Maritime environmental standards.  

126. The Written Ministerial Statement on 11 December 2008 announced that

We have also reviewed all the components of the MARS fleet auxiliary programme, and have concluded that there is scope for considering alternative approaches to its procurement which is likely to involve the deferral of the fleet tanker element.

127. We note that the MoD is considering alternative procurement approaches to the Military Afloat Reach and Sustainability (MARS) programme and that this is likely to result in the deferral of the fleet tanker element of the programme. In its response to our Report, we expect the MoD to set out what impact the expected delays on the MARS programme will have on defence capabilities such as Carrier Strike. We also expect the MoD to set out how the delay to the MARS programme will affect its ability to comply with International Maritime Organisation environmental standards which require the phasing out of single hull tankers by 2010.

Rebalancing the equipment programme better to support the frontline

128. The Ministry of Defence Annual Report and Accounts 2007–2008 states that:

The examination of the equipment programme will focus on two issues above all: bearing down on cost increases to equipment programmes; and rebalancing the equipment programme to better support the frontline.

129. At our evidence session on 4 November 2008 for our Ministry of Defence Annual Report and Accounts 2007–08 inquiry, we asked about the issue of rebalancing the equipment programme to better support the frontline. Sir Bill Jeffrey said that the aim was “to try, if we possibly can, to balance the programme more towards the nearer-term operational priorities.” At our evidence session on 25 November 2008, we asked CDM what rebalancing the equipment programme actually meant. He said that it was:

To better support the frontline in current operations. The balance is always here. We have to support the frontline on current operations. We must not lose the seed corn for the future. Have we got the balance between those two correct?

130. We asked what the rebalancing meant for the longer-term equipment programmes and the UK’s ability to fight in future conflicts. CDM told us that:

That is what I am talking about: the seed corn for the future. We must not lose that seed corn for the future. We might not need as much equipment in a particular

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196 HC Deb, 11 December 2008, Col67WS
199 Q 178
capability area now; but if we are going to need it in the future we must not lose it in totality. We have to keep that expertise going, the development, the research and the ability for soldiers, sailors and airmen to train in that capability area so we can use it in the future to the degree that we need to use it in the future.  

CDM added that the MoD needed to “guard very carefully the long-term. It is easy to spend all the money that we have got on current operations. We have to guard the long-term”.  

131. We raised the issue of rebalancing at our evidence session on 16 December 2008. The Minister for Defence Equipment and Support said that the second objective of the short examination was:

to strike the right balance between the short-term, immediate operational needs that we face with the current threats that we are facing, and the longer term requirements for the broad capability for our Armed Forces that enables us to have reasonable certainty of being able to respond to a range of threats, none of which of course can be predicted at this point. We need to retain that essential element of flexibility and diversification of the means of response for the future, so we do not want to sacrifice that to the short term entirely. We have to strike a balance, which is why you notice that we are continuing with a whole range of programmes, including submarines, combat aircraft, air superiority aircraft, and so forth, which very obviously do not relate to the present needs of theatre, although we have made a number of adjustments which are particularly influenced by the immediate operational needs that we have. The FRES programme and the rebalancing within the FRES programme would be a good example of that.  

He considered that the short examination had “achieved its purpose” in relation to both its objectives.  

132. We asked the Minister why the programme had become unbalanced. He said that it was “simply because there are always financial pressures”, which were a result of the costs associated with “operating at the frontiers of technology” and because “new requirements emerge”. We asked about the processes the MoD had in place to ensure that the equipment programme remained in balance. The Minister said that there were “several mechanisms”, which included:

- a commitment control regime at the present time to try and make sure that nobody signs off a cheque or signs a contract which has the effect potentially of threatening something which might have a higher priority in the programme later that year. We have introduced this new discipline and I think that is a sensible tool to have in any organisation.
The Minister said that he had set up a new Committee which was looking at longer term priorities:

so that we are trying a little bit ahead of time now to see how our priorities might be evolving and what kind of new requirements we might be faced with…. We are trying to take that into account and look at some of the financial consequences of that a little bit earlier in the system than previously we were.\textsuperscript{206}

133. The issue of rebalancing was raised at our evidence session with industry representatives on 18 November 2008. Mike Turner referred to the focus being, understandably, on the welfare of the Armed Forces and current operations. However industry was “concerned about the long term”. He said that “we have a world class defence industrial base and only focusing on the short term and not the long term is of huge concern to us”.\textsuperscript{207}

134. The second objective of the short examination of the equipment programme was “rebalancing the equipment programme to better support the frontline”. We note that the Minister for Defence Equipment and Support considers that this objective has been achieved. We consider that, while supporting current operations must be the priority, it is absolutely vital that the MoD continues to give sufficient attention to the longer-term equipment programme. We note that the Minister has set up a Committee to look at the longer-term priorities. The issue of keeping the equipment programme balanced is an issue we plan to monitor closely.

\section*{Status of the Equipment Programme}

135. At our evidence session on 18 November 2008 with industry witnesses we heard concerns about the status of the equipment programme. Ian Godden told us that:

\begin{quote}
I think the limbo started last year. Whilst the UORs have been very successful and have continued throughout this period, with those exceptions, I certainly in my position feel that we have been in limbo since September 2007.\textsuperscript{208}
\end{quote}

Dr Wilson said that:

\begin{quote}
this problem of companies funding teams and capabilities over an extended period has been going on for the last 18 months quite significantly. I think many companies could point to very significant spend which has come off their bottom line in that period to keep teams going until MoD makes up its mind about what it actually wants to do.\textsuperscript{209}
\end{quote}

Mike Turner told us that:

\begin{quote}
but the rest of it, the Future Equipment Programme, is paralysed.\textsuperscript{210}
\end{quote}
136. At our evidence session on 25 November 2008 we put these concerns to MoD. CDM did not agree with the view that the future equipment programme was paralysed. He told us that:

We are continuing to spend an awful lot of money with British industry and worldwide industry, so I am not too sure quite where they get that from.  

I am absolutely not going to tell you which projects I am talking about, but we had 10 projects through the commitment control review last week, and nine went forward to be spent—to be continued. I refute what industry is saying absolutely.

137. We note that industry and the MoD appear to have radically different views on the status of the equipment programme. Industry refers to the equipment programme being paralysed, yet the MoD claims to be spending substantial amounts of money with industry and denies industry’s claims. We doubt that the announcements about the equipment programme on 11 December 2008 will provide industry with much clarity about the MoD’s future requirements. There is an impression of another shoe waiting to drop. We plan to monitor this issue closely in the future.

138. The Written Ministerial Statement on 11 December 2008 announced that:

Any further significant changes to the equipment programme will be announced following the conclusion of the MoD’s current planning round in March. While that work continues, I intend to control new commitments carefully to ensure we do not restrict our flexibility unnecessarily, though this will not be allowed to hold up support to current operations or our other highest priorities.

139. We asked what sorts of announcements the MoD expected to make about equipment programmes following the completion of Planning Round 2009. The Minister said that:

We made that statement to provide, as I say, for the necessary flexibility and to recognise that these matters are uncertain and we have to continue to keep them under review, not because we have in mind any specific new, dramatic announcements.

The Minister stressed that the exercise undertaken to review the equipment programme will not be the last and that the MoD would “continue to be alert and flexible and take the responsible decisions that we need to take at any one time”.

140. We note that any further major changes to the equipment programme will be announced in spring 2009 following the completion of Planning Round 09. We expect the MoD to keep Parliament informed of such changes as soon as they are known.
4 Funding of defence equipment and support

Comprehensive Spending Review settlement for defence

141. The Secretary of State for Defence announced the overall outcome of the Comprehensive Spending Review (CSR) settlement for defence in a Statement to the House on 25 July 2007. He told the House that:

The total departmental expenditure limit [DEL] for defence over the CSR period will be £34 billion in 2008–09, £35.3 billion in 2009–10 and £36.9 billion in 2010–11. That is an additional £7.7 billion for defence by 2011, and a 1.5 per cent average annual real terms increase against our CSR baseline, excluding the costs of operations that are met from the reserves and the time-limited defence modernisation fund.216

142. The MoD placed a paper giving some more details on the CSR settlement for defence in the House of Commons Library. The details are set out in Table 9 below.

Table 9: Details of the CSR settlement for defence

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<td>35,342</td>
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Note:
The 1.5% average annual real terms increase is against the CSR baseline, excluding the costs of operations met from the Reserve and the time-limited Defence Modernisation Fund.
Total DEL comprises near cash Resource and Capital DEL, plus the cost of capital, which is a non-cash charge. This is consistent with Government Accounting.

Source: Ministry of Defence

143. We examined the Comprehensive Spending Review settlement for defence in our Report Ministry of Defence Annual Report and Accounts 2006–07.217 We welcomed the increase in the MoD’s budget for the period covered by the Comprehensive Spending

216 HC Deb, 25 July 2007, Col 865
Review 2007 (CSR 2007), but noted that the defence budget will be under substantial pressure in the period covered by CSR 2007 given the announcement of several funding commitments such as the future carrier programme.\textsuperscript{218} At our evidence session on 13 November 2007 for our inquiry into the Ministry of Defence Annual Report and Accounts 2006–07, we asked the MoD’s Permanent Secretary, Sir Bill Jeffrey, what was to happen next given that the Comprehensive Spending Review settlement for defence had been announced. He explained that:

> what we will be doing is taking the spending review outcome as the starting point, looking at where the pressures are in the programme—and there undoubtedly are some—and trying to put together the sort of advice that our ministers will need in order to set priorities and ultimately to set budgets for the next three years.\textsuperscript{219}

144. The Planning Round (PR 08) was expected to take “some months”\textsuperscript{220} and the process would go into 2008.\textsuperscript{221} Sir Bill Jeffrey said that “as we get into the early part of next year [2008], we will need to be much clearer about the budget for the three years that begin on 1 April 2008”.\textsuperscript{222} In our Report \textit{Ministry of Defence Annual Report and Accounts 2006–07} we concluded that:

> We note that the MoD is currently preparing advice to ministers about the defence budget for the three years 2008–09 to 2010–11. The MoD acknowledges that there are pressures in the defence programme and that there are likely to be cuts in some areas, including cuts to the equipment programme. We look to the MoD to be realistic about the number of equipment programmes, the number of platforms within equipment programmes, and the phasing of equipment programmes, that can be funded. We plan to monitor the progress and the outcome of the current planning round closely.\textsuperscript{223}

We examined the MoD’s short examination of the Equipment Programme in Part 3 of our Report.

**Funding of the Equipment Plan**

145. Many defence commentators have raised concerns that the current Equipment Plan is underfunded.\textsuperscript{224} In our letter to the MoD requesting a memorandum for our inquiry we asked about the funding of the equipment plan:

\begin{itemize}
\item \textsuperscript{218} Defence Committee, Fifth Report of Session 2007-08, \textit{Ministry of Defence Annual Report and Accounts 2006-07}, HC 61, paras 110
\item \textsuperscript{219} ibid, Q 13
\item \textsuperscript{220} ibid.
\item \textsuperscript{221} ibid, Q 14
\item \textsuperscript{222} ibid, Q 15
\item \textsuperscript{223} ibid, paras 117
\item \textsuperscript{224} The Department’s Equipment Plan is a set of funding assumptions related to specific projects which the Department has judged it necessary to acquire so as to deliver the military capabilities Government policy will require the Armed Forces to be able to deploy in the future. These assumptions are subject to amendment in the light of changes in individual project circumstances and the strategic environment. In addition, each project is subject to a separate approvals process which may also lead to changes in the underlying assumptions about performance, cost and time. http://www.mod.uk/NI/rdonlyres/24E4FE29-C77B-4026-A61E-262FE6B582A7/0/equipment_capability_plan2005.pdf
\end{itemize}
RUSI Acquisition Focus reported in RUSI Defence Systems Spring 2007 that “The equipment plan has been estimated as underfunded by some £15Bn or more over its ten-year period”. What is MoD’s estimate of the extent to which the Equipment Plan is underfunded?225

146. We were disappointed with the response provided by the MoD which made no attempt to provide us with an estimate:

The MoD is conducting Planning Round 09 which will help in ensuring that the equipment plan is realistic, affordable and matched with our priorities for the coming years.226

147. At our evidence session with industry representatives we asked about the issue of the funding of the Equipment Plan. Mike Turner considered than an extra £1.5 billion a year was needed for the defence equipment budget.227 We followed this issue up at the evidence session with CDM who told us that:

I do not think you can simply say that the equipment budget is under-funded. Every programming Round it is a question of balancing aspirations, requirements and the amount of money available228 […] Every government department, I suspect, would love buckets more money, but there is not buckets more money. So we have to tailor the money that is available to what is really required and not the “nice-to-haves” and the “highly desirables”.229

148. We pressed CDM further on this issue. However, he stressed that:

It is not a question I can answer. I would suggest the figures you might have picked up from RUSI and various other places are perhaps a tad ill-informed. Those people are not part of the internal Planning Round that goes on every year230[…] I think you will get a very clear feel once the PR 09 Planning Round is through. This is what we are working towards.231

149. We also raised the issue of the funding of defence equipment at our evidence session with the Minister for Defence Equipment and Support and asked if, following the short examination, the equipment programme was now affordable. The Minister said that the equipment programme was an affordable programme and explained that:

We have had to make an adjustment about exactly the pace with which we are bringing certain things forward […] some of the priorities are being increased and others are being set back a bit […] we will never have a situation in which everything can be afforded today, of which there are no changes in year—that just would not be a natural situation to be in—but I believe that the equipment examination exercise

225 Ev 78, para 2
226 ibid
227 Q 9
228 Q 166
229 Q 167
230 Q 189
231 Q 192
has relieved an awful lot of pressure, let me put it that way […] I would hope that we would only have to cut programmes if we really decided they were not really necessary, really essential, in the defence interests of the nation.\textsuperscript{232}

150. Many commentators have suggested that the defence equipment programme is under-funded, but the MoD was unable to give us a clear answer and could not provide us with an estimate of the level of any such under-funding. We note that, following the completion of the short examination of the equipment programme, the Minister for Defence Equipment and Support considers that the equipment programme is affordable, no significant equipment orders having been cancelled, although the timetables for some have been slipped. We are aware that, in the past, slipping programmes has resulted in increased costs. We plan to monitor the outcome of Planning Round 2009 which is expected to be completed in spring 2009.

**Pre-budget statement**

151. The Chancellor of the Exchequer made a statement to the House on the Pre-Budget Report on 24 November 2008.\textsuperscript{233} At the evidence session with industry representatives on 18 November 2008, we asked what representations the defence industry had made regarding the Pre-Budget Statement and, in particular, with regard to the defence supply chain and Small and Medium-sized Enterprises (SMEs). Mike Turner stressed the importance of SMEs to the UK’s defence industrial base and highlighted current concerns:

Clearly the industry over recent years has been quite optimistic about the long term, particularly the DIS. You have seen that the number of apprentices who have come into the defence industrial base is quite huge actually. Just bear in mind that in the defence industrial base of the UK we have more SMEs in the defence industry in the UK than Spain, Germany, France and Italy put together. We have a huge SME base in this country dependent basically on the defence budget and the primes feeding through this work. There is no doubt about it now that the SMEs are getting quite concerned about the situation. We are seeing signs of apprentice numbers falling, and understandably so in the current climate.\textsuperscript{234}

They [SMEs] are suffering now because, frankly, the primes are suffering on the major programmes. We are not flowing down and are unable to flow down money to the supply chain. We have made the point about SMEs in the defence industrial base. Frankly, I do not think we are being listened to. I do not see us as part of the stimulus package and I think it is a mistake.\textsuperscript{235}

152. An article in the Daily Telegraph of 25 November 2008 reported that, following the Pre-Budget Statement, Ian Godden had said that:

It is a disappointment that the Chancellor has neglected to include an injection of much-needed funds for the UK defence industry. This oversight is disappointing

\textsuperscript{232} Q 392
\textsuperscript{233} HC Deb, 24 November 2008, Cols 489-503
\textsuperscript{234} Q 16
\textsuperscript{235} Q 106
given the contribution that this industry will make to the UK’s economic recovery, a contribution that could be greater still if the Government had included it in the stimulus package. The Government not only controls the amount of investment in the defence budget but also where it is spent. This makes it the ideal sector for Government spending as a fiscal stimulus. This is more so given the regional diversity and highly skilled jobs that the industry represents, as well as the export potential of many of the projects that would bring a return on the initial investment.\footnote{Defence industry criticises lack of cash injection, Daily Telegraph, 25 November 2008}

153. We asked the Minister for Defence Equipment and Support whether he was disappointed that there was no injection of funds for the UK defence industry in the Pre-Budget Statement. He said that he thought that “the Government very adequately indeed is funding defence”. The Minister referred to the increases in the defence budget announced in July 2007 and considered that “equipment and support are doing extremely well in that context”.\footnote{Q 412} On the specific issue of an injection of funds as a fiscal stimulus, he outlined several reasons why he considered that the defence industry was not an ideal candidate for such a measure and told us that “defence is not an obviously efficient target for counter-cyclical fiscal stimulation”.\footnote{Q 417}

154. We note that there was no injection of funds for the UK defence industry in the Pre-Budget Statement of 24 November 2008. We are concerned to hear from industry that Small and Medium-sized Enterprises (SMEs) are “suffering” because money is not flowing down the supply chain. In its response to our Report, we expect the MoD to set out the extent to which it is aware that SMEs are experiencing problems and how it is proposing to address these in order to ensure that the current supply chain is retained.

155. We examine the issue of SMEs and the supply chain in Part 5 of our Report.

**Defence research spending**

156. In our Report *The work of the Defence Science and Technology Laboratory and the funding of defence research,*\footnote{Defence Committee, Eighth Report of Session 2006-07, The work of the Defence Science and Technology Laboratory and the funding of defence research, HC 84} we examined the impact of defence research funding. The Defence Technology Strategy (DTS), which was launched on 17 October 2006, notes that analysis had shown that there was a correlation between the quality of military equipment and the investment by governments in defence Research and Development (R&D). The military advantage achieved at any one time depended upon the R&D investment made over the previous 25 years. The analysis showed that “advantage can be gained or lost by increasing or decreasing R&D investment relative to other R&D investing nations”.\footnote{Ministry of Defence, Defence Technology Strategy for the demands of the 21st century, October 2006, paras A2.1 and A2.3} Figure 1 in the DTS showed the “Relative Years Advantage in Equipment Quality as a Function of R&D Spend per Year”. The DTS states that:

\[
\text{Relative Years Advantage in Equipment Quality as a Function of R&D Spend per Year.}
\]
the analysis has shown that the advantage achieved at any one time depends on the R&D investment made over the previous 25 years. In particular, investments 5 and 20–25 years earlier are critical corresponding to development activity (about 5 years earlier) and defence research activity (typically 20–25 years earlier). Clearly advantage can be gained or lost by increasing or decreasing R&D investment relative to other R&D investing nations.241

157. In its memorandum to our inquiry the Royal Aeronautical Society highlighted the importance of investment in defence technology:

The Society fully appreciates the need to support the armed forces currently deployed in intense operations. Their safety and security must have top priority in defence spending. However, there is a risk that investment in technology upon which Britain’s armed services will depend upon in the future will be squeezed between immediate operational requirements and the equipment programme. It is essential that funding for technology acquisition be maintained; without adequate MoD support in this area, the UK defence industrial base will decline, UK companies will lose their edge in world markets, global defence companies will not want to invest in the UK and ultimately the UK armed services will lose access to the high quality domestic assets needed to support equipment in the field and to acquire weapons to meet their specific needs.242

158. At our evidence session on 4 November 2008 for our inquiry into the Ministry of Defence Annual Report and Accounts 2007–08 we asked about the defence research budget and, specifically, about cuts in the research budget. Sir Bill Jeffrey said that the MoD attaches “very high importance to the Research and Development Programme”.243 However, for the research budget, he said that:

There has been some reduction recently. We are certainly very keen to protect this area of expenditure, if we possibly can, because it is, for the reason you give, long-term very significant. We are also keen, through the Defence Technology Strategy and other means, to give industry a sufficiently clear picture about some of our longer-term requirements for industry to feel able to invest more of its own money in this area because I think most of those whom I talk to in the industry feel that is not unreasonable, but they need a good sense of our judgment of what our future requirements are going to be.244

159. At the evidence session on 4 November 2008 we asked for a note setting out the level of defence research spending funded by the MoD over the last 15 years. The MoD subsequently provided this information which is set out in table 10 below.
Table 10: Net MoD research spending at current prices for the period 1992–93 to 2006–07

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Source: Ministry of Defence

Note: the spending data are inclusive of non recoverable VAT at current prices. Figures for 2007–08 are due to be published in September 2009.

160. At the evidence session with industry representatives on 18 November 2008, Ian Godden, stressed the importance of spending on defence research:

If you want an industrial capability in a country there are two factors: one is the funding of specific programmes for specific platforms for specific services and pieces of kit; and the second is the research and development which underlies it. I think we all regret missing out on Stealth as an example where in a previous era we did not invest enough. If you look behind the scenes the research and development budget this year has been cut by seven per cent. To me that is about the capability for the future as well as the current programmes that we are all debating and to me that is as significant, if not more significant as a signal of what the current climate is doing to the long-term capability. It was a seven per cent cut and there was a cut the year before.

The Winter Supplementary Estimates for the Financial Year 2008–09 were laid before the House on 25 November 2008. In our Report Winter Supplementary Estimates 2008–09, published on 15 December 2008, we noted that there was a reduction of some £120 million in the Science Innovation and Technology Departmental Expenditure Limit (DEL) under Request for Resources 1. In our Report we acknowledged that changes in DELs often amount to little more than reallocations between Top-Level Budget Holders which represent no real reductions in spending. However, we asked for:

an explanation from the MoD for this significant reduction in the Departmental Expenditure Limit for Science Innovation and Technology and whether it signals a cut in spending and, if so, what the consequences of this reduction will be.

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245 MoD’s Supplementary Memorandum [ARA 03] for the MoD Annual Report and Accounts 2007-08 inquiry available at www.parliament.uk/defcom

246 Q 92


161. We followed up the issue of defence research spending at our evidence session with the Minister for Defence Equipment and Support. We asked the Minister whether defence research spending had been cut and, if so, by how much and in what specific areas. The Minister said that “we have not made an announcement about that in the equipment examination. The matter is under review”. Whilst the Minister acknowledged the benefits from defence research spending, he said that the MoD had “to look at it from the point of view of priorities, so I am not in a position to give you any assurances about that particular matter”. He added that the MoD would be reviewing its defence research spending. We pressed the Minister on this matter and asked whether defence research spending had been cut by 7 per cent as the Chief Executive of SBAC had claimed. The Minister could not provide us with an answer as he said he did not know what baseline had been used. He said that if you looked at defence research spending over the last 5–6 years “sometimes it goes up and sometimes it goes down”.

162. The UK’s future military capability depends upon the investment made today in Research and Development (R&D) and the military advantage achieved at any one time depends upon the R&D investment made over the previous 25 years. We are extremely concerned to learn that defence research spending has been cut which, in our view, is short-sighted. We agree with the Minister that it is a matter of priorities and consider that it should be a very high priority. Sufficient funding for defence research needs to be ring-fenced. If not, the MoD must acknowledge that the role which our Armed Forces can play in the future will be substantially reduced. In its response to our Report, we expect the MoD to provide us with details of the extent of the recent cuts in defence research spending and set out the specific areas affected by these cuts. We also expect the MoD to provide us with its assessment of what impact the recent cuts in defence research spending will have on the UK’s future military capability.

**Measures to limit DE&S spending**

163. An article on the Financial Times website on 16 November 2008 reported that CDM had “ordered an unprecedented crackdown on spending in a sign of the cash crisis at the MoD”. The article said that an internal memorandum was sent by CDM to DE&S staff stating that, with immediate effect, “the default position is that no business cases are to be put to the approving authorities for approval” and “Projects that have already received approval are not to incur financial commitment”. The article also reported that the memorandum set out exceptions to the clampdown on spending which included: proposals that support current operations of UK Armed Forces over the next three years; proposals that support the future deterrent programme; ones that are necessary to satisfy contractual or international obligations; and others where the MoD has already signed a production contract.

164. At our evidence session on 25 November 2008, CDM referred to the measures to reduce spending as a “commitment regime”. We asked whether, given the memorandum
sent to DE&S staff to reduce spending on equipment programmes, he considered this to be a routine year in defence procurement. CDM said that “what I was saying was that every year what is routine is that I have to balance what I am spending to make sure I come in on control total”. We asked whether it was routine to send round a memorandum to staff each year setting out measures to reduce spending. He said:

Did I last year? I think I did. I do not know. I either send a memo out or my finance director sends a note out saying: We have now reached the point in the year where we have to make sure that we are going to come in on control total. We discuss it at my management board every month. What is unusual this year is that it has appeared in the newspapers.

165. We note that the Chief of Defence Materiel (CDM) sent a memorandum to DE&S staff in autumn 2008 setting out measures to reduce spending on equipment programmes. CDM calls the measures a “commitment regime” and considers this to be a routine practice. Whilst we support the need for robust financial control, it would appear to us that the measures taken by CDM to reduce spending on equipment programmes are a clear sign that defence funding issues are more acute than ever in the current financial year.

**Defence Inflation**

166. In our Report *Ministry of Defence Annual Report and Accounts 2006–07* we examined the issue of defence inflation and drew the following conclusion:

The Comprehensive Spending Review 2007 settlement for defence is reported as being a 1.5 per cent average annual real terms increase against the MoD Comprehensive Spending Review baseline. But this is based on the general rate of inflation and takes no account of the reportedly higher rate of inflation which applies to defence products, in particular advanced equipment projects. We look to the MoD to press ahead with its plans to develop a robust price index for defence products which will assist the MoD in both its financial planning and in its negotiations with the Treasury in future spending reviews. We consider that a robust price index for defence products is vital for allowing real comparisons to be made and to enable the Committee to undertake more effective scrutiny in this area.

167. The Ministry of Defence’s Annual Report and Accounts 2007–08 sets out some of the issues relating to defence inflation and how the MoD was seeking to address these:

Most of DE&S procurement, by value, is through long-term contracts with prime contractors. MoD policy is to use firm prices for the first five years and fixed price with variation of price (VOP) clauses after that; VOP clauses should be based on relevant high level output price indices. For contracts within the firm priced period the Department is not exposed to changes in price of raw materials, labour and energy as any increases or decreases will have to absorbed by the contractor and
supply chain as the agreed firm price is not subject to change. At present, the Department is unable to estimate its precise exposure to changes in costs of raw materials, labour and energy because it does not hold relevant information centrally. However, following the House of Commons Defence Committee comments on defence inflation in the last Annual Report and Accounts, the Government’s response has been for the Defence Analytical Services Agency to compile a database of contracts with VOP clauses upon which a measure of defence inflation can draw. The work on compiling the database and producing a measure of defence inflation is scheduled to be completed for April 2010.256

168. Professor David Kirkpatrick, an Associate Fellow of RUSI and one of our Specialist Advisers, has produced a paper examining the claim that defence inflation was higher than the GDP deflator. The paper was published in the October 2008 edition of RUSI Defence Systems. In his paper Professor Kirkpatrick concluded that:

A detailed comparison between defence inflation and the GDP deflator would demand more detailed data on MoD expenditure than is available in the public domain, and is accordingly beyond the scope of this paper. However, the speculative and approximate calculation in the table below [note: table in the paper] suggests that defence inflation is likely to be consistently about three percentage points above the GDP deflator. It follows that if the UK Government intends to maintain the nation’s military capabilities at their planned levels, it must provide increases in the annual MoD budget which are about 3% (or whatever similar percentage is derived from a more rigorous analysis) higher than the predicted values of the GDP deflator. If the government decides to provide a smaller increase, it should explicitly agree with the MoD the resulting savings in personnel and/or equipment, and acknowledge the associated reductions in the UK’s military capabilities. If it fails to acknowledge those reductions, and the defence budget is accordingly overstretched by a mismatch between the MoD’s resources and its aspirations, it is tempting for the MoD to make false economies (e.g. via delays to projects or inadequate risk management) which solve its immediate budgetary problems, but which in the longer term degrade the cost-effectiveness of the UK's armed forces.

In his paper Professor Kirkpatrick says that “it must be emphasised that all of the figures in this section are illustrative and not definitive; the argument has been put in a numerical format only in order to clarify the issues and to facilitate further discussion”.257

169. At our evidence session on 4 November 2008 for our inquiry into the Ministry of Defence Annual Report and Accounts 2007–08, we asked about the issue of defence inflation. Sir Bill Jeffrey set out his understanding of the issue:

It is certainly the case, and I can recall in the equivalent session last year discussing this with the Committee, that some of our input costs are rising faster than general inflation, although it has fluctuated hugely in the last few months, and oil and fuel is one of these. I am aware of the analysis by Professor Kirkpatrick that you were

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257 “Is defence inflation really as high as claimed?”, RUSI Defense Systems, October 2008, Vol 11 No 2
briefed on at Shrivenham and it is an interesting one. I do not think we could immediately validate the figure of three per cent. It is like any analysis of this kind, it rests pretty heavily on the assumptions that are made at each stage as Professor Kirkpatrick sets out the argument and I think we would question in particular the assumption that we should not discount technological improvements in comparing the costs of different generations of defence equipment. However, it is an interesting piece of work and it is certainly an area that within the Department we are devoting quite a lot of attention to.  

170. The MoD’s supplementary memorandum to our inquiry into the MoD’s Annual Report and Accounts 2007–08 provided an update on the work the MoD were undertaking to examine the issue of defence inflation. The relevant extract from the supplementary memorandum is reproduced in table 11 below.
Table 11: MoD’s progress in calculating the rate of defence inflation

| The programme of work underway to develop a robust measure of inflation for total defence expenditure will produce publishable estimates for FY 07/08 and FY 08/09 by April 2010. For FY 09/10 we hope an estimate will be produced in September 2010; this cannot be produced earlier because data for some UK and foreign indices is not published until September. |
| Amalgamation of these work-strands will lead to a measure of inflation in the input costs of Defence (the goods and services we purchase and the wages we pay). We cannot measure changes in the output cost of Defence as we have no quantitative measure of Defence outputs, but would expect inflation in Defence output costs to be lower than that of input costs, thanks to efficiencies and productivity improvements in delivering outputs. It is also important not to confuse Defence Inflation with the escalation in unit cost of defence equipment. The latter tends to run above deflator inflation, because new generations of defence equipment are much more capable, than their predecessor. |
| Constructing a measure of inflation for equipment projects is a complex exercise. For example, most major equipment projects have ‘variation of price’ (VOP), clauses, relating to a particular industry index or range of indices. Details of VOP clauses are not stored centrally and appropriate details have to be obtained for each contract separately. Each contract’s VOP arrangement is different. VOP clauses are a collection of formulae that use a wide range of price indices and exchange rates. |
| A prototype database for storing contract VOP details has been built. Processes for matching data to contracts payment data and to price index data should be complete by December 2009. |
| Latest estimates, based upon 123 contracts which we have been able to match to expenditure data, account for around £2.5bn annual expenditure. The average inflation rates for these was 3.6% in the year 2006/07 to 2007/08. For the top 10 contracts the rate ranged from 1.7% to 5.3%. |

Source: Ministry of Defence

171. At our evidence session on 25 November 2008, we asked CDM about Professor Kirkpatrick’s paper and why defence inflation might be running at a higher rate than the GDP deflator. CDM said that:

The Kirkpatrick article, I think, is a very interesting one, and it is attractive but it is a bit thin on fact. I understand the financiers in the MoD are looking at the whole business of defence inflation, which we are interested in when we see the result. I think we just need to be fairly careful about what is input inflation and what is output inflation. The cost of steel went up hugely—50 per cent, I think—and then came down again; aluminium oxide went up, and I do not know whether that has come down again. Input inflation does go up and down. On the other hand, we then use those inputs to produce an output, and the output… is actually, very often, more expensive than a similar output 20 years ago. On the other hand, it is very much more sophisticated, and it has to be more sophisticated because the threat is greater. I am not answering your question—and I do not intend to—but there is a lot of thought that has got to go into this, I think. It is a very interesting question, but I do think we need to think this through very carefully.

259 MoD’s Supplementary Memorandum [ARA 03] for the MoD Annual Report and Accounts 2007-08 inquiry available at www.parliament.uk/defcom

260 Q 253
The issue of defence inflation was also raised at our evidence session with industry representatives. We asked whether industry had a view as to whether defence inflation ran higher than the average rate of inflation for the rest of the economy. Mike Turner referred to the position in the US:

The US defence budget planning received wisdom is that the defence industry, because it is at the sharp end of technology, has relatively low volumes compared to what happens in commercial industry and that inflation is significantly higher. The skills that are demanded in the defence industry mean that defence inflation is significantly higher than general inflation, and that is allowed for in the defence budgeting in the United States. I believe it is obvious to anybody that inflation is going to be higher in the defence industry. Volume, skills, technologies, materials all come together, and you are demanding the very highest level of capability which costs money more than the average and that is why, if you look at the defence industrial base, we pay people well in the defence industry in the United Kingdom compared to general industry. The good news in the US is that it is recognised.261

Following the evidence session on 25 November 2008, the Defence Industries Council provided us with a note setting out some of the factors relating to defence equipment and support which may contribute to defence inflation. The note acknowledged that “there is a lack of firm statistical information on which to base any analysis and we would therefore welcome an opportunity to study this issue in greater depth with the MoD”.262

Defence inflation, and in particular defence equipment inflation, reportedly runs at a higher rate than the general rate of inflation. A recent research paper suggests that defence inflation may be running some 3% higher than the general rate of inflation. If true, this would seriously undermine the Comprehensive Spending Review 2007 settlement for defence which was reported as being a 1.5% annual real terms increase in the MoD budget for the period 2008–09 to 2010–11. The MoD is undertaking work, scheduled to be completed in April 2010, to produce a measure of defence inflation. We find the lack of urgency given to this project to be regrettable. The MoD must push forward this work as quickly as possible so that the results can feed into its negotiations with the Treasury in future spending reviews. We expect the MoD to work with organisations such as the Defence Industries Council to examine the issue of defence inflation and report back to us with its findings.

261 Q 66
262 Ev 105, para 1
5 The Defence Industrial Strategy

Background

175. The aims of the Government in the Defence Industrial Strategy (DIS), published on 15 December 2005, are summarised in its Foreword as follows:

Our Defence Industrial Strategy takes forward our Defence Industrial Policy, published in 2002, by providing greater transparency of our future defence requirements and, for the first time, setting out those industrial capabilities we need in the UK to ensure that we can continue to operate our equipment in the way we choose [...] to maintain appropriate sovereignty and thereby protect our national security [...] In doing so, it builds upon the Defence Industrial Policy, explains more clearly how procurement decisions are made, and to assist industry in planning for the future commits Government to greater transparency of our forward plans, noting that as in any business, these change over time as spending priorities shift or cost estimates mature.263

176. We have published two reports on the DIS:

- The Defence Industrial Strategy,264 published on 10 May 2006; and

177. In our first Report on the DIS we acknowledged that the strategy was produced to a tight timescale and that a wide consultation with industry had been undertaken. We congratulated Lord Drayson, the then Minister for Defence Procurement, and his team for this work. We considered that:

The success of the DIS will depend upon how well it is implemented and whether the MoD is adequately funded by the Treasury to deliver it. The Minister for Defence Procurement is providing the impetus for implementing the DIS and this must be maintained. The Minister has provided us with a timetabled programme for implementation of the DIS. We plan to monitor closely its progress.266

178. In our second Report on the DIS we concluded that:

The Minister for Defence Procurement, Lord Drayson, considered that 2006 was the year in which the DIS would be implemented; and overall, good progress has been made.267

263 Cm 6697, Foreword
266 Defence Committee, Seventh Report of Session 2005-06, The Defence Industrial Strategy, HC 824, Summary
267 Defence Committee, Sixth Report of Session 2006-07, The Defence Industrial Strategy; update, HC 177, Summary
Responsibility for implementing the Defence Industrial Strategy

179. Lord Drayson stood down from his ministerial responsibilities in November 2007. Baroness Taylor of Bolton replaced Lord Drayson as Minister for Defence Equipment and Support in November 2007 (the post of Minister for Defence Procurement was renamed Minister for Defence Equipment and Support in March 2007). Following changes to the Defence ministerial team announced in early October 2008, Quentin Davies MP was appointed Minister for Defence Equipment and Support.

180. At our evidence session on 12 November 2008 for our inquiry into the Ministry of Defence Annual Report and Accounts 2007–08, we asked the Secretary of State who was responsible for driving forward the DIS at the ministerial level and which official within the department had responsibility for the DIS. The Secretary of State said that:

The Minister for Defence Equipment is the Minister who has, as it were, day to day responsibility for the Strategy. I decided to chair the National Defence Industry Council because I am very, very interested in this work of the department. In addition to operations which I described as my focus, the equipment programme for anyone who does my job is going to be in your face day in and day out. Relations with industry are very, very important to us so I am going to be very heavily involved in this as well. Quentin [Davies] has the day to day responsibility but I see myself as very, very closely involved in this as well.268

181. At our evidence session on 25 November 2008 we asked CDM who, below ministerial level, was in charge of the DIS. He said that he was “not really sure I understand what you mean by “in charge”. If you mean “delivering to it” because it is now policy, yes, I am; we all are”.269 He added that “driving forward the current extant policy is the business of the Department and a lot of that falls on my shoulders”.270 At our evidence session on 16 December 2008 we asked the Minister for Defence Equipment and Support who had overall responsibility for the DIS. The Minister told us that “I do as a Minister and Mr Amyas Morse [Defence Commercial Director] who is here with me as an official”.271

182. We note that the Minister for Defence Equipment and Support has overall responsibility for the Defence Industrial Strategy (DIS) and that the key official within the Department with responsibility for the DIS is the Defence Commercial Director. However, the Chief of Defence Materiel (CDM) is also responsible for “driving forward” the DIS. In its response to our Report, we expect the MoD to set out the specific responsibilities relating to the DIS which fall to the Minister for Defence Equipment and Support, the Defence Commercial Director and CDM.


269 Q 154

270 Q 155

271 Q 427
Progress in implementing the Defence Industrial Strategy

183. Our Report *The Defence Industrial Strategy: update* included a summary progress report on significant DIS milestones as at 19 December 2006.\(^{272}\) The MoD has provided us with an updated summary progress report which reports that, in general, good progress has been achieved in the maritime sector. In the fixed wing sector, a key milestone was to “reach a firm decision on the viability, shape and scope of the proposed LTPA [Long Term Partnering Arrangement] by the end of 2007”. However, the progress report states that both parties have agreed that a phased approach is more appropriate and they are now “actively negotiating the next phase of the programme”. The progress report states that good progress has been achieved in the Armoured Fighting Vehicles (AFVs), Helicopters, Complex Weapons, General Munitions, and CBRN [Chemical, Biological, Radiological and Nuclear] sectors.\(^{273}\)

184. The issue of Long Term Partnering Arrangements [LTPAs] was raised at our evidence session with industry representatives. Mike Turner told us that:

> We have agreements in principle in a number of sectors now: on helicopters, land, air and maritime. The problem we have is that, having the agreements in principle, we have now basically stalled in putting those into long-term partnering agreements with the benefits that will flow.\(^{274}\)

185. Most of the memoranda submitted to our inquiry referred to the progress in implementing the DIS. For example, the memorandum from the Defence Industries Council states that:

> Since its publication in December 2005 there have been many steps taken towards embedding the principles set out in the Defence Industrial Strategy into normal business. There is now a greater understanding and appreciation within Government of the contribution industry makes to delivering defence capability and its overall value to the nation’s industrial, technological, scientific and economic base…. However overall progress has been much slower than industry would have wished. In part this reflects MoD’s ongoing financial and programme problems but also difficulties progressing some commitments on policy issues i.e. greater transparency over its plans, clarity over how operational sovereignty would be assessed and how to present, measure and deliver Value for Money. It also needs to reconcile the key roles that the Defence sector can make to delivering wider Government objectives for Innovation, skills and manufacturing.\(^{275}\)

and:

> We are heartened that the new Defence Secretary and Minister (Defence Equipment and Support) have already confirmed their commitments to the key principles in DIS and their willingness to work constructively with industry. We hope that we can make progress over the coming months on those outstanding policy issues like


\(^{273}\) Ev 95

\(^{274}\) Q 44

\(^{275}\) Ev 76, paras 5-6
transparency etc…. We continue to believe the original commitment to provide a DIS which sets out “those industrial capabilities we need in the UK to ensure we can continue to operate our equipment in the way we choose” remains the correct goal. Such a DIS should also fulfil the commitment to provide “overall indicative planning assumptions for each sector” in sufficient detail to enable “our suppliers to make informed decisions”. A retreat from this level of transparency would be a disincentive to company investment plans in the long term.276

186. Other examples of references to the progress in implementing the DIS from the written evidence submitted to our inquiry are provided in table 12 below.

<table>
<thead>
<tr>
<th>Table12: References to the progress in implementing the DIS in the written evidence received</th>
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<tbody>
<tr>
<td><strong>References to the progress in implementing the DIS</strong></td>
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<tr>
<td><strong>EDS (an HP company)</strong></td>
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<tr>
<td>“The clarity of the first DIS is in danger of being lost whilst MoD determines what should be in the affordable equipment programme, and the realisation that there will have to be a Defence Review, whatever government is in power in 2010…. Furthermore the efficacy of DIS was based on the personal commitment and drive of Lord Drayson; and it will require the same from his successors.”277</td>
</tr>
<tr>
<td><strong>VT Group</strong></td>
</tr>
<tr>
<td>“Industry has responded to the agenda initiated by the publication of DIS. The formation of BVT is a direct response to DIS as part of the Maritime Industrial Strategy (MIS). It was facilitated by the Government’s agreement to proceed with the Future Carrier Programme. If this progress is to be sustained, then focus is required now to pin down the programmes that will follow the future carriers, not least to ensure that we are able to keep together the UK’s design capability. However, DIS embodies a long-term approach. The short-term requirements of supporting current operations and the need to find immediate savings within the defence budget do not facilitate the implementation of DIS.”278</td>
</tr>
<tr>
<td><strong>Royal Aeronautical Society</strong></td>
</tr>
<tr>
<td>“Clearly, the changed financial situation and the impact of operational needs on MoD planning have affected original assumptions about the timetable for DISv2.0. Nevertheless, the failure to maintain the momentum and energy associated with work on the DIP and DIS gives the Society considerable cause for concern. Companies, now even more than ever, need some indication of Ministry thinking to set their own budgets and to define priorities. Companies, either UK or foreign, with global footprints may determine that overseas investment should have more attention than here in the UK.”279</td>
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</table>

187. Concerns about the implementation of the DIS were also raised at our evidence session with industry representatives. The issue of transparency was raised by Dr Wilson who told us that:

transparency was one of the big tenets of the first Defence Industrial Strategy. I think everybody in industry thought that was going to be the opening of a rather better
regime and relationship between industry and MoD. The transparency, sadly, has not materialised yet.\textsuperscript{280}

Bob Keen also referred to transparency:

We are being consulted on a number of programmes as a company at the moment. I suppose if you take a step back and look at what the DIS was trying to achieve in terms of transparency, the sort of generic openness that the DIS was talking about, I think that has proved a challenge in a time of financial constraint.\textsuperscript{281}

188. At the evidence session Mike Turner told us that:

It was quite clear that the Government did not give Lord Drayson, the MoD, the financial support necessary to execute that strategy, and that is the limbo-land we have been in ever since. We have a DIS and have it spelt out in DIS 1 sector by sector with a Strategic Defence Review some ten years old now, which is the background for that, but we do not have the financial wherewithal to execute that strategy and that is where we are and that is where we have been for some time.\textsuperscript{282}

and:

It [the DIS] is on hold. First of all, the principles are magnificent but also we saw before us long-term planning taking place in helicopters, on land, air and sea, against which industry could then plan resources, apprentice intakes, investments and all the rest. We welcomed it and I remember the board meeting where we said good, at last we have a future in the United Kingdom, because that was very much in question. Now I think I think it is in doubt. We are very pessimistic about the future because we have the DIS, we have the principles, we have the strategy; we do not have the money.\textsuperscript{283}

189. Bob Keen saw the progress in implementing the DIS as more of a “mixed picture”:

I am not disagreeing with anything either of my colleagues has just said, but I do go back in relation to the DIS to the work that is actually already taking place on a daily basis. We are actually implementing the DIS in a number of important sectors in the defence industry. That is not to say we are doing it everywhere and there are key areas for the future, particularly in the air sector, where key decisions have got to be made about the industry and about the skills and technology that we are able to maintain over the long term and the extent to which that will enable to us deliver operational sovereignty, I would say it is a mixed picture. There are some huge decisions yet to be made and the industry really is waiting for some of those big decisions to be made, but we are also making progress.\textsuperscript{284}
190. We asked the MoD about the claim that the DIS was “on hold”. Dr Tyler, DE&S’ Chief Operating Officer did not share the concerns which we had heard from industry representatives. He told us that:

I would love some of the managing directors, for example, in the maritime sector, the armoured fighting vehicle sector, the helicopter sector, or the fixed-wing sector to sit here and say that; because the evidence and their engagement in it has been very great over the last two years since the Defence Industrial Strategy was progressed. Indeed, there is lots of evidence that has come in front of this Committee of exactly the outputs from the implementation of the Defence Industrial Strategy: the partnering agreement with AugustaWestland; the formation of BVT in the maritime sector and the surface ship support project; in the armoured fighting vehicle sector—the work we are doing at the moment in maturing that sector strategy. There is evidence right across the piece, all of which has involved industry to a great degree.285

191. We raised Mike Turner’s concern as to whether we still have a Defence Industrial Strategy with CDM. He told us that “I am absolutely clear that we do and it is on the stocks and that is the one we are working to”.286 We followed up the concerns with the Minister for Defence Equipment and Support. The Minister was adamant that, since its publication, the DIS was being implemented. He stressed that “it has been implemented and is being implemented and will continue to be implemented”.287 We raised the specific concern that funding issues were limiting the progress in implementing the DIS. The Minister emphasised that “the Government are completely committed to those principles [DIS principles], we are continuing to implement the Defence Industrial Strategy”.288 On the issue raised in the memorandum from the Defence Industries Council that the progress in implementing the DIS had been slower than industry would have hoped, the Minister told us that:

It would intensely surprise me if the customers of the MoD at any one stage said “Thank you very much, we are quite satisfied with the flow of orders, we are quite satisfied with the defence budget, we do not want any more.” That would not be a natural state of affairs, so I regard it as a very natural understanding of the state of affairs. When they say they would like a bit more money that is perfectly reasonable but they recognise realities, they are getting more money all the time but not, obviously, at the pace that they might conceivably be asking for.289

192. We questioned the Minister further on the claim by Mike Turner that the DIS was “on hold”. However, we could not get a meaningful response. He told us that “As for “on hold”, that term is slightly ambiguous. It may mean valid, still in existence, unchanged, and if that is the characterisation he was giving it that is the correct characterisation”.290 This was certainly not our view of the “characterisation” that Mike Turner was giving when he gave evidence to us.

285 Q 157
286 Q 150
287 Q 428
288 Q 430
289 Q 431
290 Q 451
193. When we asked the Minister about Mike Turner’s claim that that “It is extremely difficult for industry to plan as we hoped we would be able to when we had a DIS, but that is reality”,291 He responded as follows “He said it is difficult to plan when we have a DIS?”.292

194. We have heard mixed messages about the progress made in implementing the Defence Industrial Strategy (DIS). The MoD reports that good progress has been made in most of the industrial sectors. However, we have heard several concerns from industry, including concerns that the progress has been slower than hoped, that the expected transparency has not materialised, and that the DIS was “on hold”. In its response to our Report, we expect the MoD to consider the evidence we have received from industry, and explain to us why there is a difference of opinion between the MoD and industry on the progress made in implementing the DIS. We are particularly concerned to hear from industry that the expected transparency has not materialised and expect the MoD to set out how it plans to address this specific issue.

195. We also look to the MoD to provide us with an update on the progress in negotiating a Long Term Partnering Arrangement in the fixed wing sector, including when it expects to have reached agreement on such an arrangement.

Through-Life Capability Management

196. A key objective of the DIS was to move to a Through Life Capability Management (TLCM) approach to acquiring and managing defence equipment programmes. At our evidence session with industry representatives concerns were raised about the progress in embedding the TLCM approach. For example, Dr Wilson told us that:

Following on from what Ian Godden has just said, I agree entirely with that and I think TLCM is key. I think the process is only part way through and has to be driven quite hard in future to the point where we get proper programme boards with industrial representation on them and it is at that point that we start to get true transparency on future requirements.293

Ian Godden considered that:

in the context of TLCM that we were talking about earlier there is a risk because to implement that programme you actually probably have to spend a bit higher up-front in order to get the lower positions later. I think some of that is at risk in the current situation. It is not just a matter of delaying the programmes but also the idea of the TLCM being a longer term value for money is at risk from this current situation.294

Mike Turner also referred to funding issues and TLCM:
Through life capability management depends on having sufficient money up-front... We have never done that in MoD. That is why DIS was so important. It focused on through life capability management through partnering, but it does mean investment up-front. In the current climate, you cannot do that.295

197. A key objective of the DIS was to move to a Through Life Capability Management (TLCM) approach to acquiring and managing defence equipment programmes. However, some industry representatives have raised concerns that the TLCM approach has not been fully embedded. In its response to our Report, we expect the MoD to set out its assessment of the extent to which the TLCM approach has been embedded across the department.

Updated version of the Defence Industrial Strategy

198. At our evidence session on 21 November 2007 for our inquiry into the UK/US Defence Trade Cooperation Treaty we asked when the MoD planned to publish the updated version of the DIS. The updated version was originally expected to be published in December 2007. Baroness Taylor, then Minister for Defence Equipment and Support, told us that:

I think the date that was previously suggested was 13th, and I have just written to you, Mr Chairman, to say that as I have come into this position I want to review the whole situation, so we will not be publishing anything on 13th. I think we need to make sure that anything we publish on the Defence Industrial Strategy dovetails in with decisions we are taking on the planning round. I think it would be foolish for me, having just come into this, to make statements on 13th in advance of other work that is going on.296

199. At our evidence session on 4 November 2008 for our inquiry into the Ministry of Defence Annual Report and Accounts 2007–08, Sir Bill Jeffrey acknowledged that the MoD had “a longstanding commitment to reissue” the DIS. However, he said that the MoD had taken the view, which industry supported, that it would be “pretty pointless to reissue the Defence Industrial Strategy until we completed the examination of the equipment programme”.297 We reminded him that the MoD had told us last year that the delay to publishing the updated version of the DIS was to await the outcome of Planning Round 08. This year, the delay was to await the outcome of the short examination of the equipment programme. We pressed him on when he expected the updated version of the DIS to be published. He told us that “I hope by next year [2009] that it will have been issued”.298

200. The MoD’s memorandum set out its position regarding the updated version of the DIS and its assessment of the impact on industry of the delay in publishing:

The Department remains firmly committed to the Defence Industrial Strategy and has engaged closely with industry to develop it further. Work continues on

295 Q 20
296 Defence Committee, Third Report of Session 2007-08, UK/US Defence Trade Cooperation Treaty, HC 107, q 141
298 ibid, Q 123
developing the policy framework and examining the medium and long term equipment programme issues that will inform the industrial sector strategies. We are discussing the revision of the Strategy with the National Defence Industries Council; and through bilateral meetings with individual companies at all levels.

We do not believe that the lack of an updated version is having a significant impact on the achievement of the original DIS objectives, where we continue to make good progress. The principles set out in the original DIS still underpin all MoD’s acquisition activity and are driving transformation that will deliver equipment to the front line at value for money for the taxpayer.299

201. We followed up the issue about the delay in reissuing the DIS with CDM and, specifically, the claim that industry supported the delay. CDM told us that:

I sit on the NDIC [National Defence Industries Council], and industry quite openly and publicly at the NDIC were clear that they did not want DIS 2 published until it could be published in its totality; and that cannot be done until PR 09 is complete. At some point we will be able to publish DIS 2. Industry, I think, would have liked it a year ago, or two years ago; but until we have got our mind round the sector strategies and exactly the sort of funding that might be available for the various strategies, industry would rather stick with DIS 1.300

CDM was “absolutely clear” that the MoD would publish “DIS 2 as soon as we are able to”.301

202. Most of the memoranda submitted to our inquiry referred to the updated version of the DIS. Examples of references to the updated version of the DIS from the written evidence submitted to our inquiry are provided in table 13 below.

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299 Ev 90, para 14
300 Q 158
301 Q 159
Table 13: References to the updated version of the DIS in the written evidence received

<table>
<thead>
<tr>
<th>Reference</th>
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<tbody>
<tr>
<td><strong>Unite Amicus Section</strong></td>
<td>“Unite is clear that the best way forward for the UK defence sector is for a second Defence Industrial Strategy.” 302</td>
</tr>
<tr>
<td><strong>VT Group</strong></td>
<td>“Industry hopes that the current capabilities review will create the circumstances in which it will be possible for the DIS process to regain momentum and for DIS 2 to be published finally.” 303</td>
</tr>
<tr>
<td><strong>Royal Aeronautical Society</strong></td>
<td>“The DIS promised to be a dynamic document subject to discussion, review and regular updating. Even if this would not approach the annual review of American defence industrial affairs as mandated by the US Congress, there were hopes that a second version (DISv2.0) would be published by early in 2008 at the latest. There was a strong expectation that several lacunae present in the DIS would be addressed, particularly in respect of supply chain issues and a more extensive reference to space technology and the promotion of UK space technology.” 304</td>
</tr>
<tr>
<td><strong>Defence Industries Council</strong></td>
<td>“Companies of all sizes still need the clarity for planning decisions that we had hoped DIS v2.0 would provide. However we need to be pragmatic about what it is sensible to publish now in light of the recent financial crisis and when a general election will be held within the next eighteen months. Given these circumstances we do not believe it is the right time to push for early publication of a DIS v2.0 at a time when it may not provided the clarity industry needs to plan with confidence for the long term. We have advised HMG of this conclusion and we hope that the Government will prepare a revised DIS when the necessary conditions are in place.” 305</td>
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203. Both Sir Bill Jeffrey, MoD’s Permanent Secretary, and CDM told us that they were confident that the MoD would be publishing an updated version of the DIS. We asked about the progress in producing DIS 2 at our evidence session with the Minister for Defence Equipment and Support. Amyas Morse told us there had been more of a delay in producing DIS 2 than “we planned originally”.306 The Minister said he was committed to the principles of the DIS. However, he added that:

Whether it makes sense to have a second version of that, Defence Industrial Strategy 2, is a matter on which I am open-minded and I have expressed myself along those lines with industry. In so far as Defence Industrial Strategy 2 gave a greater degree of clarity, a greater degree of investor confidence to industry, in other words in so far as it was more explicit on the sectoral information, on the budgetary information and so forth than the existing one, industry would no doubt be pleased to have it, but if it did not achieve those things—and it might be difficult for us to achieve those things—then there is a great danger having too frequent a re-issue of the Defence Industrial Strategy because it is supposed to be a long-term framework.307

302 Ev 68, para 2.6  
303 Ev 72, para 5  
304 Ev 73, para 6  
305 Ev 76, para 9  
306 Q 429  
307 Q 430
204. We found the Minister’s statement odd given that DIS 2 was originally expected to be published in December 2007 and then spring 2008, and now we were hearing that the MoD might not publish DIS 2 at all. We asked the Minister why Lord Drayson considered it important to produce an updated version of the DIS and why the new Minister did not. The Minister said that he did not “exclude having a new document”, but:

I am open-minded about when that should best be and I am very conscious that there is no point having a document for the sake of having a document, there is no point having a document which is full of general principles and aspirations, the only sort of document that industry is actually interested in—and you will know this as well as I do—is a document which gives a very great deal of clarity and certainty about our purchasing plans.\(^{308}\)

205. Given that the short examination of the equipment programme has finished we asked what was now holding up the publication of DIS 2. The Minister considered that it would “not be sensible to have a new Defence Industrial Strategy every year, it would be crazy”.\(^{309}\) We reminded the Minister that it was envisaged in the Defence Industrial Strategy that there would be a DIS 2. The Minister provided us with another lengthy response:

I personally do not think that we should have these documents too frequently, you devalue them if you have them too frequently, I really mean that. I do not think we should have one every year, I do not think we should have one every two years, we should not necessarily have one every three years. I think we need to make sure that when we do have one it is at the right strategic moment when we can say something which is novel, which is original, which is arresting, which is detailed, which is full of sectoral and financial information of the kind that industry wants. As and when we get to that position the advantages of having such a document would be greater than the disadvantages. If we cannot agree those degrees of clarity then I do not think that the advantages necessarily would override the disadvantages and one of the disadvantages might be to devalue the existing document.\(^{310}\)

206. An updated version of the Defence Industrial Strategy was expected in December 2007, but the MoD did not meet this deadline, nor the next deadline of spring 2008. The MoD claimed that the original deadline was missed because of the need to finalise Planning Round 2008. More recently, the MoD has claimed the delay has been caused by the need to complete the short examination of the defence equipment programme. The short examination has been completed and both the MoD’s Permanent Secretary and the Chief of Defence Materiel have told us they were confident that the updated version of the DIS would be published in 2009.

207. We find it astonishing that the new Minister for Defence Equipment and Support was “open-minded” as to whether it made sense to have an updated version of the DIS. The DIS is now over three years old and a key aim was to provide industry with clarity about the MoD’s future requirements. In its response to our Report, we expect the MoD to tell us whether, or not, it plans to publish an updated version of the DIS. If it

\(^{308}\) Q 434
\(^{309}\) Q 440
\(^{310}\) Q 441
does plan to do so, we expect the MoD to set out when it plans to do so. If it does not, we expect the MoD to set out how it plans to keep industry informed of its future requirements and the industrial capabilities which the UK needs to retain. We condemn the failure to date to publish an updated version of the DIS and consider that its continuing absence increases the risk that the UK Defence Industrial Base will not be able to meet the future requirements of our Armed Forces.

The Defence Industrial Base

208. At our evidence session on 12 November 2008 for our inquiry into the Ministry of Defence Annual Report and Accounts 2007–08 we asked the Secretary of State about the DIS and the Defence Industrial Base. He told us that:

I think we should do everything we can to help sustain sovereign defence capabilities in a number of very critical areas. The Defence Industrial Strategy tried to set those out. I think it is a balance we have to strike here. We must retain the ability to equip and provide the vital kit that we need from within our own defence industrial base if we are going to retain essential sovereignty in defence policy…. We have to see the defence industrial base. Of course a successful defence base here in the UK can actually help us address some of the value for money issues that you have described. Nowhere is that more evident to me than in the area of exports where we have to get right behind our defence manufacturers in the exporting work that they do because that can help address some of these knotty problems about value and marginal costs and everything else that bedevil defence procurement.311

209. At our evidence session with industry representatives concerns were raised about the UK’s Defence Industrial Base (DIB). Mike Turner referred to this issue on several occasions:

The big concern that the defence industrial base has is the third area, the future equipment programme. Will this country be able to able to play a role in the world, five, ten, 15 years out? […] We have a world class defence industrial base and only focusing on the short term and not the long term is of huge concern to us.312

I tell you now this industry is in decline and unless people pay attention to the budgeting of defence in this country and the defence industrial base we do not have a future.313

Bob Keen told us that:

It seems to me the central challenge that the Secretary of State has is particularly to do it, as far as the equipment programme is concerned, in a way that maintains the industrial capability that Mike Turner has been talking about. That is essential, both in terms of delivering capability to the front line in the future and also from the point of view of generating the technology and skills in this country that the DIS


312 Q 1

313 Q 76
recognised were important, not least because of the need to maintain operational sovereignty in the future. From my point of view, I think that is the priority.\textsuperscript{314}

210. We were concerned to hear from industry that the UK’s Defence Industrial Base was in decline. However, the Minister for Defence Equipment and Support did not share this view and considered that Mike Turner’s concerns reflected his role as an “advocate for the defence industry”.\textsuperscript{315} He said that:

\[\ldots\] I do understand that the role of advocacy of any particular sector does require putting pressure on the major customer to come up with as much money as possible as rapidly as possible; that is the way the game has got to be played. There is no misunderstanding on either of our parts about the role which Mr Turner plays on behalf of his industry, and he does it extraordinarily well and extremely ably.\textsuperscript{316}

211. We are worried to hear from some industry representatives that they are concerned about the future of the UK Defence Industrial Base. However, the MoD does not appear to share these concerns. In its response to our Report, we expect the MoD to set out what assessment it has made of the health of the UK defence industry and, in particular, those parts of the defence industry where the MoD wishes to retain industrial capability in the UK.

\textbf{Small and Medium-sized Enterprises and the supply chain}

212. In our Report \textit{The Defence Industrial Strategy} we examined issues relating to Small and Medium-sized Enterprises (SMEs).\textsuperscript{317} In the Report we expressed concern that the MoD was only at “the start of a journey” in terms of understanding supply chains and how to manage them. We noted in our Report that the MoD was working with the DTI, the Regional Development Agencies and the agencies of the devolved administrations to understand defence supply chains better.\textsuperscript{318} At our evidence session with industry representatives on 18 November 2008, Ian Godden outlined some of the work to improve the supply chain:

If we go back to the supply chain and say that we have in this country anywhere from 3,000 up to 7,000 companies involved in the supply chain, there is an issue about how efficient that supply chain is \[\ldots\] In an absolute sense, if we compare ourselves with other industries, and we have a nice direct comparison with the civil to defence side in aerospace, we would say that the whole supply chain and the SME community and the primes have got work to do in terms of developing a much leaner, more efficient supply chain that will match the needs of the programmes, so I think on behalf of the industry I accept the challenge. We have established a

\begin{footnotesize}
\begin{enumerate}
\item\textsuperscript{314} Q 4
\item\textsuperscript{315} Q 463
\item\textsuperscript{316} Q 465
\item\textsuperscript{317} Defence Committee, Seventh Report of Session 2005-06, \textit{The Defence Industrial Strategy}, HC 824, paras 67-78
\item\textsuperscript{318} ibid, para 77
\end{enumerate}
\end{footnotesize}
programme, Supply Chain 21, which is an attempt to overcome some of those difficulties for which we get criticised.\(^{319}\)

213. We sought further information on the Supply Chain 21 programme. Ian Godden told us that:

Effectively it is a programme of establishing lean timeliness and efficiency into the whole supply chain. The MoD signed up in Farnborough this year to that whole programme, which is an industry-wide programme, essentially self-help, funded partly by work going on in the regions and partly by work going on from central government, but largely funded by the primes themselves in terms of their programmes of lean manufacture, lean design and the whole concept of eliminating duplication in the chain. There are 300 companies that have signed up out of 3,000 that are actively working on that. It is a very large programme […] established approximately 18 months ago. I myself am proud to say that the programme is alive, well and kicking and doing a good job, but it could be faster, it could be better and it needs to be pushed hard from all angles because I think that will have the ripple effect upwards along with things about timeliness downwards that we are talking about.\(^{320}\)

214. We have previously highlighted concerns about the problems some SMEs experienced in accessing the supply chain. Ian Godden said that the Supply Chain 21 was part of the solution to this problem.\(^{321}\) He considered that there was “still a long way to go” and looked at Supply Chain 21 as a 5–7 year programme. He considered the UK defence supply chain to be more efficient and better value for money than the defence supply chains in the US and France. However, the UK defence supply chain had “got some way to go” compared with the supply chains for other industrial sectors.\(^{322}\)

215. We note that the MoD has signed up to the Supply Chain 21 programme which aims to improve the defence supply chain. In its response to our Report, we expect the MoD to set out the contribution it is making to this programme, its assessment of the progress of the programme to date, and what specific benefits it expects the programme to deliver.
Conclusions and recommendations

Overview of DE&S progress

1. DE&S was created on 1 April 2007 following the merger of the Defence Procurement Agency and Defence Logistics Organisation. Some 20 months after the merger, DE&S appears to have made good progress and is considered to be “heading in the right direction”. The progress made has been achieved against a backdrop of supporting current operations in Afghanistan and Iraq. We commend the Chief of Defence Materiel and DE&S staff for their achievements to date. (Paragraph 10)

2. While industry has generally welcomed the progress made to date by DE&S, it has also called for this progress to be accelerated and considers that the establishment of programme boards will be particularly beneficial. In its response to our Report, we expect the MoD to set out its plans for accelerating the progress achieved to date, the key changes it expects to see implemented in 2009, its plans relating to the establishment of programme boards, including the benefits expected from such boards. (Paragraph 11)

Performance in supporting current operations

3. It is extremely serious that the A400M transport aircraft programme, which is to provide much needed new tactical and strategic airlift for our Armed Forces, is now running two years late and further delays cannot be ruled out. We expect the MoD to press the contractor for a new delivery schedule for the programme and examine closely the assumptions and estimates in the schedule to ensure they are robust. Once the new delivery schedule is confirmed, the MoD needs to act swiftly to take the decisions which will prevent any capability gap emerging in the future relating to air transport. We expect the MoD, in its response to our Report, to provide us with an update on the forecast in-service date for the A400M programme and to update us on the action it is proposing to take once the new delivery schedule has been received from the contractor. (Paragraph 20)

4. We consider that the Government has no choice but to consider the options referred to by the Chief of Defence Materiel. We call on the Government to set out its most up-to-date thinking on these options and to say whether it considers that there is a real risk that the entire A400M project might be so delayed that abandonment would be preferable. The costs and benefits attributable to any such decision should be clearly explained. (Paragraph 21)

5. The Minister for Defence Equipment and Support has assured us that all the A400M transport aircraft which will be deployed into theatre will be fitted with a full Defensive Aids Suite, a fuel inertion system and explosive suppressant foam. Given that risks to aircraft are not restricted to operational theatres, we consider it surprising that a decision has yet to be made on whether the A400M aircraft not earmarked to be used in operational theatres will be fitted with all three systems. The safeguarding of our Service personnel should be paramount and the equipment they operate should have the maximum protection available. We note that the MoD
considers that the risk of catastrophic fire on Chinook helicopters with pannier fuel tanks is low. We look to the MoD to ensure that its assessment about such risks is robust and is re-examined on a regular basis. (Paragraph 26)

6. We note that the Urgent Operational Requirement process has continued to prove highly effective in enabling vital equipment to be provided in quick time to our Armed Forces in Afghanistan and Iraq. (Paragraph 29)

7. We welcome the announcement on 29 October 2008 that a substantial number of protected vehicles are to be procured as Urgent Operational Requirements. The protection of our Service Personnel against continuously evolving threats must be the top priority. In its response to our Report, we expect the MoD to provide us with an update on its progress in acquiring these new vehicles and a breakdown of the procurement costs, including details of how much is to be funded from the MoD’s budget. We also expect the MoD to provide us with details of which of the vehicles are expected to provide “longer-term benefit” beyond the current operations in Afghanistan and Iraq. (Paragraph 31)

8. In November 2007 new arrangements for the funding of Urgent Operational Requirements (UORs) were announced. These new arrangements mean that, once the cost of UORs in a year have exceeded an agreed total with the Treasury, the MoD will have to contribute to half of the costs exceeding the agreed total and repay this two years later to the Treasury. In its response to our Report we expect the MoD to provide us with details of how the new arrangements have operated in practice, including its estimate of how much of the spend on UORs in 2008–09 will be funded from the MoD budget. We also expect the MoD to set out which of its programmes or activities will need to be re-prioritised in order to fund the cost of the UORs in 2008–09 which fall to the MoD’s core budget. (Paragraph 36)

9. While we are satisfied with UOR process, we remain concerned that the extent of UORs represents at least a partial failure by the MoD to equip adequately its forces for expeditionary operations which were anticipated by the Strategic Defence Review a decade ago. (Paragraph 37)

10. We are concerned that the MoD appears to have made little progress with regard to its examination of the impact of current operations on equipment. While the MoD appears to have robust data on the cost of equipment procured through the Urgent Operational Requirement process, it does not have information on the cost of recuperating equipment returning from current operations nor on the impact of those costs on other areas of its budget. Such costs must be substantial given the length of time that UK Armed Forces have been involved in current operations in Afghanistan and Iraq. The MoD must identify accurately the costs to date of recuperating equipment and the likely future costs of recuperation. Without such information, there is a real risk that these costs will fall on the Defence Budget, which is already under pressure, rather than on the Reserve as they rightly should be. (Paragraph 44)
**Equipment procurement performance**

11. We are concerned to learn that, once again, the Nimrod MRA4 programme has experienced further cost growth and in-service date slippage. In its response to our Report, we expect the MoD to set out the findings from its examination of the extent of further cost increases, to provide us with the latest position on the current forecast in-service date, and to outline the “mitigation measures” it has identified and what it expects these to deliver. We have not been satisfied by the explanations for these delays given by the MoD to date, nor by the Department’s assurances as to how performance would be improved. We will return to this matter in the future. (Paragraph 48)

12. In its first year of operation, DE&S failed to meet its Public Service Agreement target to “Deliver the equipment programme to cost and time”. We note that the National Audit Office examined the procurement performance relating to the 20 largest projects and found that the aggregate forecast cost for these projects increased by £205 million and the aggregate in-service date slippage increased by eight years in 2007–08. We are concerned that DE&S has failed to control delays on equipment projects with almost half of the 20 largest projects experiencing in-service date slippage in 2007–08. We have not been satisfied with the explanations given by the MoD as to what it intends to do to rectify this decline in performance, and we will be returning to this matter in the near future. (Paragraph 50)

13. Financial Year 2008–09 saw the introduction of new Departmental Strategic Objectives (DSOs) which include a Performance Indicator under DSO 3 covering “Procuring and Supporting military equipment capability through life”. The MoD’s performance, six months into 2008–09, has been disappointing with average in-year forecast in-service date slippage and average in-year forecast cost increases both exceeding the targets set. The MoD considers that exchange rate changes account for most of the forecast cost increases reported in 2008–09. In its response to our Report, we expect the MoD to set out its estimate of how much it anticipates exchange rate changes will add to the cost of equipment programmes in 2008–09 and what action it is taking to minimise the risk of such cost increases. (Paragraph 55)

14. In its response to our Report, we expect the MoD to set out what specific action it is taking to reduce the Demonstration and Manufacture timescales of equipment projects by 50% from 2009 onwards, a target set out in the DE&S Business Strategy 2008–12 and how such reductions will be measured and reported. (Paragraph 56)

15. The MoD does not consider it possible to assess how, if at all, support to current operations has impacted on performance against its procurement targets. We consider that, while it would appear that only a small proportion of DE&S staff have been involved on Urgent Operational Requirement projects, support to current operations has had an adverse impact on its procurement performance, although we doubt that this factor alone is responsible for the state of parts of the equipment programme. DE&S staff involved in UOR projects have had to be transferred from longer-term equipment projects and, given the importance of UOR projects, more experienced project staff are likely to have been transferred. We would hope that as work supporting current operations begins to reduce, and staff are transferred back
to the longer-term projects, that this will have a positive impact on procurement performance. (Paragraph 58)

16. We note that the MoD considers that a key contributor to cost increases or delays on equipment projects is “the realisation of unplanned or low level / high impact risk”. The MoD states that it was placing greater emphasis on investment prior to Main Gate to address this risk. In its response to our Report, we expect the MoD to set out, for the current projects which have passed Main Gate, the proportion of such projects where 10–15 per cent or more of the forecast project budget was spent in the Assessment Phase. (Paragraph 61)

17. We note that DE&S has made good progress in improving the skills of its staff across a range of key acquisition disciplines. We note also that the Defence Commercial Director has recently been announced as the new Comptroller and Auditor General, but we consider it essential that the MoD build upon the progress he and the Chief of Defence Materiel have achieved to date. (Paragraph 66)

18. Equipment programmes have often experienced delays at various points in their life cycle. We note that the MoD is looking at training programmes which focus on the “value of time”. In its response to our Report, we expect the MoD to set out what consideration it has given to such programmes and its future plans in this area. (Paragraph 68)

19. By 2012, DE&S plans to have reduced its staff by 25% compared to the number in post at the start of April 2007. At the end of September 2008 the number of staff had been reduced by some 15%. Given that procurement performance declined in 2007–08 and that DE&S is supporting two operations, we find it surprising that DE&S is pushing ahead with its streamlining programme. DE&S must monitor closely the morale of its staff and recognise the uncertainty that such programmes create. In its response to our Report, we expect the MoD to provide us with its rationale for reducing staff at a time when procurement performance has declined and when DE&S remains busy supporting two overseas operations. We also expect the MoD to provide us with details of the costs incurred to date, including redundancy and early retirement costs, as a result of the streamlining programme. The response should also set out how many consultants have been employed to undertake work previously undertaken by DE&S staff who have left under the streamlining programme, and the costs of these consultants. (Paragraph 71)

20. We note that the Secretary of State has instituted a review to examine the progress in implementing acquisition reform and make recommendations for securing better value for money in the acquisition of major equipment programmes. There have been several such reviews over the last decade, yet major equipment programmes continue to experience cost increases and delays. It will be vital that the recommendations are implemented quickly and fully so that the expected benefits are delivered. We expect the MoD to provide us with a copy of the review once completed and to set out how the findings and recommendations in the review are to be taken forward. (Paragraph 73)
Progress with the short examination

21. The FRES programme has been a fiasco. In February 2007 we concluded that the MoD’s attempts to meet its medium-weight vehicle requirement had been a sorry story of indecision, changing requirements and delay. Two years later the story is, incredibly, even worse. We find it extraordinary that, some seven months after announcing General Dynamics UK as the provisional preferred bidder for the FRES Utility Vehicle, the MoD has announced that priority is now to be given to the FRES Scout Vehicle. Whilst we recognise that the MoD’s equipment requirements need to reflect changing threats, that is no excuse for the MoD’s behaviour in this programme; they have wasted their and industry’s time and money. The FRES Utility Vehicle programme was, from the outset, poorly conceived and managed. The MoD must work out what its requirements are for medium-weight armoured vehicles and identify lessons from the saga of the FRES Utility Vehicle programme. In its response to our Report, we expect the MoD to set out the cost to date of the FRES Utility Vehicle programme and how it plans to take forward this programme in the future. (Paragraph 95)

22. We welcome the announcement made on 11 December 2008 that the MoD will be further increasing helicopter capacity in Afghanistan over the next two years. Given our continuing interest in helicopter support for current operations, we plan to monitor closely the progress in delivering the commitments set out in the announcement. (Paragraph 97)

23. The MoD’s confirmation that some 60 Future Lynx helicopters are to be procured is to be welcomed. However, in his evidence to the Committee, the Minister for Defence Equipment and Support was unsure as to whether the programme had passed the main investment decision or whether the contract had been signed. This may have been what caused him to say that the programme had been brought forward. We recognise that the Minister had taken up post only two months before the evidence session, but we do note that this was one of the programmes referred to in the Written Ministerial Statement of 11 December 2008. In its response to our report, we expect the MoD to provide us with the latest forecast cost and in-service date for the Future Lynx programme. It is also difficult to judge on the evidence currently available whether these numbers are sufficient to meet all battlefield and maritime needs. (Paragraph 104)

24. We find it very strange that, only six months after awarding the contracts to build the carriers and announcing the in-service dates, the MoD has decided to delay the entry into service of the two new aircraft carriers, the first by one year and the second by two years. We do not share the view of the Minister for Defence Equipment and Support that the delays to the in-service dates will result in “no loss to the defence capability of the nation at all”. In its response to our Report, we expect the MoD to set out its latest forecast of when the two carriers are expected to enter service. (Paragraph 112)

25. We were surprised to hear that HMS Ark Royal was due to be paid off earlier, despite it being the newest of the three Invincible Class Carriers. The Minister’s evidence would seem to indicate that for a period prior to the introduction of the new Carriers
only one Invincible Class Carrier will be in service, which represents a significant reduction in capability. (Paragraph 113)

26. We are concerned that the MoD could not provide us with an estimate of how much the decision to delay the in-service dates for the Future Carriers will cost, as the estimates that the MoD has been given were not considered robust. We would expect DE&S to have the ability to produce robust estimates, given that one of its key roles is to be an intelligent customer. There will also be a cost in extending the life of either one or both of the existing Carriers, but the Minister for Defence Equipment and Support did not apparently consider this a matter of any importance. We consider that, while the delay to the entry into service of the two carriers may provide some short-term savings, the Future Carrier programme is likely to cost substantially more in the long-term. In its response to our Report, we expect the MoD to provide us with details of the additional cost of delaying the entry into service of the two carriers—both the additional contractual costs relating to the Demonstration and Manufacture phase and the costs of extending the life of either one or both of the existing Carriers currently in service. (Paragraph 114)

27. The Minister for Defence Equipment and Support has assured us that the decision to delay the in-service dates of the carriers will not result in any job losses or loss of specialist skills. We remain to be convinced and will be monitoring the programme closely, in particular, the industrial implications of the decision to delay the entry into service of the two carriers. We are also puzzled as to why this decision was made so soon after Main Gate. The timing suggests that the decision had nothing to do with the carrier programme itself but with easing problems with other programmes identified in the short examination of the equipment programme. We expect from the MoD clarification of this change to plans so soon after Main Gate in response to this Report. (Paragraph 117)

28. We note that the MoD considers that the Joint Strike Fighter STOVL programme is progressing well and that it plans to procure three aircraft for Operational Test and Evaluation. We also note that the MoD considers that technology relating to the programme was being transferred to the timescale originally agreed. We plan to continue to monitor the progress of this key programme. (Paragraph 124)

29. We note that the MoD is considering alternative procurement approaches to the Military Afloat Reach and Sustainability (MARS) programme and that this is likely to result in the deferral of the fleet tanker element of the programme. In its response to our Report, we expect the MoD to set out what impact the expected delays on the MARS programme will have on defence capabilities such as Carrier Strike. We also expect the MoD to set out how the delay to the MARS programme will affect its ability to comply with International Maritime Organisation environmental standards which require the phasing out of single hull tankers by 2010. (Paragraph 127)

30. The second objective of the short examination of the equipment programme was “rebalancing the equipment programme to better support the frontline”. We note that the Minister for Defence Equipment and Support considers that this objective has been achieved. We consider that, while supporting current operations must be the priority, it is absolutely vital that the MoD continues to give sufficient attention
to the longer-term equipment programme. We note that the Minister has set up a Committee to look at the longer-term priorities. The issue of keeping the equipment programme balanced is an issue we plan to monitor closely. (Paragraph 134)

**Status of Equipment Programme**

31. We note that industry and the MoD appear to have radically different views on the status of the equipment programme. Industry refers to the equipment programme being paralysed, yet the MoD claims to be spending substantial amounts of money with industry and denies industry’s claims. We doubt that the announcements about the equipment programme on 11 December 2008 will provide industry with much clarity about the MoD’s future requirements. There is an impression of another shoe waiting to drop. We plan to monitor this issue closely in the future. (Paragraph 137)

32. We note that any further major changes to the equipment programme will be announced in spring 2009 following the completion of Planning Round 09. We expect the MoD to keep Parliament informed of such changes as soon as they are known. (Paragraph 140)

**Funding of Equipment Plan**

33. Many commentators have suggested that the defence equipment programme is under-funded, but the MoD was unable to give us a clear answer and could not provide us with an estimate of the level of any such under-funding. We note that, following the completion of the short examination of the equipment programme, the Minister for Defence Equipment and Support considers that the equipment programme is affordable, no significant equipment orders having been cancelled, although the timetables for some have been slipped. We are aware that, in the past, slipping programmes has resulted in increased costs. We plan to monitor the outcome of Planning Round 2009 which is expected to be completed in spring 2009. (Paragraph 150)

**Pre-budget statement**

34. We note that there was no injection of funds for the UK defence industry in the Pre-Budget Statement of 24 November 2008. We are concerned to hear from industry that Small and Medium-sized Enterprises (SMEs) are “suffering” because money is not flowing down the supply chain. In its response to our Report, we expect the MoD to set out the extent to which it is aware that SMEs are experiencing problems and how it is proposing to address these in order to ensure that the current supply chain is retained. (Paragraph 154)

**Defence research spending**

35. The UK’s future military capability depends upon the investment made today in Research and Development (R&D) and the military advantage achieved at any one time depends upon the R&D investment made over the previous 25 years. We are extremely concerned to learn that defence research spending has been cut which, in
our view, is short-sighted. We agree with the Minister that it is a matter of priorities and consider that it should be a very high priority. Sufficient funding for defence research needs to be ring-fenced. If not, the MoD must acknowledge that the role which our Armed Forces can play in the future will be substantially reduced. In its response to our Report, we expect the MoD to provide us with details of the extent of the recent cuts in defence research spending and set out the specific areas affected by these cuts. We also expect the MoD to provide us with its assessment of what impact the recent cuts in defence research spending will have on the UK’s future military capability. (Paragraph 162)

Measures to limit DE&S spending

36. We note that the Chief of Defence Materiel (CDM) sent a memorandum to DE&S staff in autumn 2008 setting out measures to reduce spending on equipment programmes. CDM calls the measures a “commitment regime” and considers this to be a routine practice. Whilst we support the need for robust financial control, it would appear to us that the measures taken by CDM to reduce spending on equipment programmes are a clear sign that defence funding issues are more acute than ever in the current financial year. (Paragraph 165)

Defence Inflation

37. Defence inflation, and in particular defence equipment inflation, reportedly runs at a higher rate than the general rate of inflation. A recent research paper suggests that defence inflation may be running some 3% higher than the general rate of inflation. If true, this would seriously undermine the Comprehensive Spending Review 2007 settlement for defence which was reported as being a 1.5% annual real terms increase in the MoD budget for the period 2008–09 to 2010–11. The MoD is undertaking work, scheduled to be completed in April 2010, to produce a measure of defence inflation. We find the lack of urgency given to this project to be regrettable. The MoD must push forward this work as quickly as possible so that the results can feed into its negotiations with the Treasury in future spending reviews. We expect the MoD to work with organisations such as the Defence Industries Council to examine the issue of defence inflation and report back to us with its findings. (Paragraph 174)

Responsibility for implementing the Defence Industrial Strategy

38. We note that the Minister for Defence Equipment and Support has overall responsibility for the Defence Industrial Strategy (DIS) and that the key official within the Department with responsibility for the DIS is the Defence Commercial Director. However, the Chief of Defence Materiel (CDM) is also responsible for “driving forward” the DIS. In its response to our Report, we expect the MoD to set out the specific responsibilities relating to the DIS which fall to the Minister for Defence Equipment and Support, the Defence Commercial Director and CDM. (Paragraph 182)
Progress in implementing the Defence Industrial Strategy

39. We have heard mixed messages about the progress made in implementing the Defence Industrial Strategy (DIS). The MoD reports that good progress has been made in most of the industrial sectors. However, we have heard several concerns from industry, including concerns that the progress has been slower than hoped, that the expected transparency has not materialised, and that the DIS was “on hold”. In its response to our Report, we expect the MoD to consider the evidence we have received from industry, and explain to us why there is a difference of opinion between the MoD and industry on the progress made in implementing the DIS. We are particularly concerned to hear from industry that the expected transparency has not materialised and expect the MoD to set out how it plans to address this specific issue. (Paragraph 194)

40. We also look to the MoD to provide us with an update on the progress in negotiating a Long Term Partnering Arrangement in the fixed wing sector, including when it expects to have reached agreement on such an arrangement. (Paragraph 195)

41. A key objective of the DIS was to move to a Through Life Capability Management (TLCM) approach to acquiring and managing defence equipment programmes. However, some industry representatives have raised concerns that the TLCM approach has not been fully embedded. In its response to our Report, we expect the MoD to set out its assessment of the extent to which the TLCM approach has been embedded across the department. (Paragraph 197)

Updated version of the Defence Industrial Strategy

42. An updated version of the Defence Industrial Strategy was expected in December 2007, but the MoD did not meet this deadline, nor the next deadline of spring 2008. The MoD claimed that the original deadline was missed because of the need to finalise Planning Round 2008. More recently, the MoD has claimed the delay has been caused by the need to complete the short examination of the defence equipment programme. The short examination has been completed and both the MoD’s Permanent Secretary and the Chief of Defence Materiel have told us they were confident that the updated version of the DIS would be published in 2009. (Paragraph 206)

43. We find it astonishing that the new Minister for Defence Equipment and Support was “open-minded” as to whether it made sense to have an updated version of the DIS. The DIS is now over three years old and a key aim was to provide industry with clarity about the MoD’s future requirements. In its response to our Report, we expect the MoD to tell us whether, or not, it plans to publish an updated version of the DIS. If it does plan to do so, we expect the MoD to set out when it plans to do so. If it does not, we expect the MoD to set out how it plans to keep industry informed of its future requirements and the industrial capabilities which the UK needs to retain. We condemn the failure to date to publish an updated version of the DIS and consider that its continuing absence increases the risk that the UK Defence Industrial Base will not be able to meet the future requirements of our Armed Forces. (Paragraph 207)
The Defence Industrial Base

44. We are worried to hear from some industry representatives that they are concerned about the future of the UK Defence Industrial Base. However, the MoD does not appear to share these concerns. In its response to our Report, we expect the MoD to set out what assessment it has made of the health of the UK defence industry and, in particular, those parts of the defence industry where the MoD wishes to retain industrial capability in the UK. (Paragraph 211)

45. We note that the MoD has signed up to the Supply Chain 21 programme which aims to improve the defence supply chain. In its response to our Report, we expect the MoD to set out the contribution it is making to this programme, its assessment of the progress of the programme to date, and what specific benefits it expects the programme to deliver. (Paragraph 215)
Annex: List of Abbreviations

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<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>AFV</td>
<td>Armoured Fighting Vehicles</td>
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<tr>
<td>BFPO</td>
<td>British Forces Post Office</td>
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<tr>
<td>BVRAAM</td>
<td>Beyond Visual Range Air-to-Air Missile</td>
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<tr>
<td>CBRN</td>
<td>Chemical, Biological, Radiological and Nuclear</td>
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<td>CDM</td>
<td>Chief of Defence Materiel</td>
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<tr>
<td>CIPS</td>
<td>Chartered Institute of Purchasing and Supply</td>
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<td>CPM</td>
<td>Certificated Project Manager</td>
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<tr>
<td>CSR</td>
<td>Comprehensive Spending Review</td>
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<tr>
<td>CVF</td>
<td>Future Aircraft Carrier (Carrier Vessel Future)</td>
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<td>DACP</td>
<td>Defence Acquisition Change Programme</td>
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<td>DAS</td>
<td>Defensive Aids Suite</td>
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<td>DEL</td>
<td>Departmental Expenditure Limit</td>
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<td>DE&amp;S</td>
<td>Defence Equipment and Support</td>
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<td>DIP</td>
<td>Defence Industrial Policy</td>
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<td>DIS</td>
<td>Defence Industrial Strategy</td>
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<td>DLO</td>
<td>Defence Logistics Organisation</td>
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<td>DPA</td>
<td>Defence Procurement Agency</td>
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<td>DSO</td>
<td>Departmental Strategic Objective</td>
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<td>DTS</td>
<td>Defence Technology Strategy</td>
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<td>FRES</td>
<td>Future Rapid Effect System</td>
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<td>GDUK</td>
<td>General Dynamics UK</td>
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<tr>
<td>IPT</td>
<td>Integrated Project Team</td>
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<td>ISD</td>
<td>In-Service Date</td>
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<td>JCA</td>
<td>Joint Combat Aircraft</td>
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<td>JSF</td>
<td>Joint Strike Fighter</td>
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<td>Min (DE&amp;S)</td>
<td>Minister for Defence Equipment and Support</td>
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<td>MoD</td>
<td>Ministry of Defence</td>
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<tr>
<td>Acronym</td>
<td>Definition</td>
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<td>MOU</td>
<td>Memorandum of Understanding</td>
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<td>MPR</td>
<td>Major Projects Report</td>
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<td>NAO</td>
<td>National Audit Office</td>
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<td>NDIC</td>
<td>National Defence Industries Council</td>
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<tr>
<td>PACE</td>
<td>Performance, Agility, Confidence and Efficiency</td>
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<td>PI</td>
<td>Performance Indicator</td>
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<td>PR 09</td>
<td>Planning Round 2009</td>
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<td>PSA</td>
<td>Public Service Agreement</td>
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<td>PUS</td>
<td>Permanent Under-Secretary</td>
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<td>RAF</td>
<td>Royal Air Force</td>
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<td>Ro-Ro</td>
<td>Roll-on Roll-off</td>
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<td>R&amp;D</td>
<td>Research and Development</td>
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<tr>
<td>SMEs</td>
<td>Small and Medium-size Enterprises</td>
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<td>STOVL</td>
<td>Short Take Off and Vertical Landing</td>
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<td>TADS</td>
<td>Training Accountant Development Scheme</td>
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<td>TLB</td>
<td>Top Level Budget</td>
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<td>TLCM</td>
<td>Through Life Capability Management</td>
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<td>UK</td>
<td>United Kingdom</td>
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<tr>
<td>UOR</td>
<td>Urgent Operational Requirement</td>
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<td>UV</td>
<td>Utility Vehicle</td>
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<tr>
<td>VOP</td>
<td>Variation of Price</td>
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Draft Report (Defence Equipment 2009), proposed by the Chairman, brought up and read.

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

Paragraphs 1 to 215 read and agreed to.

Annex and Summary agreed to.

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

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

Ordered, That embargoed copies of the Report, be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report, together with written evidence reported and ordered to be published on 18 November 2008, in the last Session of Parliament.
Witnesses

Tuesday 18 November 2008

Mr Mike Turner CBE, Chairman of the Defence Industries Council and Joint Chairman, with the Secretary of State, of the FDIC; Mr Ian Godden, Secretary to the Defence Industries Council and Chief Executive of the Society of British Aerospace Companies; Dr Sandy Wilson, Chairman of the Defence Manufacturers Association; and Mr Bob Keen, Head of Government Relations BAE Systems

Tuesday 25 November 2008

General Sir Kevin O’Donoghue KCB CBE, Chief of Defence Materiel, Dr Andrew Tyler, Chief Operating Officer, DE&S and Rear Admiral Paul Lambert CB, Capability Manager (Precision Attack) and Controller of the Navy, Ministry of Defence

Tuesday 16 December 2008

Mr Quentin Davies MP, Under Secretary of State and Minister for Defence Equipment and Support, General Sir Kevin O’Donoghue KCB CBE, Chief of Defence Material, Lieutenant General Andrew Figgures CBE, Deputy Chief of the Defence Staff (Equipment Capability), and Mr Amyas Morse, Defence Commercial Director, Ministry of Defence
List of written evidence

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^ Government response published as Memorandum in the Committee’s Eighth Report (HC 400)

^ Government response published as Memorandum in the Committee’s Eleventh Report (HC 885)

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Oral evidence

Taken before the Defence Committee

on Tuesday 18 November 2008

Members present:
Mr James Arbuthnot, in the Chair
Linda Gilroy
Mr David Hamilton
Mr Brian Jenkins
Robert Key
John Smith

Witnesses: Mr Mike Turner CBE, Chairman of the Defence Industries Council and Joint Chairman, with the Secretary of State, of the FDIC, Mr Ian Godden, Secretary to the Defence Industries Council and Chief Executive of the Society of British Aerospace Companies, Dr Sandy Wilson, Chairman of the Defence Manufacturers Association; and Mr Bob Keen, Head of Government Relations BAE Systems, gave evidence.

Q1 Chairman: We start this first evidence session on defence equipment. May I declare an interest at the beginning. Mr Keen, I should declare that you were my Private Secretary when I was in the Ministry of Defence. You are welcome to this evidence session. You will each have your own different answers to this question. If you had to suggest priorities to the new Minister for Defence Equipment and Support and you each had to produce three priorities for him to consider, what would those three priorities be? I am not necessarily talking about programmes—maybe initiatives, capabilities, concepts or programmes. What should, in your view, those three priorities be?

Mr Turner: Overall, and this is what we said at the NDIC to the Secretary of State, there are really three main areas of defence and defence expenditure on which to focus: clearly, the welfare of the Armed Forces; secondly, the capabilities they need for today’s operations, the current operations; and, thirdly, the capabilities, systems and equipment they need for future operations, five, 10, 15 years hence to defend the defence interests, the security interests, of the UK in those out years. There is no doubt over recent years, and understandably the attention has been on the first two, the welfare of the Armed Forces and current operations, that there has been a focus and a great deal has been done in those areas and, frankly, needed to be done. The big concern that the defence industrial base has is the third area, the future equipment programme. Will this country be able to play a role in the world, five, 10, 15 years out? I think it is no secret that there is not sufficient money in the defence budget for the future equipment programme and we have an incompatibility between a Strategic Defence Review of 10 years ago and the role that rightly this country should and wants to play in the world alongside the United States and the amount of money available for that third category. As I say, it is understandable that the first two categories get the attention in the current times, but we are concerned about the long term. The defence industrial base of the United Kingdom not only supports the Armed Forces, and without the defence industrial base we could not have the Armed Forces that we have doing the job for this country, but the skills, technology, R&C, innovation, apprentices, exports that all flow from that. We have a world class defence industrial base and only focusing on the short term and not the long term is of huge concern to us.

Q2 Chairman: But if you give three priorities and those three are the ones you give, would you give them in that order?

Mr Turner: I think I would put the capabilities for current operations first, welfare second and the future third, but they are all very important. The first two are getting it; the last one is not.

Mr Godden: I would add, perhaps on a different tack, that the reform of the defence procurement and the issues around TLCM, etc. should continue to be a priority on the operational side. Mike Turner was talking mainly about the resources going in for the programmes, equipment and services associated with the Armed Forces. I would say that the reform of the defence procurement initiatives should continue as a priority. In fact, it could possibly be accelerated.

Dr Wilson: Following on from what Ian Godden has just said, I agree entirely with that and I think TLCM is key. I think the process is only part way through and has to be driven quite hard in future to the point where we get proper programme boards with industrial representation on them and it is at that point that we start to get true transparency on future requirements. I remind you that transparency was one of the big tenets of the first Defence Industrial Strategy. I think everybody in industry thought that was going to be the opening of a rather better regime and relationship between industry and MoD. The transparency, sadly, has not materialised yet and I think TLCM is an excellent way of ensuring that it does.

Q3 Chairman: When you say that transparency has not materialised yet, and we will come on to that in a bit, would it not be a better thing to say that the transparency did materialise and then went away?
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18 November 2008  Mr Mike Turner CBE, Mr Ian Godden, Dr Sandy Wilson and Mr Bob Keen

**Dr Wilson:** I think transparency in times of budgetary constraint is extremely difficult. That might answer the question.

**Q4 Chairman:** Not really. **Mr Keen:** Most of the priorities that I would suggest to the Secretary of State have already been mentioned: to emphasise the long term nature of the challenge and the need to balance resources with equipment programmes going forward. It seems to me the central challenge that the Secretary of State has is particularly to do it, as far as the equipment programme is concerned, in a way that maintains the industrial capability that Mike Turner has been talking about. That is essential, both in terms of delivering capability to the front line in the future and also from the point of view of generating the technology and skills in this country that the DIS recognised were important, not least because of the need to maintain operational sovereignty in the future. From my point of view, I think that is the priority. Taking your point about transparency, that takes a number of forms. We are being consulted on a number of programmes as a company at the moment. I suppose if you take a step back and look at what the DIS was trying to achieve in terms of transparency, the sort of generic openness that the DIS was talking about, I think that has proved a challenge in a time of financial constraint. I think the MoD have felt more constrained in opening up the kimono, as it were, to industry through that period.

**Q5 Chairman:** I want to get personal here. I had the impression that when Lord Drayson, with his knowledge of industry, was in charge of the Defence Industrial Strategy, his approach was to involve the defence industry at every opportunity that he could come to, so that the Defence Industrial Strategy, his approach was to involve the knowledge of industry, was in charge of the Defence Industrial Strategy, and it was the central challenge that the Secretary of State has is particularly to do it, as far as the equipment programme is concerned, in a way that maintains the industrial capability that Mike Turner has been talking about. That is essential, both in terms of delivering capability to the front line in the future and also from the point of view of generating the technology and skills in this country that the DIS recognised were important, not least because of the need to maintain operational sovereignty in the future. From my point of view, I think that is the priority. Taking your point about transparency, that takes a number of forms. We are being consulted on a number of programmes as a company at the moment. I suppose if you take a step back and look at what the DIS was trying to achieve in terms of transparency, the sort of generic openness that the DIS was talking about, I think that has proved a challenge in a time of financial constraint. I think the MoD have felt more constrained in opening up the kimono, as it were, to industry through that period.

**Mr Keen:** I am not sure I desperately want to personalise it. Around the same time, it is the case that the financial challenge was becoming very apparent.

**Q6 Chairman:** It has always been bad, has it not? **Mr Turner:** To help, Chairman, with John Reid and Lord Drayson, we did work together hand in glove to formulate a Defence Industrial Strategy, and it was about the defence industrial base of the United Kingdom. Sector by sector we spelt out what should be onshore, what operational sovereignty should be maintained onshore to support the Armed Forces, and then basically what would go offshore for or compete for through life. The issue quickly became apparent that, having a DIS, when we go to our boards and get a strategy approved, we also get the financial backing to execute the strategy of the company. It was quite clear that the Government did not give Lord Drayson, the MoD, the financial support necessary to execute that strategy, and that is the limbo-land we have been in ever since. We have a DIS and have it spelt out in DIS 1 sector by sector with a Strategic Defence Review some 10 years old now, which is the background for that, but we do not have the financial wherewithal to execute that strategy and that is where we are and that is where we have been for some time.

**Q7 Robert Key:** Gentlemen, can I invite you to focus on the situation in which we find ourselves today? Mike Turner, you have just mentioned the word limbo? Currently we are waiting for the outcome of the short examination of the equipment programme; we are waiting for the updated version of the Defence Industrial Strategy and we are waiting for decisions on a number of key programmes. Does industry feel that we are in a state of limbo at the moment? **Mr Turner:** Yes, we are undoubtedly and we believe that for the next 18 months at least we will have delays, which inevitably in the long term will cost money, but it is something we have to live with over this period. It is extremely difficult for industry to plan as we hoped we would be able to when we had a DIS, but that is reality. That is the politics that we are facing today.

**Mr Godden:** I think the limbo started last year. Whilst the UORs have been very successful and have continued throughout this period, with those exceptions, I certainly in my position feel that we have been in limbo since September 2007. Therefore, there have been 15 months of fairly serious lack of progress, mainly as a result not of personalities but of budgets. Whilst personalities have had an effect, that has not really been the driver for it; I think it has been a budgetary issue in discussions behind the scenes on such. In addition, I think there is a realisation that the defence industrial base is not only a matter of ensuring we can continue to operate our equipment but also its role in exports, innovation, manufacturing and skills has been added. That as a government policy has added some difficulty I think for the debate. It has not just been purely budget; it has been the expectation on other matters which have been in many respects attempted to be brought into the Defence Industrial Strategy in DIS 2 versus DIS 1 and the combination of budget and those extra pressures, let us say, have caused a limbo period, which I hope we will come out of but I certainly do not yet feel we are out of.

**Q8 John Smith:** I wondered to what extent you think the current state of play in the continued development in the defence industrial base is directly related to the priority that Mr Turner spoke about, and that is the urgent operational requirements, and the extent to which our Armed Forces are currently committed on two fronts? Is it not inevitable that the focus of the Government is going to remain on capability and the wellbeing of our forces and that the strategic overview is going to step back a bit? Is that not inevitable? **Mr Turner:** I think so. If there is not sufficient budget, clearly you focus on today and that is what is happening. What we are trying to do is focus on tomorrow as well. We do not want just to sit back and watch this country in five, 10 or 15 years’ time
have no capability of playing a role in the world for its defence and security interests and, frankly, that is what we are facing.

Q9 John Smith: When you mention insufficient budget, what do you think the budget should be?
Mr Turner: I have always put on a figure of about £1.5 billion a year more.

Q10 Mr Jenkins: Always?
Mr Turner: Not always,

Q11 Robert Key: Returning to the partnering issue, the short examination of the equipment programme we hope is going to come to a conclusion in the not too distant future. Has industry been sufficiently involved in that short examination?
Mr Turner: All the companies have been asked a number of questions about the impact of this, that and the other. Clearly there is a concern about jobs in the current climate, not surprisingly, but the feeling we get is that programmes will be stretched out; some will clearly have more favourable funding than others. We do not see any major programme cancellations in the current climate. We think the equipment examination will come to a conclusion in the next few weeks, but there will be no major changes. As I say, some programme will be more favoured than others, but with limited funding available what we want to do is work transparently with MoD to make the best of the situation we are in until we can get to a new situation.

Dr Wilson: My view is that there is a good dialogue taking place company to MoD at a level of programmes, but in terms of the overall programme and the overall industrial strategy on behalf of the nation, that is the thing that is in limbo and not really being discussed in the meantime.

Q12 Robert Key: I have always thought that there is a difference between asking the questions and having a dialogue. It seems to me that you are saying you have not really been having a proper dialogue over the future of our defence industrial base.
Mr Turner: MoD has to be careful because every time they ask a question, it gets out in the press—Typhoon is going to be cancelled, the future of BVRAAM, that it is going to be cancelled, and Lynx. You have seen it almost daily in the newspapers, so they have to be careful. Fundamentally, they do not have enough money and that is at the bottom of everything we are facing at the moment. They have to take some decisions to spread out the limited amount of money they have, certainly for the next 18 months.

Mr Keen: I think there has been a dialogue, as Ian Godden said, but certainly as far as a number of the programmes in which we are involved, I guess we will not know the extent to which we have been exposed to the MoD’s thinking until the equipment examination is published. Our sense at an individual programme level is that we are being consulted and that we are being given the opportunity to talk about some of the industrial implications of some of the options that they are considering, which would be significant in some of those cases. Hopefully, when we see the results of the equipment examination, we will see the MoD having taken account of the sorts of representations we have made on individual programmes.

Q13 Robert Key: The Permanent Secretary told us two weeks ago that he anticipated the review would be completed within weeks rather than months. Is that your understanding, too?
Mr Turner: Yes, it is.

Q14 Robert Key: Meanwhile, what impact is this having on your industry?
Mr Turner: It makes it difficult to plan. The DIS was all about long-term planning assumptions, what we are going to keep onshore United Kingdom and this short-termism that we are experiencing. It will be a bit clearer after the next few weeks but industry is going to have to manage for at least 18 months to two years and decide in the longer term what the UK Government may or may not decide to keep onshore UK, and that is what we are very concerned about. I think industry is going to have to do its best in this period but it is an 18 months to two year period of uncertainty we are facing.

Q15 Robert Key: How are you going to finance that? That is a long period for you to wait with your employees who are highly skilled and highly paid. How long can you hang in there?
Mr Turner: It is known that MoD will fund to some extent the long-term programmes and, as I say, I do not think any major programmes will be cancelled but industry, companies, will have to take a view on whether they are prepared, on the basis of optimism in the longer term, to keep some resources in place. Dr Wilson: This is not going immediately to be a problem generated by the equipment examination; this problem of companies funding teams and capabilities over an extended period has been going on for the last 18 months quite significantly. I think many companies could point to very significant spend which has come off their bottom line in that period to keep teams going until MoD makes up its mind about what it actually wants to do. It is quite an invidious position to find oneself in and one has to make a commercial judgment on it. As Mike Turner has just said, sometimes you will decide enough is enough and you will pull out of it; sometimes you will stick with it. In order to do that, we do need some view of the long-term plan. The other thing about the equipment examination is that I think the Secretary of State stated that it would provide the basis for going into PR 09, so I do not think equipment examination should be viewed as giving all the answers. I think we will then go into a period of many months of continued debate about options and we will see clarity emerge through the year in PR 09.
Mr Godden: Can I add one other point which is that certainly my observation from recent trips to Washington is that there is a new dynamic in the shareholder perspective that you talked about. The UK has always been perceived as a good base to
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invest in for the long term. I think there is a renewed worry that has come, partly because the issues on the US budget are beginning to come into focus now having had a period of long growth and high established positions, but there is now a nervousness from the shareholders from outside this country who have very strong positions in the country and have invested in it that, fine, a year and a half (if you take my premise that we have been in limbo for, say, 15 months) is probably acceptable but if this carries on, they will look at the UK as an industrial base and say, “Is this worth investing in in the future?” My worry is about that as well, shareholders from outside this country saying, “Whereas previously we have invested for the long term, will that be affected by the situation that we have at the moment?”

Q16 Linda Gilroy: This is about maintaining skills bases. You have just been discussing that. Some of those are more fragile than others and it is not just industry that makes decisions about these things; it is individual workers who have scarce skill resources. In this situation of limbo, are there particular programmes which are more vulnerable to that skills base haemorrhaging with the passing of time than others, and, if so, what are they?

Mr Turner: Clearly the industry over recent years has been quite optimistic about the long term, particularly the DIS. You have seen that the number of apprentices who have come into the defence industrial base is quite huge actually. Just bear in mind that in the defence industrial base of the UK we have more SMEs in the defence industry in the UK than Spain, Germany, France and Italy put together. We have a huge SME base in this country dependent basically on the defence budget and the primes feeding through this work. There is no doubt about it now that the SMEs are getting quite concerned about the situation. We are seeing signs of apprentice numbers falling, and understandably so in the current climate. In terms of programme areas, I think you know about Lynx, you know about FRES for the land forces, and you know about Typhoon development and engineering. There are many areas where we are very concerned about the ability to keep the skill base together and indeed your point of young people wanting to come into this industry.

Q17 Chairman: Could I pick up something you said about what you expect to come out of this brief examination, namely no major programmes to be cancelled but things to be stretched out—in other words, moved to the right and presumably salami sliced?

Mr Turner: No, I think it will just be stretched out to the right. Some things will be accelerated and some things delayed even more because clearly there are priorities for current operations. People need to bear in mind in the long term it costs money. V programmes do continue to fruition, in the long term it costs significantly more by doing that.

Q18 Chairman: That is what I was going to ask you about. Are you able to quantify how much it costs to delay programmes or to reduce the unit numbers or to reduce the capability of programmes?

Mr Turner: There is one programme I am aware of at the moment where over the next two or three years we could probably save £400 million, reduce the expenditure by £400 million. I know that that will add £600 million to the bill, 50%.

Mr Godden: I think also in the context of TLCM that we were talking about earlier there is a risk because to implement that programme you actually probably have to spend a bit higher up-front in order to get the lower positions later. I think some of that is at risk in the current situation. It is not just a matter of delaying the programmes but also the idea of the TLCM being a longer term value for money is at risk from this current situation.

Q19 Chairman: In our last equipment report we as a Committee said that it is expensive to salami slice and to move things to the right and it is time consideration was given actually to taking a programme and saying, “This is unaffordable”. What was your reaction to that and what now would your reaction be to such an approach?

Mr Turner: We do not like it. The reason we have come out clearly and said we do not now want a DIS 2 sector by sector is because we think it would be counterproductive for the UK in the long run. The Armed Forces of our country depend on a defence industrial base being there; they go hand in glove. Maybe we have made a bad job of making that point. We seem to have a public that supports the Armed Forces but we do not have the linkage to the defence industrial base. We think in the current budgetary climate if people were forced to take decisions sector by sector it would be disastrous for the long-term defence industrial base of this country, therefore the UK Armed Forces and therefore for the UK’s role in the world. We would rather not have that happening at the present time. We like the principles of DIS; we like Ministers and the Secretary of State saying that is what they are going to stick to, partnering through that capability management. Frankly, that cannot happen until we are through this situation we are in for the next 18 months to two years and sorting out the budget. Without the budget, we cannot do anything.

Q20 Chairman: So the Defence Industrial Strategy is currently unaffordable?

Mr Turner: Through life capability management depends on having sufficient money up-front. What people do not understand is that for every pound you spend initially buying the equipment, you spend £3 to £4 through life, so it is very important when you design and develop these programmes that you think of reliability and maintainability. I have been in the defence industry 40 years. We have talked about it; we have never done it. When I went into Airbus and regional aircraft, when you design and develop an aircraft for civil use, you think about reliability and maintainability through life. We have never done that in MoD. That is why DIS was so
Mr Keen: The largest part of the expenditure. Extra cost put in to reduce that tail, which is the constraints year by year that prevent that sort of industry, and that is because of the budgetary have not fully established that principle within this industry. It used to be that trains were built, tested for 1000 miles and then repairs for ever more. We have seen it in the rail civil aircraft industry where that had to be adopted by both Boeing and Airbus; we have seen it in the rail industry; it used to be that trains were built, tested for 1000 miles and then repairs for ever more. We have not fully established that principle within this industry, and that is because of the budgetary constraints year by year that prevent that sort of extra cost put in to reduce that tail, which is the largest part of the expenditure.

Mr Godden: If I could reinforce that, we have seen it in the car industry with Japan; we have seen it in the civil aircraft industry where that had to be adopted by both Boeing and Airbus; we have seen it in the rail industry; it used to be that trains were built, tested for 1000 miles and then repairs for ever more. We have not fully established that principle within this industry, and that is because of the budgetary constraints year by year that prevent that sort of extra cost put in to reduce that tail, which is the largest part of the expenditure.

Mr Keen: I would make a slightly different point. You ask if the DIS is unaffordable. In many respects the defence budget is unaffordable without the DIS. If I think about the maritime sector, for example, where we have made good progress in the DIS, we have established VT; we have a Terms of Business Agreement which hopefully will be turned into a contractually-binding document at any time. The essence of that is that in return for an absolutely clear position from the Government about future workload, industry has said it will transform the industry. Part of that transformation is baking in very significant savings to the defence budget. From my perspective, I think where the DIS has been implemented in a number of areas, we are actually seeing the long-term benefit of the strategy for the defence budget; similarly in individual partnering arrangements where the sort of transparency I was taking about earlier enables industry and the MoD to look at particular programmes and actually drive costs down for the programme. From my perspective it is not an either/or choice. The DIS is absolutely essential for the future defence budget of the UK.

Chairman: We will come back to the DIS because it is essential to all of these issues.

Mr Turner: No, it is not. If you read any document that MoD puts out, it talks absolutely clearly about current operations, as you would expect, and the priority of current operations. What it then says about the future equipment programme is highly questionable. There is no commitment. It talks about having to consider the future equipment programme, the equipment examination. There is no commitment.

Q22 Mr Jenkins: I think you misunderstand me. Priority one, priority two and priority three that you give would be exactly the same as priority one, priority two and priority three that the MoD would give.

Mr Turner: I am very happy with one and two, and they recognise priority three, but it is not being enacted. That is my problem. One and two are but three is not.

Q23 Mr Jenkins: Because all they want is more money?

Mr Turner: There are always savings you can make. I think we have pointed to areas where you can do that, and industry will, through partnership and outsourcing, make those savings in concert with MoD, but, frankly, for the Strategic Defence Review of 10 years ago and the UK’s role in the world, the role we hopefully want to play in five, 10 or 15 years’ time, there is not enough money.

Q24 Mr Jenkins: But we now know the short report outcome is simply going to be rebalancing the equipment programme to better support the front line. That is what the outcome will be. Great, that is what it is going to be. You know what the implications are for the industry. Will you tell us exactly what it means for our defence industry, apart from sitting there thinking: if it pays more money, everything is going to be fine and we will be back to the good days. I tell you, there were never any good old days. I can go back to the legacy programmes where things were pushed to the right and you were still sitting there thinking: if it pays more money, what will we be faced if we do put a lot more money into the front line troops? This is not like Keynes; in the long term we are dead and it looks as though in the short term we are dead, so we have to make sure the troops get the best equipment to do the job.

Mr Turner: I think in Iraq and Afghanistan what the Government has done over the last few years is good. The problem we have is looking this five, 10, 15 years out. They were the good old days actually. We were able to play a role in Iraq and Afghanistan because of the good old days. Frankly, with the money that is now being given to MoD at the present time, in our view, we will not be able to play that role in five, 10 or 15 years’ time. If you look at 12 Type 45s, now six; if you look at 21 Nimrods, now maybe nine: future frigate programme, Typhoons, FRES—how are we going to play that role in the world?

Q25 Mr Jenkins: It is going to be difficult but there would be a repositioning of our programme and our equipment. I was in a ship a couple of years ago that
had more fire power than the British Navy in the Second World War—one ship—so we have moved on a little bit; the equipment is much more impressive.

**Mr Turner:** Absolutely, and that is why six Type 45s are very capable but they do not cover the globe like 12 Type 45s.

**Q26 Mr Jenkins:** One of the things that I am getting the feeling for is that as an industry you would prefer the Government or the MoD, and they have to face up to this, rather than to delay a programme and push it back with continued uncertainty, to cancel—cut, cut, cut—and then concentrate on the programmes we have left to work with. Am I getting the right message?

**Mr Turner:** We do not want that to happen.

**Mr Godden:** If that is done, I can see a time in five to 10 years when we will sit back and we say, “We regret getting rid of that operational sovereignty”, be that in rotocraft, in military aircraft or naval. We will sit down 10 years from now and say, “We exited that capability”. That is what we are facing. If you do not want a broad capability, fine, cut the programmes, cut any of those programmes but you will remove the capability in that sector for ever from this country. That is what we are facing.

**Q27 Mr Jenkins:** Some of the legacy projects which I remember looking at years ago were so old that they were planned for my grandfather to fight or fly in. They were still in a box to be delivered in X years’ time. What is the point of buying this old technology when there is no demand and it is no longer needed and keeping it in the box? If they are going to rebalance this programme, what are you as an industry going to do get rebalanced to meet this front-line capability?

**Mr Turner:** Industry will respond to what MoD wants in terms of the future equipment programme. You talk about Nimrod, Astute and Typhoon; yes, they were conceived many, many years ago, if not decades ago, but they are still relevant today and they are weapon system platforms, highly capable of being developed, spiral development, and we are getting something in DIS that we need to be doing. Ian’s point is well made. Once you stop doing these things onshore, you become dependent on foreign powers; you lose operational sovereignty and that has gone. By the way, we lose the capability to export; there were £7 billion of exports last year, highly successful, and we now face the prospect of losing all of that. That is why we are speaking out.

**Q28 Mr Hamilton:** I am puzzled. I picked up on your opening remarks about the relationship between Lord Drayson and John Reid and I think that is really important; it is important you understand who you are talking to and get a feel for what going to happen in the future. The two you missed out of course are Trident to which the Government have committed to and the aircraft carriers. If you go back to the point that you are making, how many Typhoons can you have alongside our Trident programme? A balancing act has to be done. If the Government is not going to increase the budget for the MoD, with the long-term problems that we face and the problems this country is facing with the pound, is it not the case that it might be better looking at some of the major projects which are going to cost of billions of pounds and as an alternative where we can have what you are looking at?

**Mr Turner:** I do not think so. I think we all believe in this country that we need a nuclear deterrent and we need capability to play a role in the world. We do not want to see the United States as the only country left in the world able to play a role. We think it is very good to have UK Armed Forces. It is all very well having diplomatic skills but without the big stick, who takes any notice? If it is only the United States that has the diplomacy and the big stick, what role do we have in the world? I think that is bad for the world going forward, and it is certainly bad of the defence industrial base; it is bad for the UK Armed Forces and we need to point that out to people. You cannot have UK Armed Forces without a UK defence industrial base. There is a lot of nonsense talked about buying off the shelf. Remember that £1 to £4: £1 off the shelf, £4 through life. Once it is gone, as Ian has said, it has gone. I believe across the piece you need the nuclear deterrent, but then you need the conventional forces to play a role in the world. We face losing that.

**Mr Godden:** I have a very simple view that in traditional terms we require land, air and sea if we have a full capability. Off the shelf, as we have discovered in certain areas, means very often more expensive without the capability to twist it into the type of equipment that our forces need. There is an idea that off the shelf is cheaper. I have not seen any evidence of that in my 13 years working in the US, in the UK and in France. It just does not happen that way. With the idea that you can remove one segment, say land or sea or air, and then buy off the shelf from France or the US, I just think we are deluding ourselves.

**Q29 Mr Jenkins:** I do not know if I asked a question about off the shelf. You are answering your own question. I never posed that question. I am making the point that there are two major projects, Trident and the aircraft carriers. Those projects are worth billions of pounds. There is an argument and an ongoing debate about feet on the ground. The point that you make is that at the end of the day it is more important that we cover air and sea and land. I think that is right. You dismiss the fact that Trident is also important. I assume the aircraft carriers are also important.

**Mr Turner:** I believe, we believe, we need a nuclear deterrent for this country. We believe we need the carriers to play a role in the world. Yes, then you need the frigates to protect the carriers; you need the aircraft to go on the carriers. All that at the moment is in jeopardy.

**Q30 Chairman:** Ian Godden, can I put to you a paragraph that has been put to us in evidence and ask you what you think about it? “In practice
timely and cost-effective means ‘off the peg’. Our foreign policy would be in a vastly improved position if we had not wasted so much of our defence budgets re-inventing the wheel. Our Service people would not recognise their improved lot were they not forced to make do with whatever material the British arms industry deigns to produce decades after it was first needed”. What do you say about that?

Mr Godden: Give me the evidence. It is a very nice statement. Give me the evidence. I have not ever seen it. Give me an aircraft that is of the capability we require. I think this is actually an issue about Europe because the European joint programmes such as Typhoon are an attempt to avoid the conundrum of a low volume for a country such as ourselves, and we all argue that at this stage we are a small country in terms of the total capabilities. Europe does not exist in the full sense of defence equipment in the way that Airbus and the civil programmes have created a European defence industry. In that period when we do not have a European scale and volume, it is very tempting to make statements like that but all the evidence of buying so-called off the shelf such a JSF demonstrates what happens. It is a very interesting statement. I have yet to see the evidence that proves it.

Q31 Chairman: Surely the number of different armoured vehicle manufacturers in Europe suggests that we will never actually come together as a European continent to produce something in the cost-effective way that a single country, the United States, is able to do. How do you solve that?

Mr Turner: It is almost impossible with politics. I spend a lot of time in the States and they always have a go at Europe not being able to get its act together and some of the criticism is right about Europe; we do not spend enough on defence in Europe to help around the world. I always say to the Congressmen and the Senators, “Could you imagine if you were a Senator in California agreeing that this one should go to Michigan?” You will never agree it. I am afraid we start with the realities of politics in Europe that each country wants to work with other countries but they want the jobs, skills and innovation in their own country.

That is the reality. We were very fortunate to get Typhoon coming together with the nations that we did but it is really hard work. On FRES, on armoured fighting vehicles, we should somehow have got Europe together; we have failed. We failed to produce for the UK Armed Forces therefore a new family of armoured fighting vehicles that is desperately needed. I have said many times in Europe “Why can we not get industry together on the land side to produce a family of armoured fighting vehicles?” The world is crying out for armoured fighting vehicles. Whilst many countries will not war fight, they will peace keep and they do need decent vehicles. Here is a great opportunity for Europe and for the UK and we have failed.

Q32 Chairman: Would it be right to say that possibly the only person that could have achieved that was you?

Mr Turner: We looked at acquiring more companies on land in Europe. You know we bought in the UK and in the United States, but we are very concerned about defence. It is bad enough in the UK but you look at defence budgets across Europe. I am afraid governments in Europe are not committed to defence expenditure. Clearly there are no votes in defence in countries in Europe like there is in the United States and it was not in our economic interests to do so.

Dr Wilson: One of the reasons that the last pan-European armoured vehicle programme came apart was that each country demanded a different requirement within the broad sphere that was being considered. The old MRAV programme split up into what can now be traced to VBC1, Boxer and even Piranha came out of that because it was postulated as an alternative to that vehicle. Everybody came at it from a different point of view. One of the things we currently find in operations is that working with our closest allies is quite difficult in many respects. Logistically we require different things. In communications, a subject close to my heart, there is a lack of interoperability. So things that have been developed purely for the UK now have to be widened so that they can actually start to work across the various countries’ indigenous systems. The great problem is fundamentally at the country level, at their ministries of defence, at their armies as a direct point, to start getting common requirements that we will stick to over time. The way to enable that is to do precisely what was said in the original Defence Industrial Strategy, which was to have open system architectures so that at least if things differ, you can plug and play different parts into an overarching framework that starts to make sense. We are not there yet in the UK, and we are certainly nowhere near it in Europe. If we want to find commonality and we want to get the economics of scale, we have to start at that point.

Q33 Linda Gilroy: The merger of DPA and DLO is about 18 months old now and it was formed with the objective of creating the fit-for-purpose integrated procurement and support organisation, which underpins a lot of the goals that you have as industry. In our earlier questions we have been exploring how the brakes seem to have been put on things. Can you give us a flavour of the extent to which progress and movement have been made in the right direction?

Mr Turner: We fully supported the coming together of DPA and DLO. It was the right thing because of the through life capability management, thinking at day one about through life, that £1—£3 to £4 equation. I think MoD should be congratulated on the speed with which they did that and brought it into effect. I think the rest speaks for itself. We are now stuck. We have the right organisation in MoD;
we have the right principles in partnering and outsourcing and with through-life capability management. We do not have the budget.

Q34 Linda Gilroy: Just now you were saying this is a ball-park figure of £1.5 billion to invest generally. How much of that would be needed to get the through life capability management that we all want to see?

Mr Turner: In my view, that is the amount of money per annum that the future equipment programme needs. The organisation that the MoD now have in place, the combined organisation of initial procurement and through life, would make sure that that money was well spent, not only on initially getting the equipment into service but in thinking through life on spiral development, supporting, reliability and maintainability. I think that would be sufficient.

Mr Godden: In terms of a merger of interest, it takes 18 months typically in any corporate entity or any government entity to put the two things together and develop. I think it has made the right move; it has progressed, etc. I think, however, in the organisation the issue is not so much a big budget issue but the fact that the pressure on the organisation on the very things we have talked about earlier, which are UORs, the whole concept of developing and revising the equipment review and so on and the issues around government policy on skills and technology, has acutely distracted the organisation from getting on with that programme. I think it has done excellently; it has worked hard at it, but it could be accelerated with a bit of stability in terms of what is happening to the overall picture. That is my observation of it.

Q35 Linda Gilroy: It is poised to deliver?

Mr Godden: It is poised to deliver and we need to encourage it to accelerate that delivery and get on with it.

Mr Keen: I would agree with all of that but I think it is worth saying that there is quite a lot of work going on to embed some of the through-life capability management principles into the way the new organisation does its business. There has been a good lead, from our perspective as a company, given by the capability area in MoD, the next stage of which is the establishment of a series of programme boards which will bring together the various stakeholders and interests in a particular capability area. I do not think we should ignore the work that has been going on, having established the organisation, to embed some of those principles into the way it operates. As Ian says, clearly that has been clouded by the general background against which they have been operating.

Q36 Linda Gilroy: The whole point of it presumably is to invest to save over time. Are you saying that the investment to save bit and the horizon that you are scanning is looking as if it is going to be put into front-line urgent operational requirements rather than into having the complete programme that was envisaged to get DIS to deliver on the strategic defence role?

Mr Keen: I think there is a slightly broader issue as well, which is understanding the trade-offs between various ways of meeting a capability. That is the sort of discipline that the programme boards will bring. There is a long way to go but I think it is an important development.

Q37 Linda Gilroy: Can you give us any tangible benefits that industry has seen as opposed to these rather broad conceptual things?

Mr Keen: I think it is the broader stuff. In particular programmes where we have been dealing with one IPT across both acquisition and support, I would guess we could offer specific advantages that have accrued, but it is in the general sense rather than the specific.

Q38 Chairman: These are benefits that you have not seen yet?

Mr Godden: You have to watch that you do not over-generalise here. I can point to one or two examples where it has happened and it is happening but I am talking about a broad summary. The danger of saying “a broad summary” is that we will miss out the two that are happening out of 10, or whatever. I think we have to watch that we do not over-generalise here. There are good examples of where progress has been made faster than others.

Mr Turner: If you take Tornado where the long-term agreement between MoD and BAE Systems not only to maintain but upgrade the Tornados through life, you pick points in the life of the Tornado in future where you will have upgrades of capability fitted into the maintenance programme. There have been huge savings there to MoD: huge reliability savings, maintainability savings, cost savings and also planning through life on the Tornado programme. That is a really good example of where it has worked.

Q39 Linda Gilroy: We saw that, Chair, when we visited RAF Marham and there was the gain share concept embedded in that, which seemed to be a very good incentive.

Mr Turner: Exactly.

Q40 Linda Gilroy: Are the lessons from that not being learnt?

Mr Turner: I think on existing programmes like Tornado and Harrier, yes, this issue comes down to the future programme and getting an agreement. We have some in principle, as on the naval side and the military aircraft side and on the helicopter side. Without the long-term funding commitment, MoD cannot go beyond statements in principle; this is what we want to do. You can have the strategy, back to the original DIS, but without the money to put it into effect, you cannot do it. All the intent is there and I am pleased that MoD now talks about partnering and outsourcing and transparency. John Hutton and Quentin are very committed to that. The problem they face is this future equipment programme.
Q41 Chairman: Did not the Tornado savings get put in place before the merger?
Mr Turner: Yes. We were talking about it with the DLO for many years, yes, before the merger but bringing the DPA and the DLO together made the budgeting and planning of it all that much easier because we had the wall between them before.
Mr Keen: I do not think it derived from the merger because we had the wall between them before.

Q42 Chairman: Consistent with but the merger was not necessary for those savings to be made?
Mr Turner: It made it much easier.

Q43 John Smith: That was the one example you gave of the specific benefits of the merger and it predates the merger. What examples can you give of direct benefits to industry of the merger of DLO and DPA?
Mr Godden: You have to be careful here. It takes 18 months to get these things embedded. You cannot give historical evidence of something that is happening right now.

Q44 John Smith: You were unanimous in your welcome of the merger. You said it was great and everything is going to work out well.
Mr Turner: We have agreements in principle in a number of sectors now: on helicopters, land, air and maritime. The problem we have is that, having the agreements in principle, we have now basically stalled in putting those into long-term partnering agreements with the benefits that will flow. Having the combined organisation on the MoD side makes that easier, as with the Tornado: yes, it was thought of before but actually enacting, executing and running it is much easier with the combined organisation that we now have.

Q45 Chairman: Ian Godden, I am going to be extremely unfair here. I apologise for this. You said we must not get too general and we must look at the specific issues. John Smith has asked you to give us one example. You said you could give us one or two examples. Can you give us one example?
Mr Godden: I think Mike has just given the examples.
Chairman: Mike Turner has given the example of something that was happening beforehand.

Q46 John Smith: It pre-dates it.
Mr Turner: Since we have the combined organisation, each sector has in principle an agreement for the long term, a long-term partnering agreement, which is great news for the industry. If it ever gets the funding to execute the strategy, I think we have a very sound defence industrial base in maritime, air, helicopters and on land; it will be in place. A lot of work has been done in principle to put these agreements in place for the long term.

Q47 Chairman: That is a rather large "if", is it not because you have said that the entire problem with the Defence Industrial Strategy is not the Defence Industrial Strategy itself but whether it is funded?
Mr Turner: Correct.

Q48 Chairman: That is the problem with the long-term maintenance agreement?
Mr Turner: Yes.
Mr Keen: The struggle I am having is with the couple of examples I can think of that have happened. The most particular one is the long-term munitions agreement that has been put in place over the summer. To be honest, putting hand on heart, I am struggling whether that is as a result of the coming together of the two organisations. The problem is that there is an amalgam of different issues coming together here. There is the DIS and the reorganisation. Part of the reorganisation is the embedding of through life capability management. It is quite difficult to pick out individual elements that have been put in place as a result of the reorganisation. I suppose in the land sector generally, as Mike has said, there is an armed fighting vehicle partnering agreement, which is progressing as well. I would guess that the coming together of the acquisition and support bits of the organisation is definitely helping to bring a more holistic approach to that, in principle anyway, although, rather as Mike has said, we have not actually seen some of the tangible evidence of it.

Q49 Chairman: All right, and I do not suppose we should over-play this point because industry welcomed the merger; this Committee welcomed the merger because in principle it seemed to be going in the right general direction. Let me ask you one specific question. Why has a through life maintenance agreement not been put in place?
Mr Turner: It is the same issue. I am now Chairman of Babcock and very familiar with the issues of putting a long-term agreement in place on the maintenance of submarines, for the reasons we have given many times this morning—money.
Dr Wilson: Can I give you just one example at a quite low level of the bringing together of DPA and DLO? I will wear my other hat of General Dynamics here and comment. We now have an IPT which is dealing with both the continuing development and the through-life support, which was not the case three years ago. You can argue that that has come out of the merger. We have been able to do a number of things there, including a trade-off between how much we put into the support line and how much we put into the on-going development line, and we can actually see synergies between the development line and the support line developing things which will actually make support less expensive in future years. Even there, however, I think ultimately the absolute amount of money that can be made available will affect the effectiveness of that new arrangement. However, it is there and it is working and that is at an everyday working level, so there are things like that are going on.
Q50 Chairman: That is helpful.
Mr Wilson: But money still will determine whether the most optimised support solution will be there and the most optimised spiral development will be there, and we will wait and see what happens in the forthcoming PR09.
Chairman: Linda Gilroy has not finished yet.

Q51 Linda Gilroy: Moving on to the staffing side of DE&GS, what is the industry's view on the plans to reduce the number of staff by some 25% by 2012? Is this creating additional pressures? How does it seem from your point of view?
Mr Turner: It is a bit of a management consultant thing from your background, Ian.
Mr Godden: My feeling is that it is right to do them both and that is absolutely the case. On occasions it will conflict obviously, as any cost reduction exercise or any productivity improvement exercise would, at the same time as re-organising, and at the same time as fighting two wars. There is a lot of pressure on but I do not see the evidence that says that the cuts themselves are getting in the way of the programmes. I think those two are such that they can be combined. There are plenty of examples of other large organisations that are able to do two at once. In fact, there is an argument for saying we need 150 to 300 very good people to drive these sorts of programmes through. That is the sort of level we are talking about. We are not requiring 10,000 people to do that and therefore as long as that core of people who are associated with Change programmes are in place and are stable and their futures are certain, then it is at that sort of level that is required to improve the programmes, so I do not see those as necessarily in conflict at all.

Q52 Linda Gilroy: We have heard in evidence that there are some tensions between the good people being sent to the urgent operational requirements to meet them. Alongside this very significant reduction in staff, 25%, it is one in four of every staff, are the right people in the right places to do the jobs that need to be done?
Mr Godden: Personally I have not seen evidence where that gets in the way. All I know is that the uncertainty it creates is more the issue than the actual resources. I think the uncertainty of any reduction programme lives on and lives in the minds of people more than the actual resource issue itself, and that is what I think we need to get the other side to.
Mr Turner: There are two general areas of comment. I think industry has proved through outsourcing the benefits in terms of cost reduction and reliability improvements and we would like to see more of that. I think there is a willingness now on the MoD, because of the evidence, to do more of that, so clearly that would benefit manpower on the MoD side. Secondly, we are concerned on some programmes at the level of man-marking that takes place and we think there could be savings there, so we hope that is all being taken into account.

Q53 Linda Gilroy: I do not recognise that; what is man-marking?
Mr Turner: As you are undertaking programmes and as you are executing programmes in industry and companies, you have maybe too many MoD people alongside you.

Q54 Linda Gilroy: It is an issue of second-guessing?
Mr Godden: It is like the oil industry from which I came where the large oil companies like BP used to second-guess all the contractors and then the contractors used to second-guess the sub-primes and you had man-marking basically going on all the way down the line. BP eliminated that and removed a large chunk of that man-marking and discovered it actually improved things.

Q55 John Smith: An issue that has come up for us time and time again, and it might be related to this, is whether the skills within what was the agency exist to be able to oversee long-term partnering contracts, which are very complex and which are still fairly new to private industry. We were assured that there were training programmes in place and big developments had been made. Is that your perception on the industry side?
Mr Turner: I think Amyas Morse has done an excellent job coming in as the Commercial Director of MoD with the training programmes and bringing more commercial people in. Clearly in the bad old days of fixed price design, development and production, “throw it over the fence”, you did not need it. In the enlightened world of partnering we are now in you do need that, but the real help in that is what Linda mentioned about gain-sharing, the fact that both sides can benefit, it is a win/win situation. If you get the right structure in these partnering agreements costs come down, industry makes an acceptable return and both sides and the Armed Forces, which is the end result, win on that, so, yes, significant strides have been made and I think Amyas Morse and the guys in the MoD should be congratulated on that.
Mr Godden: I agree with that entirely. I see it every day, secondments out to industry, secondments the other way, plus Amyas and his programmes, and that has had a big effect and will for the future.

Q56 Mr Jenkins: As you know, the MoD only “partly met” its Public Service Agreement target of delivering equipment programmes to cost and time. In fact, the MoD Annual Report and Accounts 2007–08 states that “procurement performance declined”. Do you have a view on why this performance declined?
Mr Turner: There is the legacy. To give the helicopter view, there are two leading countries which have the highest level capabilities in Armed Forces in the world and those are the United States and the United Kingdom. If you compare the UK’s overspends and delays with the US’s it is a fantastic result. In any comparison between what the UK overspends and the length of their programmes compared to the United States, the UK is doing an amazing job. What we are now benefitting from, and
still suffering from as well, is the legacy programmes, but the change away from fixed price design, development and production on complex programmes without the right risk mitigation being taken up-front, the investment up-front, before industry enters into the commitments and politicians stand up in Parliament and give in service dates and commitments to budgets, that is a huge step forward. On the Carrier, for example, that has been well done. We had refused and the MoD had gone along with our refusal to commit to dates and budgets until risk mitigation had taken place and proper risk registers were put in place. I have lots of evidence and I have the scars from Nimrod and Astute when that was not the case. I think we are still suffering from those legacies. The way the MoD now conducts itself in risk mitigation upfront is absolutely right and we should be proud compared to the US of what the MoD has achieved.

Q57 Mr Jenkins: Because it is said that the MoD and industry had a so-called “conspiracy of optimism”?  
Mr Turner: Sir Peter Spencer.

Q58 Mr Jenkins: You think that time is more or less past?  
Mr Turner: I am afraid in the past when there was so much budget available people, largely within the MoD, said, “Yes, we can do it for that,” and industry, by and large, to stay in business, went along with it.

Q59 Mr Jenkins: If I remember the term they said, “If we offered them the true cost they would run a mile so we offer them a lower price and then we get them hooked.” It is like that advert on the telly, “We put a juicy worm on the hook and when we hook them we put them in the keep-net.”  
Mr Turner: I was party to the Nimrod in the mid-1990s and we wrongly believed that we could do it for that price. We convinced ourselves, I do not know on what basis but we did, having spent only a few million pounds up-front that, yes, it was possible to do that. We were wrong and it is only in time as you spend what is recommended, which is some 15% of the total programme bill up-front, that you understand the technical risks and the risk registers and you do it properly. It is good that that has happened. Companies do not do that.

Q60 Mr Jenkins: There is some nagging doubt because you are now saying that was in the bad old days and the MoD now are all-singing all-dancing, they are much better, and that that should not happen. But of course in the old days it was a partnership of two, was it not? If the MoD has got its side right what have you done to improve your side to make it difficult not to con the MoD like you did in the past into the future?  
Mr Turner: Frankly, what we said was that we were no longer playing that game. We were not going along with a monopsony customer saying, “This is the programme and these are the terms and if you do not take this programme on those terms you do not get the job.” Frankly, the UK defence industrial base, my own company at the time was so small, and we did not have the assets we now have in the rest of the world, but we had to take it or we were out of business. Eventually we said, “We cannot go on like this. We cannot go on taking these complex weapons programmes on fixed price design, development and production programmes even if it means not staying in business in that particular area. I am sorry, we cannot do it,” and I am pleased to say that the MoD came along with that, and rightly so.

Mr Godden: I think there is another factor at work here. If we go back to the supply chain and say that we have in this country anywhere from 3,000 up to 7,000 companies involved in the supply chain, there is an issue about how efficient that supply chain is. As Mike Turner said, if you do comparisons between the UK and the US we come out, in a relative sense, very well. In an absolute sense, if we compare ourselves with other industries, and we have a nice direct comparison with the civil to defence side in aerospace, we would say that the whole supply chain and the SME community and the primes have got work to do in terms of developing a much leaner, more efficient supply chain that will match the needs of the programmes, so I think on behalf of the industry I accept the challenge. We have established a programme, Supply Chain 21, which is an attempt to overcome some of those difficulties for which we get criticised. I think there is that element to it as well.

Q61 Mr Jenkins: I understand that complex projects do get difficult, but whilst we now, as you just told us, have a more intelligent customer in the MoD, to do with merging and the way we work with industry, is it solely legacy projects that brought down the performance last year? It is last year that procurement performance declined; why?  
Mr Turner: You will probably find the odd one that is a current programme having some difficulties, even when the right level of risk reduction has taken place, but I think if you look carefully at the Major Programmes Report it was the legacy programmes, yes.

Mr Godden: I would also say that there has been a lot of focus on value for money but if you talk to the Ministry of Defence itself, I think it understands that the value of time has been somewhat under-valued, and it goes back to this budget issue that you start with at the top end which is you push to the right because of budget constraints, that delays your programme, and you start going into that cycle. The value of time is something that I know that Amyas Morse and the current Ministry of Defence team are very keen to establish a programme on and to develop that timeliness in terms of decision-making, in terms of the risk/reward, getting to the risk/reward boundary as quickly as possible and agreeing that. I think those are programmes that would help, in addition to what Mike Turner has said.

Q62 Chairman: Would you describe the MoD over the last six months as having been more decisive than previously?
Mr Godden: At the top level I started off by saying we are in limbo so how can I come back and say that, so the answer is no, at the top level, but obviously on individual programmes I think it is happening faster.

Mr Turner: We should give them great credit on UORs. They have responded for what the lads need out in Iraq and Afghanistan in a magnificent way and so has industry, but the rest of it, the Future Equipment Programme, is paralysed.

Q63 Linda Gilroy: Somebody mentioned Supply Chain 21, I think it was Ian just now. Could you just set for the record what that involves and what it brings to the table?

Mr Godden: Effectively it is a programme of establishing lean timeliness and efficiency into the whole supply chain. The Ministry of Defence signed up in Farnborough this year to that whole programme, which is an industry-wide programme, essentially self-help, funded partly by work going on in the regions and partly by work going on from central government, but largely funded by the primes themselves in terms of their programmes of lean manufacture, lean design and the whole concept of eliminating duplication in the chain. There are 300 companies that have signed up out of 3,000 that are actively working on that. It is a very large programme. A bit like I said earlier about 18 months, this was established approximately 18 months ago. I myself am proud to say that the programme is alive, well and kicking and doing a good job, but it could be faster, it could be better and it needs to be pushed hard from all angles because I think that will have the ripple effect upwards along with things about timeliness downwards that we are talking about.

Q64 Linda Gilroy: One of the things we were concerned about in examining the initial Defence Industrial Strategy was the ability of small and medium enterprises to access the supply chain. Is that part of the solution?

Mr Godden: That is part of it.

Q65 Linda Gilroy: If so, is it working well enough across the piece or are there lessons to be learned from that for other parts of the supply chain?

Mr Godden: There is still a long way to go. It is one of those comments where I would say we have made huge progress in the last two to three years. I would see this as a five to seven-year programme. If you look at the analogies in the automotive industry in this country, the automotive supply chain has still got a long way to go in terms of its quality and its world standard, but at least on the automotive side we have final assembly in units which are world-class and very effective, as we have for example in some of the facilities in defence and aerospace, but the chain is not yet efficient, in my opinion. Not when you compare it with other defence, industries I hasten to add, because versus the French and versus the US our chain is much more efficient and better value for money but versus other sectors we have got some way to go.

Q66 Chairman: I would like to move into the issue of defence inflation now. We have an adviser, Professor Kirkpatrick, who suggests that defence inflation is above the average rate of inflation in the rest of the economy and it is broadly the GDP deflator plus 3%. Does industry have a view as to whether that exists and whether that is roughly the right rate?

Mr Turner: The US defence budget planning received wisdom is that the defence industry, because it is at the sharp end of technology, has relatively low volumes compared to what happens in commercial industry and that inflation is significantly higher. The skills that are demanded in the defence industry mean that defence inflation is significantly higher than general inflation, and that is allowed for in the defence budgeting in the United States. I believe it is obvious to anybody that inflation is going to be higher in the defence industry. Volume, skills, technologies, materials all come together, and you are demanding the very highest level of capability which costs money more than the average and that is why, if you look at the defence industrial base, we pay people well in the defence industry in the United Kingdom compared to general industry. The good news in the US is that it is recognised. They worry, even today, about the good times returning and people leaving the defence industry to go into other commercial industry at the expense of the defence industry and they are concerned therefore to make sure that the defence industry in the US is properly funded and inflation is properly funded in the defence industry and that profits are allowed in the defence industry. They get disappointed if you cannot make 15% profitability in the US defence industry in the US is properly funded and inflation significantly higher. The skills that are demanded in commercial industry and that inflation is relatively low volumes compared to what happens in the defence industry and they are concerned therefore to make sure that the defence industry in the United Kingdom compared to the US is properly funded and inflation significantly higher. The skills that are demanded in the defence industry mean that defence inflation is significantly higher than general inflation, and that is allowed for in the defence budgeting in the United States. I think you could study forever about whether it is 2%, 3%, 5%. I just know it is higher and for very good reasons.

Q67 Chairman: Is that because you pay yourselves more?

Mr Turner: We do and rightly so because the skills that are needed in the defence industry are higher, I would argue, than any other industry. You go round the nuclear submarine at Barrow or a Type-45 or an armoured fighting vehicle the skills and the systems that come together and all the many types of technologies that come together to make that capability for our Armed Forces are second to none.

Q68 Chairman: Is that not creating long-term serious problems for the defence budget in this country?

Mr Turner: Not if it is recognised as it is in the United States.

Q69 Chairman: One of the problems is that the Government says that until 2011 it will be putting into the defence budget an increase over and above inflation of 1.7% and yet if the defence inflation is actually 3% then on an annual basis it is in fact cutting the defence budget.

Mr Turner: Yes.
Q70 Chairman: Does that not make it quite important that industry should actually play its part in trying to keep defence inflation down by for example paying its people less?

Mr Godden: Can I add two factors here. One is if you look at medical equipment it is very similar. Medical equipment is inflating much higher than general inflation, so it is something to do with the equipment and the capability of that equipment. If you look at a Typhoon versus a Spitfire do you see it as a like-for-like? No, it is not. There is a capability inflation that is going into this which is something to do with the need for extra capability. If the professors have said they have done like-for-like on a Spitfire versus a Typhoon, that is not the case, so there is distortion there and the answer to your question is that the industry itself does not know any more than the professors who have studied it. If they have come out with 3% that is what industry believes it is. That is partly to do with capability and partly to do with requirements being put on the equipment itself as well as the things that Mike Turner mentioned.

Dr Wilson: As to on-going inflation, if I might just make the point, I do not think, from the data I have seen, that the defence industry is inflating salaries at any greater rate than the corresponding general civil industry.

Q71 Chairman: So you would disagree with Mike Turner?

Mr Turner: I did not say that. Dr Wilson’s point is that in the defence industry people get paid a certain level above the average. What has happened in recent years is that the pay increases in the defence industry are in line with general industry but the gap is still there, and so it should be.

Dr Wilson: I think that was the point well made. I think the other point is really if one wanted to simplify this most defence products are really bespoke craftsmen products compared to mass produced products. The volumes are so small and even large runs of armoured vehicles are actually quite small compared to their equivalent trucks, cars and what have you in the civil sector, and so there is necessarily a premium simply because the volumes never get up to the levels in the civil business. If you put in traditional learning factors for going through production, you would see that you need to go many times more in order to get really significant reductions.

Q72 John Smith: I must say that I am very sceptical about pleading a special case for unique inflationary pressures in any industry, defence, health, or anywhere else, and by your own admission holding up the American defence industry in terms of its record on procurement and its record on efficiency is not a very good example. Yes, there is a much bigger defence budget in the USA and there is much less competition within the USA for the delivery of defence products, and I think they pay the price for that. I am concerned that it just becomes an excuse for inefficiency and for the industry not addressing the cost increases and the cost overruns. You can take other industries that are far more technically advanced and require far higher technical skills but they are driving down costs dramatically. The obvious area is computing/information technology.

Mr Turner: That is for a mass world market. I sit on the Prime Minister’s Ambassadors Apprenticeship Network and we compare apprentices across the whole industrial base of this country. An engineering apprentice in defence costs each company about £30,000 to train and develop over a four-year period so the cost that industry invests is significant and we attract young, bright people into the defence industry because of the rewards many years out that they will get by being in that industry. I think the skills that they bring are second to none. I cannot think of any other industry that requires what you need on a nuclear submarine or a Type-45 or a Typhoon or an armoured fighting vehicle, and it is right that the people who train, and industry invests significantly during that four-year apprenticeship period, and go through university get the rewards to which, frankly, they are entitled. Without those rewards we would not have the defence industrial base of this country.

Mr Keen: I agree with all of that. I would refute any suggestion that we were not seeking efficiencies in the company. If you look at the sort of investment that we have made as a company in lean manufacturing facilities in BAE Systems, it is massive. In the efficiency that you see at Warton on Typhoon, as compared with what you would have seen there 20 years ago, there is an unbelievable difference, so I think we are driving out efficiencies. More generally I would argue, as Mike has said, that there are some particular complexities about the defence industry. I understand your scepticism but I think the reality is that we are like no other industry. That said, I think there is an issue that we have to address and I think we have to address it in a number of ways. We have to address it with the MoD in driving costs down at every opportunity (and we have already spoken about the sort of things we are doing on partnering) but I think also we have to try and contribute to the work that I know the MoD is doing trying to understand what defence inflation is. I think we can probably help there.

Mr Godden: I think we are mixing a couple of things up here because we have just published our annual review of last year and over the last four years the productivity of the defence industry has gone up between 4% and 6%. That is people productivity, et cetera. Secondly, just to reinforce Bob’s point, when I go to the SELEX facility in Edinburgh, which I was born next to, and I look at that facility versus five years ago, versus 10 years ago, versus 15 years ago, that is a world-class facility that has been invested in. It has one of the best supply chain systems and lean manufacturing systems anywhere in the world. I have been to Japan and I have been to the US and I have been to France. We have a world-class, productive, highly capitalised investment in SELEX, for example, so there is a mismatch between what we are being challenged on here versus what is going on. I agree that we need to study this inflation issue if it is a big issue for the Government and we should do, but I do not think there is any answer that
says we are an unproductive (and getting worse) industry; quite the opposite because that is the implication of saying that. The inflation then must be something else and I am saying I think it is a capability inflation myself. That is my own personal opinion; unproven.

Q73 Chairman: I think that was actually factored into Professor Kirkpatrick’s article. Dr Wilson.

Dr Wilson: I come back to John Smith’s point about the obvious comparison between the UK defence industry and the worldwide computing and communication industries. Offshoring is a major factor in keeping costs low because hardly any of that volume production is done in the UK. Even the development is now done offshore in many cases and that is something that is just impossible to do in the defence industry. We really need to take that factor into account. It is not open to us to go and have a whole pile of critical software developed in India. If it is not critical yes we can; if it is absolutely mission-critical we cannot because it is absolutely essential that that core capability is in the UK and no-one else knows what it is.

Q74 Linda Gilroy: I too am very sceptical about what you are saying. I think that the areas that you work in like computer-aided design should be able to deliver huge savings in the programmes. They must have done.

Mr Turner: It has done.

Linda Gilroy: I still think there is the whole monopoly/monopsony-type culture in the industry that does not drive hard enough to match the undoubtedly defence inflation there is with the savings that can be made. I think that we would have to try and unbundle the two sides of it. We do know that in the MoD budget they have made a lot of savings with your help and that that has been rededicated to front-line capability. Therefore, you cannot just take a straight line of what the increase in the MoD budget is without recognising that there have been some major efficiency savings. I just do not get the impression that you guys are dedicated enough to try and combat that as an issue, given the tensions that there are, because the gap in the rewards that come to people who work, quite rightly, and get well-rewarded in the dockyard at Plymouth, for instance, against what young men and women who are going out to put their lives on the line in Afghanistan and Iraq are getting is wrong. That is a very visible example of the tensions that exist that we were talking about earlier in the equipment programme as well. There needs to be more passion injected into trying to achieve that, which I know from what you have said in your introductory remarks you recognise and you care about.

Chairman: That was a comment, rather than a question.

Linda Gilroy: Sorry!

Q75 John Smith: I just want to come back, it is not my intention to claim that the industry is unproductive or inefficient; far from it. I think you have a very good story and a very good track record.

I do not think there is anybody on this Committee who does not support you in your bid for additional budget funding for the good work that you do. I am fairly sceptical about the argument about inflation and I think in the long run it may be counterproductive for you to be arguing a special case on your costings rather than showing what a good job you are doing.

Mr Godden: What I would like to do out of that is to promise to study that with you because I agree with you that it needs reconciliation because it has got a number of factors in it.

Q76 Chairman: May I say that that is welcome because I think that, whatever the scepticism of my colleagues, there are some points that we have to understand here and we need to get to the bottom of what is the effect of this small volume, what is the effect of the materials that are used and the cutting-edge nature of the defence industry, and so if you can work with us to get to the bottom of that that would be most helpful. I am glad you are working with the Ministry of Defence.

Mr Turner: Chairman, it is all very well having these discussions but the bottom line is today we have a world-class defence industry in this country, one of the few industries left. If we carry on debating these things such as inflation—we know how efficient we are and that we give value for money and if you compare with anybody else in the world, capability for capability, value for money, what we bring to the UK economy, what we do in support of UK Armed Forces, in 10 years’ time I will not be here but people will be sitting around here saying, “Where did it go? What went wrong? What did we do wrong?” I tell you now this industry is in decline and unless people pay attention to the budgeting of defence in this country and the defence industrial base we do not have a future.

Chairman: We have to pay attention to that on the basis of our own knowledge and of the facts that we get by debating it in these fora and so your help in getting to the bottom of it would be much appreciated.¹

Mr Jenkins: Before we leave that area, I am glad you brought up the automotive industry and the increase in capabilities because there has been a tremendous increase in capabilities and a dramatic fall in the cost of cars in this country. They are not offshored, they are built here, designed here and planned here, in the main. In the world out there technology has been driving prices down and has produced additional capabilities but when the argument is made, “We have to pay high wages because when the good times come back, people will leave the industry,” what happens then, as the wages outside go up so does the rate of inflation go up in the economy, so you would be exactly on a par with the normal economy. There is no reason why your inflation rate should be any higher because of outside wage rates going up. That is the first thing. The second point on small batch production, small batch production was used to set the original price, it is not about the rate of inflation

¹ See Ev 105
because that was a given to start with. I think we should put those two things on the record. Your argument that servicing offshore costs may lead to a fall in inflation in Britain now that the GDP deflator might be slightly lower may be an argument, but it is going to be so marginal as to have virtually no effect, I believe.

Chairman: I think we ought to move on from a debate on the issue of defence inflation.

Mr Hamilton: Chairman, could I just ask for one bit of information. When Ian sends that information to you, could you also indicate across the board what type of wages we are talking about. I take the point that Linda makes, the comparisons are not between industry, the comparisons are in the area in which the industry is working. I know from my area where there is a small engineering firm, Taggart's, that the people are well-paid and it is a good company, but the comparisons are not with areas like Glasgow or London, the comparisons are with local wage levels, so if you get that information that would be quite helpful also.

Q77 John Smith: I was going to cover the effect of current operational requirements on strategic planning but I think that has been dealt with right from the start in your opening comments. There is just one area of the impact of current operational requirements and that is: is there any evidence that equipment is being used to such an extent now that its life is being shortened? You are talking about us not progressing with future equipment requirements. It could be creating an even bigger gap because the life expectancy of the equipment, especially air frames, is being impacted upon by current requirements. Is there any evidence of that and does the industry have a view?

Mr Turner: I think the usage on helicopters and the need for continued urgent action on helicopters is well-known. On the fixed wing, the Harriers, yes it is a concern that they have a stated life and that is being used more rapidly than was originally planned. At the present time we are building two splendid aircraft carriers and we all support that, and it is the right thing for our country to have, but we will have no aircraft to put on them and that is a big issue for us going forward. One good thing that comes out of the UORs is there is a debate that goes on between the MoD and the Treasury about this additional equipment, in response to UORs how much should come out of the defence budget and how much should be funded by the UORs. I have no evidence that the MoD is suffering because of that but I do not think we have a Treasury that is that helpful to the defence budget, and I think there is a concern that, yes, the MoD is getting new equipment on the back of Iraq and Afghanistan and therefore that is good but some equipment is not having the attention it will need for different kind of campaigns five, 10 15 years out. We hear about piracy again today and yes, we have six splendid Type-44s and two aircraft carriers and seven or eight Astute submarines but we need frigates. Where is the money for the frigates?

Mr Jenkins: Saudi Arabia to defend their oil route or China to defend their routes.

Q78 Chairman: Moving on then to the Defence Industrial Strategy, was I right in hearing Mike Turner say that it is extremely difficult for industry to plan as we were able to do when we had a Defence Industrial Strategy? Is that one of the things that you said earlier in the day? Do you believe the Defence Industrial Strategy is dead?

Mr Turner: It is on hold. First of all, the principles are magnificent but also we saw before us long-term planning taking place in helicopters, on land, air and sea, against which industry could then plan resources, apprentice intakes, investments and all the rest. We welcomed it and I remember the board meeting where we said good, at last we have a future in the United Kingdom, because that was very much in question. Now I think I think it is in doubt. We are very pessimistic about the future because we have the DIS, we have the principles, we have the strategy; we do not have the money.

Mr Godden: In terms of DIS I mentioned earlier the limbo of 15 months, I think that is what we had, and our preference is to stick with DISv.1 as a set of principles and allow the Government and the civil servants to work out what needs to be done in the current situation for all the pressures and then come back to the subject, whether that is early next year or later, of the extra principles that need to be built into DIS, in the hope that we will not dilute DISv.1 but we will enhance it. The issue for us is there is no point in publishing a DISv.2 that either does not reflect the sector strategies or the specifics around adjustments to the thinking at this stage. Our view therefore is that it is a balance between being in that limbo period and therefore the uncertainty for shareholders about what is happening versus the pressures of the moment. Industry has taken the decision that does not wish to add to the pressures of either the Government or of the Ministry of Defence at the moment until it has sorted out one or two matters, so that is really where we are. I have worked very, very hard for the last year and I am disappointed that we do not have a DISv.2 but I accept the principle that we are unlikely to have it until next year or perhaps beyond.

Q79 Linda Gilroy: Some people are arguing for a Strategic Defence Review. What are the pros and cons of that from your point of view and what would that do to the process that we are discussing?

Mr Godden: We have an incompatibility today between George Robertson's SDR and the money available for the Future Equipment Programme, so one of those two things has to give.

Q80 Linda Gilroy: So do we need one and what would that do to your programmes?

Mr Godden: Against the current budget we need one. I would hope for the sake of the UK Armed Forces and the defence industrial base and all it brings for this country, that budget will give. If not, SDR will have to give. I think SDR was right for this country and its role in the world but it is in jeopardy.
Q81 Linda Gilroy: Is there a danger if that comes about that that just parks the issues even further and results in further uncertainty and limbo?

Mr Turner: That is where we are.

Mr Godden: We are not calling for an SDR but in a sense we need some guidance at this point and, as Mick Turner said, it is either budget or guidance, one or the other.

Q82 Linda Gilroy: Do you think you can have the guidance that you want but if the guidance then becomes something that affects the underlying principles of the Strategic Defence Review is there something short of a Strategic Defence review that can give you that clarity?

Mr Godden: DISv.2 was supposed to be that in a way, it was an interim.

Mr Keen: Just a couple of additional comments. I am not disagreeing with anything either of my colleagues has just said, but I do go back in relation to the DIS to the work that is actually already taking place on a daily basis. We are actually implementing the DIS in a number of important sectors in the defence industry. That is not to say we are doing it everywhere and there are key areas for the future, particularly in the air sector, where key decisions have got to be made about the industry and about the skills and technology that we are able to maintain over the long term and the extent to which that will enable to us deliver operational sovereignty. I would say it is a mixed picture. There are some huge decisions yet to be made and the industry really is waiting for some of those big decisions to be made, but we are also making progress.

Q83 John Smith: The budget has come up right throughout this session. There is much speculation in the press about a looming fiscal stimulus to the British economy. Where are you in the queue outside the Treasury on this point?

Mr Turner: As you would expect, we have made a strong case to be at the top of that queue. When you look, as I have said, at skills, technology, R&T (we represent 10% of the UK’s R&T spend) apprentices, jobs in regions, high-skilled jobs, systems jobs, exports, wealth creation, in terms of a stimulus to the economy we should be number one. We get the feeling we are not on the list.

Q84 Chairman: Why is that?

Mr Turner: Priorities.

Q85 Chairman: Of Government?

Mr Turner: The Government decides where money is spent.

Q86 Chairman: But a new Strategic Defence Review would be of no benefit if there were no extra money, would it?

Mr Turner: A new Strategic Defence Review might say we are not going to play the role in the world that the SDR said. I would regret that but at least we would understand as an industry where we needed to invest or not invest.

Q87 Chairman: If there were a new Strategic Defence Review would you trust the result that came out? Would you not think that any government in the future would be buffeted by financial fortunes?

Mr Turner: We do not. The evidence in the past, if we look at DIS which we liked (but, as I said, any board that agrees a strategy without funding you have got to question whether that is a way to go forward) so, yes, we would have to test a new SDR if there was one and say do you really mean it, do you therefore rewrite the DISv.2 sector-by-sector onshore UK and are going to fund it? Yes, we would have to hold people’s feet to the fire to see if they really meant it.

Mr Godden: We had a debate on this earlier this year with the Ministry of Defence and the Government about market attractiveness and given that the defence budget is not growing in Europe, what is the next best thing to growth. If growth is not available, and that is what we are being told at the time that it is not available, what is the next best thing? The next best thing is certainty and that certainty is therefore the thing that would be sought in a Strategic Defence Review of equipment. Whether that means no growth, slightly higher growth or lesser growth or decline, the next best thing is certainty. At the moment, unfortunately, because of the uncertainty on budget the certainty on the other matters is not coming through, so I think that is our position and always will be. The Government has to decide on the industry and the operational sovereignty and the requirements for the defence industry base in this country and we would hope, as we did with DISv.1, that we would be actively involved in that debate, but in the end the policy on defence is a Government policy and that then determines the certainty of what we can invest in with shareholders’ money.

Mr Turner: Very importantly the industry has come to the view that we do not want certainty today. It would be the wrong thing to push for a DISv.2 and sector-by-sector certainty today because we will get what we believe is the wrong answer for the defence industrial base of the country, for the Armed Forces and for the country, so we would want to defer it. Keep the principles but defer the sector-by-sector.

Q88 Chairman: Was this not the answer last year when DISv.2 was caught up in planning round 08?

Mr Turner: Exactly the same.

Q89 Chairman: And it is exactly the same this year?

Mr Turner: Yes.

Q90 Chairman: Might it be exactly the same the next year?

Mr Turner: I fear the worst.

Q91 Linda Gilroy: You are talking about on the one hand do you need a Strategic Defence Review to resolve that uncertainty or do you have a sector-by-sector review of DISv.1? Surely—and tell me if I am wrong—when DISv.2 was evolved there must have been discussions about what sovereign capabilities needed to be included and presumably there was at
least one, if not more, programme within that that was on the margins of whether it needed to be sovereign capability or not sovereign capability?

Mr Turner: Exactly, and Lord Drayson and the team in MoD sector-by-sector, complex with weapons, for air, land and sea decided what long-term capabilities the UK Government wished to see onshore. The wheels came off when the money was not there to support those sector-by-sector long-term programme assumptions. That was the fundamental problem. We travelled in hope for some time and I know the CSR settlement last year put an end to that. There was not sufficient money given to MoD to implement the industrial strategy of DIS. That is the limbo land we are in and we will stay there.

Q92 Linda Gilroy: I think what I am saying is in that debate and discussion about what should and should not be included in the DIS there would have been a long list and a short list which would have been whittled down bit by bit and at the edges there would have been one or two programmes that just made it and presumably therefore relating to the underlying principles of the Strategic Defence Review, the threat analysis, et cetera, was slightly more marginal as to whether they needed to be sovereign capability or not. Which were those programmes?

Mr Turner: I think Lord Drayson and the team looked hard right across all sectors of what was needed on shore and, in concert with the DTI and Treasury at the time, they came to the view that these capabilities for operational sovereignty reasons and security reasons were needed UK onshore and it was believed could be funded onshore UK rather than going to buy off-the-shelf with the long-term negative consequences of that in terms of cost and operational sovereignty. In the event that has not proved to be the case and for some time we did push as an industry for a DISv.2 to reflect the reality. The situation as of today is that we do not think that is as much an indicator of the long-term interest in maintaining capability as the discussions about Lynx and about future Typhoons and so on.

Chairman: I would entirely agree. I think it is an absolutely crucial issue of capability as a country over the coming decades.

Q97 Linda Gilroy: If you are going to be able to offer us a note on that in relation to the protect and prevent strands of the National Security Strategy, what else is happening in terms of research and development and trying to make that cross into other government departments? I guess this will partly be resolved by the new committee on the National Security Strategy?

Mr Godden: Yes.

Q98 Chairman: Can we get on to the UK and the US and also exports. The Trade Co-operation Treaty has yet to be ratified. Are you hopeful that it will be?

Mr Turner: I think it is very important for future cooperation across the Atlantic that it is ratified. We were disappointed, as I know the MoD and Government were, that it was not ratified before Congress broke up this time. We are optimistic that by the summer of next year, yes, we will get there.

Q99 Chairman: Will it make much of a difference to the British defence industry?

Mr Turner: A lot of difference. The fact that companies and governments can share research and development money across the Atlantic in an open
way would be a very good thing and there would be benefits to both taxpayers and to the Armed Forces of both countries. Yes, it is very important.

Mr Keen: I think the benefits will increase progressively. We may see at the outset that the areas in which we are able to make a difference will be relatively small because I think it just makes sense to take it in bite-sized chunks, but ultimately, as we go forward, it will make a huge difference.

Q100 Chairman: There was a recent article in Jane's Defence Weekly which suggested that the UK industry and the MoD were developing ITAR-free programmes. What does that mean in practice?

Mr Keen: Well, I guess it means if in particular areas the MoD are concerned about access to US technology they will drive a capability that is free from US technology.

Q101 Chairman: So it would be ITAR-free?

Mr Keen: If it were the case.

Q102 Chairman: It would be helpful to US industry to see what progress could be made on this Treaty?

Mr Keen: I think so and I think you had Dr McGinn give evidence to you from the AIA last year setting out how supportive that association is of the ratification of the Treaty, and certainly from the time I was in Washington a couple of weeks ago that support is still very evident. I think the industry over there is supportive and we have just got to take advantage of that and hope that Vice President-Elect Biden, who was the Chairman of the Senate Foreign Relations Committee and was supportive of the Treaty in that role, gives us support within the Administration in an effort to put it high enough on the Congressional agenda.

Q103 Chairman: The Administration has never been the problem there?

Mr Keen: No.

Q104 Chairman: Can I get on to exports. I will ask this in as neutral a way as I possibly can because there are two stories on it. What was the effect of the removal of DESO from the Ministry of Defence and marrying the new organisation into the Department of Business, Enterprise and Regulatory Reform?

Mr Turner: We were very concerned, as you know, as an industry when the Prime Minister took the decision to move it. However, we are pleased with the result. We have worked hard with government to make the transfer as seamless as possible and to keep—this was the important thing—the MoD involved. All the evidence to date is that the MoD are very much still involved in supporting the export of UK products, so it has gone far better than we dared fear at the beginning. Is that fair?

Mr Godden: Yes.

Mr Keen: I think it is fair enough. I am fresh from the DESO Defence Advisory Group of which I am a member yesterday, as indeed is Ian Godden, and I think it is very clear there that Richard Paniguian, the new head of the DESO, is absolutely clear that the key test of how the arrangement works will be the extent to which they deliver ministerial support particularly from the MoD, and more general support from the MoD, so I think it is absolutely on his agenda. The other important factor against that background is the fact that John Hutton has made it very clear over the last couple of weeks that he is going to take a personal interest in supporting defence exports. I think that is a hugely important commitment to industry.

Dr Wilson: I think there has been a very positive development on exports with regard to the MoD in the last year. In the first DIS there was hardly any mention of it and in some of the documentation that we have seen from review, using exports to maintain the UK’s capability is actually described as white. It is very attractive to us to see that support for export because they have realised the on-going benefit it would give to keeping the industrial capability which will then deliver through-life capability to real programmes in the UK. I think that is a very significant change and is to be welcomed and maintained.

Mr Turner: It is always helpful of course if you have products to export! Hawk has proved, if you get it right at the beginning, what it can do for the country. It would be useful to FRES and it would be useful to have Typhoon fully developed as a multi-role fighter. It would be useful to have frigates to export and that is why again the campaign to improve the situation is so important.

Q105 Chairman: Can I ask you a question about some of the things that we do try to export. Might there be a criticism perhaps of the Ministry of Defence that the equipment that the Ministry of Defence buys is so sophisticated, so difficult to operate, so expensive, that other countries cannot afford to buy it and therefore that damages our export markets and also therefore the Ministry of Defence’s own capability?

Mr Turner: It is how seriously you take defence and your Armed Forces. Clearly we have a history of wanting our Armed Forces to play at the highest level and you have to give them the highest level of capability. I remember the Horizon Frigate Programme where we were unable to come to a conclusion in Europe because the requirements of the Royal Navy, rightly, were that they were possibly going to fight with these ships. Other countries, dare I say, did not have the same view and therefore we have to have capability that supports our Armed Forces. The good news on the Future Frigate Programme, if we ever get there, is that we are looking at a modular construction where you have units you can put on the hull that will be for the Royal Navy and a lesser capability for export markets, and I think that is the kind of thinking that we need. Today we have an aircraft second to none in Typhoon that if we fully develop to its multi-role capability there is not a competitor in the world for the capability and the cost of that aircraft. That is why I am appealing to the MoD to finish the job on Typhoon. Again we come back to the budget. That would be a wonderful export for this country to a number of countries.
Mr Godden: Just to reinforce Dr Wilson’s point, the exportability issue has clearly come up the agenda. I think that is probably one of the issues where we have, as it were, benefited from the thinking over the last six months or so in terms of the economic impact, because there is an economic impact. Clearly that has very little effect in the short term, but in the medium term this is very important for the period when we all think that there is going to be a pay-back period of some sort in two, three, four or five years’ time. Maintaining our success at defence exportability to the type of nations that we are comfortable with, which is a Government policy, is a very important thing to encourage and to encourage the changes in attitude that go with that.

Dr Wilson: Can I just come back to DIS again and emphasise how right it was. Its emphasis on systems engineering and its emphasis on open architectures are exactly the things that enables things to be developed for the UK and then slightly different things exported within the constraints that the Government wishes to place on them. I think that is why we were really enthused by the original Defence Industrial Strategy. It got so much right that it does not just permeate the UK programme but it enables UK industry to get to the point where we could have open, architected systems and plug-and-play components that would allow you to adapt it to whatever market you wished to play in, and that seemed to me at the time fundamentally a good thing. As I have said before today, I hope the MoD continues with that thrust and its support of exports using that principle.

Q106 Linda Gilroy: I realise that our time has come to an end but I have a fairly small question and it was really just to pick up on a point that Mike Turner was making earlier about the representations in relation to the pre-Budget statement that we are expecting and the extent to which the supply chain, small and medium enterprise part of maintaining employment has been stated as a case within the global case that you would have been making. Do you feel that has been made strongly as part of your representations and can you just for the record of the Committee perhaps give a broad-brush outline of how important that is?

Mr Turner: Just to reiterate, we have more SMEs in the defence industrial base of this country than Spain, Italy, Germany and France put together. SMEs are a very important part of the defence industrial base. They are suffering now because, frankly, the primes are suffering on the major programmes. We are not flowing down and are unable to flow down money to the supply chain. We have made the point about SMEs in the defence industrial base. Frankly, I do not think we are being listened to. I do not see us as part of the stimulus package and I think it is a mistake.

Q107 Chairman: I think we will end on that point and thank you very much indeed for a very interesting and very helpful evidence session to start us off on this inquiry. We are most grateful.

Mr Turner: Thank you very much.
Tuesday 25 November 2008

Members present:
Mr James Arbuthnot, in the Chair
Mr David S Borrow  Mr Brian Jenkins
Mr David Crausby  Robert Key
Mr Adam Holloway  John Smith
Mr Bernard Jenkin

Witnesses: General Sir Kevin O'Donoghue KCB CBE, Chief of Defence Materiel, Dr Andrew Tyler, Chief Operating Officer, DE&S and Rear Admiral Paul Lambert CB,Capability Manager (Precision Attack) and Controller of the Navy, Ministry of Defence, gave evidence.

Q108 Chairman: Good morning. General, welcome to the second evidence session into Defence Equipment. I wonder if you could possibly introduce your team, please.
General Sir Kevin O'Donoghue: Thank you very much; I am delighted to be here. Dr Andrew Tyler is my Chief Operating Officer in DE&S; and Rear Admiral Paul Lambert is Capability Manager (Precision Attack), and also Deputy Chief of Defence Staff Equipment Capability designate.

Q109 Chairman: I am very sorry—I should have introduced you as CDM. Let us begin by asking about the question of the equipment that is used in current operational theatres. What is the state of the examination that you are doing into the equipment that is used in operational theatres? Have you produced any terms of reference for that examination? When do you think that the examination will be completed, because the impact on that equipment is very heavy at the moment?
General Sir Kevin O’Donoghue: The equipment examination is an examination into the equipment programme; it is not an examination into the UOR programme.

Q110 Chairman: In our last report we said in paragraph 56: “We note that the MoD has initiated a study to assess the impact of current operations on equipment, such as vehicles, and the subsequent costs of recuperation. We see the costs of recuperation as a cost of operation to be funded from the Reserve . . . ”, and we will come on to the brief examination into procurement in due course, so this is about a different issue.
General Sir Kevin O’Donoghue: I am sorry, I did not understand. What you are saying there as I understand it is the cost of recuperation. That work is in hand; it is in hand in the equipment capability area; we are looking at the costs; we are looking at the timescale; and it is not yet ready to report. If I may, I will turn to Admiral Lambert.

Rear Admiral Lambert: That is exactly it. We are still in the middle of looking at this. There will be a debate on the costs and where those costs fall. We are in no position yet to say precisely where we are.

Q111 Chairman: Have you an idea of when you will report on that? Is it a formal inquiry of any sort which will produce something that might be published?

Rear Admiral Lambert: No, it is a continuous investigation on the equipments; how quickly they are being burnt up; and what the issues are on recuperation etc. It is a continuous process.

Q112 Chairman: Are you concerned about the general impact on equipment in current operational theatres; and do you expect capability gaps to arise from the heavy attrition that is happening to equipment there?

Rear Admiral Lambert: As far as attrition goes, no, because things that are attrited get replaced under the Reserve. We are looking very carefully at whether we are burning up equipments faster in theatre than had been programmed. I had a look this morning at the air systems, the helicopters and the aircraft, and they are not being burnt up any faster than we had predicted. In that particular area, that is not going to be an issue.

Q113 Chairman: What role does the Defence Support Group have in this recuperation work?

General Sir Kevin O'Donoghue: The Defence Support Group is constantly involved in recovering and repairing vehicles as they come back through the system (base overhauls and so on) as they have always done; but of course the workload is heavier at the moment. They are also involved in theatre. They are also involved in BATUS² in Canada where some of the training for theatre takes place. They will almost certainly be involved in whatever recuperation process goes on. They are the UK’s experts in recovery and recuperation of armoured vehicles.

Q114 Chairman: Is the Treasury funding that recuperation work out of the Reserve, or is it something that falls on the MoD’s main budget?

General Sir Kevin O’Donoghue: I do not think we have discussed that yet. I can see it being quite difficult to discuss. Until we know the costs—which we do not yet—it is quite difficult to have a discussion about who is going to pay for it. We are not there yet.

Dr Tyler: One of the difficulties intrinsically in being in enduring operations is that you have got a bit of a moving target here, because you are using different equipments at different times in the way that the theatre threat changes for different equipments into theatre. We have got a constant programme obviously of responding to theatres needs, so you

² British Army Training Unit Suffield
cannot be specific at any particular point in time about exactly what the sort of volume, type, scale and nature of that recuperation is going to be. That is why any look at this has got to be on a continuous basis. I would expect the discussions with Treasury would also be on a similar basis.

Q115 Chairman: Are you not able to relax into the knowledge that the Government normally funds the costs of operations from the Reserve? Is this not an ordinary cost of operation?  
Dr Tyler: I think that is a debate that is ongoing. We have been very focussed up until this point on ensuring that we are having the right equipment in theatre, and that the Treasury are meeting their commitments to us in terms of funding the additional cost of current operations. That has been the focus hitherto.

Q116 Chairman: Why is that a debate?  
Dr Tyler: It has not been a debate to date, but I think going forward, when we are talking about recuperation, which is intrinsically a longer-term activity, then I think that debate will have to continue.

Q117 Chairman: From the sound of things, you are not confident that the costs of recuperation will automatically be met from a contingency Reserve?  
General Sir Kevin O'Donoghue: No, that is correct, but then I do not know yet what the costs of recuperation are going to be.

Q118 Chairman: We understand that.  
General Sir Kevin O'Donoghue: It is difficult to have a debate as to where the costs should lie when you do not know what the costs are.

Q119 Chairman: Is it not a matter of principle that operations are covered by the contingency Reserve?  
General Sir Kevin O'Donoghue: That is some operations—most operations—operations not part of the contingency, yes, you are right.

Q120 Mr Jenkins: I am in a bit of difficulty now on two fronts: firstly, the principle front, I thought the costs of operations were met by contingencies, and the cost of damage to any equipment being part and parcel of the operation would be funded out of the contingency. Secondly, exactly on what timescale do you do your accounting? I should have thought, having operations that have gone on for three months or four months, yes, you would have difficulty in costing it out; but these operations have gone on a little longer now. Are you telling me that the cost of repairing and maintenance of operational equipment for five or six years ago has yet to be allocated?  
General Sir Kevin O'Donoghue: No. In the first of your two points you make you are absolutely correct. The costs of those operations are covered by the contingency Reserve. The cost of repairing vehicles that are required to be repaired, replacing and buying UORs, the cost of those operations is covered by the contingency Reserve. That is on a continuous basis, as Dr Tyler has said. What I thought we were talking about was, if one of these operations ceases and then everything comes out of theatre, if that were to happen, who then pays for the cost of doing whatever needs to be done to it? Bear in mind, a lot of it will have been brought up-to-date, brought up to the most recently required specification anyway, and that is paid for out of the contingency Reserve. We are talking about something which is a bit of an unknown here, and that is our difficulty.

Q121 Chairman: Do you spend the money before you know where it is coming from?  
General Sir Kevin O'Donoghue: No, because we are still in theatre. Everything that is being repaired—everything that requires to be recuperated, if you like, on an ongoing basis—is paid for by the Treasury. I thought your question was about when something stops everything comes out and is sitting there who pays for that to be recuperated? That is quite a difficult debate to have until we know how much has to be spent on doing what to it, and what the requirement is.

Q122 Mr Borrow: Is essentially the argument that if kit is brought back out of theatre if that kit had been used in ordinary training exercises the funding of bringing that up to scratch would come from your ordinary budget?  
General Sir Kevin O'Donoghue: Yes, correct.

Q123 Mr Borrow: But there will be extra costs because it had been in theatre, and therefore there will be a debate as to what proportion of that cost when it comes out of theatre should be met from your ordinary budget, and what proportion should be met from the contingency Reserve, and that is the key issue which has not been resolved?  
General Sir Kevin O'Donoghue: Indeed.

Q124 Mr Jenkins: We did bring a lot of equipment home from Iraq so that was repaired and maintained. Who picked the bill up for that?  
General Sir Kevin O'Donoghue: The answer is that I do not know. I would have to come back to you on that. I do not know I am afraid.

Q125 Chairman: We hear that the Harrier Force is coming back from Afghanistan, to be replaced by Tornados. Who will pay for the cost of recuperating those?  
General Sir Kevin O'Donoghue: The Harrier Force is in very good condition and the aircraft that are out there do not need recuperating. The aircraft that are there are fit to fight. They are at the standard for theatre entry and they are good to go.

Q126 Chairman: So why are they coming back?  
General Sir Kevin O'Donoghue: This is to give the Force a rest. It has been out there for five years. This is very much the Chief of the Air Staff’s business to advise the Defence Board and Ministers on what should be deployed where. This is not an equipment issue.
Q127 Chairman: We heard in a debate in the House of Commons last week that £860 million has been spent on fine-tuning the Harriers to get them operating as well as they can in Afghanistan. Is that money that was Harrier-specific; or is it money that could be applied to UORs or to equipment that, like pods could be moved to perhaps the Tornados that are going to take their place?

Rear Admiral Lambert: Most of the urgent operational requirements for Harrier are Harrier-specific, and another set of UORs are being staffed through before they can be turned into a Tornado Force. The Harrier Force is being brought back, not only to give the Force a rest but also to give the Force the ability to be able to be deployed on other operations. They have been in theatre now for five years and their tasking has been very specific. The more general tasking that one would want for aircraft has not been done. That wider training piece and wider deployability piece is why Harrier is coming home. The GR4s are being fitted with the new UORs at the moment.

Q128 Robert Key: General, DE&S appears to be supporting the frontline very effectively. In January last, when you appeared before the Committee, we asked you “what keeps you awake at night” and you replied “current operations”. Is that still the case?

General Sir Kevin O'Donoghue: Yes, it is. If anything were to keep me awake then it is support of current operations. That is where it is so vital that what we do we do accurately and effectively.

Q129 Robert Key: What are those specific issues about current operations that concern you most?

General Sir Kevin O'Donoghue: Do the Forces in theatre and the Forces in contact have the right equipment? Is it the best equipment that we can give them? Is it properly integrated? Do they have the right amount of combat supplies, ammunition, food and so on? That is going well. I think the answer is: yes, they do. To answer your specific question: that is what I do worry about.

Q130 Robert Key: What would be top of your wish list for supporting current operations?

General Sir Kevin O'Donoghue: Things we have perhaps not quite got right yet. I think it would be more strategic air. I think the great raft of other issues—and I am skating round some of the technical issues here which I do not want to talk about in public—I think we are doing alright on. I am happy—and this comes from the commanders in the field—that our Forces are the best equipped that they can be. I do not know if you saw Andy McNab over the weekend, if I can quote him, saying that the American infantry are looking to use the British infantry’s equipment. That is an interesting comment.

Q131 Robert Key: It is a great compliment.

General Sir Kevin O'Donoghue: I think that is where I would come from.

Q132 Mr Crausby: We have an elderly transport aircraft fleet, so to what extent is that affecting your ability to support current operations? Do you have a fallback position if, for example, TRISTAR was unavailable and needed maintenance?

General Sir Kevin O'Donoghue: Can I answer in two parts. First of all, the air bridge is successful. Something like 80% of aircraft leave Brize Norton within four hours of the time that they said they would, and that is not bad bearing in mind the challenges they meet at the other end. The plan to deal with aircraft on the ground is a hub and spoke method—it is spare aircraft and so on—that works. What we do about delays to incoming aircraft, aircraft that we are procuring (A400M is a good example) is a secondary issue, and I am very happy to talk about that if you wish. I am satisfied that the air bridge is workable. I think it is fragile and that, in answer to Mr Key, is my biggest concern at the moment.

Q133 Mr Holloway: Is there a crunch looming in terms of the air transport fleet in 2012 or 2014?

General Sir Kevin O'Donoghue: We have got a number of alternatives. We have got the C130s which are fine; we have got the Ks which should be going out of service—we could extend them at a cost, that is one option; we could try to bring forward the A330s from the future strategic tanker aircraft—that is another option we are exploring; we could buy more C17s—that is another possibility. There are a number of options sitting on the table. There are also some commercial options as well—we could hire aircraft. There are a number of options sitting on the table. The key here is to find out what the schedule for delivery of the A400M is, and that is the challenge at the moment.

Chairman: We will come on to that, as you no doubt could have predicted, later on!

Q134 Mr Crausby: What about transport assets in general: are you content with other assets, or other non-aircraft assets, such as ships, land vehicles and helicopters?

General Sir Kevin O'Donoghue: Yes. Ro-Ros are good—they work well; and shipping we can take up from trade fairly easily to get the sea line of communication out to Karachi or out to Iraq. I am happy with that. Helicopters—you can always use more helicopters. We can increase the flying hours—over 35% in theatre—and there are more aircraft on the way. Yes, I am satisfied. As I say, one of my highest risks is the strategic air as far as transport is concerned.

Q135 Mr Borrow: From what the Committee have seen and heard the Urgent Operational Requirements process has been a success. Is that still working effectively? How effective is that process currently? Are there aspects of the process that you would wish to see improve further and, if so, what are they?

General Sir Kevin O'Donoghue: Yes, it is working successfully. It is continuing to work successfully. You can always make improvements, but I am
satisfied that the UOR process is working well. Let me just ask Dr Tyler under whose remit it falls for some more details.

**Dr Tyler:** This is practically our top focus in ensuring the delivering of UORs. Earlier this year we established a UOR programme office whose specific remit was to look across all of our areas of UOR activity, and make sure that we were continuously trying to improve delivery. Indeed, the numbers for this year so far have improved on last year’s numbers. Last year we were delivering 67% of our projects at their 50% forecast; and 86% at their 90%; and this year we have improved—79% of them being delivered at their 50% forecast; and 89% at their 90% forecast, so we are on an improving trend. One of the things that is an increasing challenge for us is the technical complexity and scale of some of the UORs, the sophistication of them. Some of the pieces of equipment we are putting in under UORs previously would have been small core, programme projects in their own right; but of course what we are having to do is get them into theatre very, very quickly. That is certainly putting pressure on our resources and the time and effort we have to spend on prosecuting the UORs. Currently there is something of the order of 700–750 of our staff engaged in the UOR activity, and we are making sure that across our organisation we are balancing our resources across the whole of our current projects and support to ensure that the UORs are getting the priority. Overall we are certainly on an improving trajectory on what was originally a good position in the first place.

**Q136 Mr Borrow:** In February 2006 Lord Drayson, who was then at the MoD, appeared before the Committee, and he said that he wanted to see the best aspects of the UOR process applied to longer term projects. I would be interested to learn what has happened since then in terms of applying the best part of the UOR process in ordinary procurement processes; in particular the extent to which there are aspects that could actually speed up the ordinary process of procurement of major projects?

**Dr Tyler:** I think this is something we have thought a lot about, and there are some areas like, for example, the way we are using our resources more flexibly, which is a lesson we can pull over. I would approach this one with some caution though, because the UORs are very different in their nature from the longer-term core projects. We do tend to trade quite rapidly between performance, cost and time, because time is obviously a very, very critical variable with these projects. Certainly hitherto we have not paid a huge amount of attention to ensuring support solutions, because they are designed to be short-term requirements. That is now changing; and one of the things that is increasing our UOR activity is the need to have a more enduring support solution to go along with some of these UORs. The other thing is that, generally speaking, they are not implemented within an integrated framework of defence capability; they are put in as individual measures. Although we do our very best to try and ensure that they are integrated as best as possible within the wider infrastructure, the speed at which these are being implemented means that they are often coming in as single item, almost stand-alone equipment with minimal integration. When we are looking at the longer term strategic programmes those are areas which we would have to think very carefully about if we were going to compromise. What that means is that when we are looking at the lessons we can pull through, we have to look quite carefully. I think one of the positives, and we are challenging this, is the speed at which we perhaps make decisions, and some of the administration that goes along with the projects. Those are areas which you could argue, up to a point, are non-value-adding activities in the acquisition process. Obviously we are demonstrating that we can short-cut those through the UOR process. Bear in mind that some of those short-cuts in themselves are compromising the absolute degree of scrutiny that is going on on some of these projects, because the urgency of the requirement overrides that.

**Q137 Mr Borrow:** Are you really saying that the optimism that seemed to be there two and a half years ago has not actually been fully justified?

**Dr Tyler:** I think we are doing what we can, but we also very conscious of the law of unintended consequences here. If you start applying this sort of process too liberally to what is a strategic core programme, I think our view is that you would find a lot of unintended consequences coming out as a result of that.

**Q138 Chairman:** Has this UOR approach meant that, for example, the vehicle fleet is now much less cohesive and coherent than it previously was?

**Dr Tyler:** Yes, I think that is the case.

**Rear Admiral Lambert:** With trading almost in every area other than time you will end up with non-integrated systems. It is the criticism of UORs now that we have not integrated well enough, and that is because we have tried to get them to theatre as fast as we can. It is a criticism we accept, and we are now going back to see how we can integrate some of these systems together to get a more cohesive Force.

**Q139 Mr Jenkins:** I was very interested in Dr Tyler’s answer, because it is not about the piece of equipment Lord Drayson was talking about, I think he was talking about the process and the culture. It is this culture of “let’s make sure everything is nailed down, screwed and painted three times” that takes up so much time and so much money there is nothing left for the actual project. Unintended consequences are in all walks of life, so do not try and make this a reason why it is not done; but let us make sure we can streamline the process. I can get you legacy projects that would make your hair curl in the MoD. They are an absolute national disgrace because, as a client, you were not that clever: a contract was taken for a ride for years. Are you, through UORs, becoming a cleverer, more intelligent client; and can the process be speeded up so it does not become a long-term legacy project, but can deliver for the amount of
people we need to deliver to—the ones at the frontline? That is all we are asking. Has the culture changed?

**General Sir Kevin O'Donoghue:** I think the answer is, yes, it has. We are much better now at accepting that it is very much more effective to have an 80% solution tomorrow, than a 100% solution in 10 years. That is one area. I think we are much better at the scrutiny and assurance process. We still need to scrutinise and assure these projects to make sure they are value for public money but we are much slicker at it; we are much better at it. Yes, there are a lot of things that we are doing very much better; but we do need to remember a UOR is going into theatre for perhaps six months, perhaps nine months, at which point life will have moved on—either the threat has changed or the requirement has changed and we need something else. Something out of the equipment programme is probably there for 15, 20, or perhaps 30 or 40 years. We just need to draw this balance between rushing in for a UOR which is fine for the circumstances of today, and not rushing in and doing that for something that will have to be adjusted. This is all to do with open architecture and incremental improvement as we go through its life; but the base vehicle has to be thought through so that it is upgradeable as circumstances change.

**Q140 Mr Jenkins:** I understand that, but surely there is no guiding rule or unwritten law within the Department that a piece of equipment that is going to last for 20 years should take 20 years to procure, is there?

**General Sir Kevin O'Donoghue:** No, and it is a very fair criticism. It used to. Setting aside one or two of those projects which have been going on for many years already, I would be very disappointed if anything that we were setting off on procuring now—out of a requirement from the requirement and capability area, through Dr Tyler's organisation, and through mine—if you could accuse us of the same problems in a year or two.

**Dr Tyler:** We must be clear about the difference in the scale of the endeavour of most of the UORs; which might be some new sites, or might be some new piece of communications equipment, by comparison with, let us say, a new nuclear submarine. Just the size of the endeavour, the amount of public money that is being committed, the rigour that needs to go in to ensuring you are getting the requirements right (because the cost of changing those requirements as you know only too well is so enormous later), the amount of rigour that has got to go into that whole process is of a completely different scale from what it is when we are talking about a UOR—the investment for which might be a small number of millions, maybe tens of millions at the most.

**Q141 Mr Jenkins:** General, do you think you could take this opportunity to dispose of something that we in the defence world are often accused of which is being in the pockets of certain leading manufacturers and not being open-minded enough about buying off the shelf. The example always thrown to us is about helicopters. Why are we buying expensive bespoke helicopters? Why do we have the future Lynx programme? Why do we not just buy Sea Hawk or Black Hawk off the shelf much cheaper? Can you use this opportunity to explain why we do things in the way we do them?

**General Sir Kevin O'Donoghue:** I do not actually agree with you that we could buy a helicopter which you could fly off the back of a ship and fly in the battlefield and have a common helicopter. I do not agree that we could buy that cheaper. Yes, you could buy a cheap one no doubt to fly in a land battle space. I do not think you could find an aircraft that could fly off the back of a ship much cheaper. Then you are back into something the Chairman was talking about earlier, which is a lot of very small fleets, and you do not have coherence across the fleet. I would actually challenge your original premise, if I may, which is that we do go through the value for money argument in quite considerable detail. The Defence Commercial Director, my own DG Commercial and the Treasury, when our projects go to them, and the equipment capability customer, who is the guardian of our budget, are very careful that what we are buying is value for money.

**Dr Tyler:** I would add the fact that we have got some of the best defence equipment manufacturers in the world in the UK. As we have some of the best defence equipment in the world it is not unlikely that we will be turning to our industry to source quite a lot of our defence equipment. The other thing I think is worth adding to is the fact that, in order for us to have an operationally sovereign capability in the UK, particularly when you are in the in-service phases of equipment, that ability to be able to make decisions at a time of your own choosing does require us to sustain an industrial base within the UK, and you cannot sustain an industrial base unless they have a continuing supply of work to do so. Our challenge is getting the balance between the sustainment of that capability inside the UK in order so that we can be a sovereign nation, along with the value for money to ensure that at any point in time that industry is not oversize for the activity that we wish it to sustain.

**Q142 Mr Jenkins:** I agree with all that, but I think the difficulty arises as we tailor these programmes and take so much time over them we add risk and cost to those programmes, which rather undermines the argument. How are we going to explain to these off-the-shelfers that the extra risk in costs is still worthwhile?

**General Sir Kevin O'Donoghue:** Off the shelf is very often the only answer for a UOR. Off the shelf means you are buying almost probably the last of the last generation of equipment. If you want it to last 30 or 40 years you are pushed. What you need is something which has that stretch potential; has open architecture; has the ability to be upgraded throughout the rest of its life (for example if we are talking about aircraft) either as civil aviation requirements change, as the threat changes, as the
25 November 2008  General Sir Kevin O’Donoghue KCB CBE, Dr Andrew Tyler and Rear Admiral Paul Lambert CB

weapons systems change. Yes, you can buy something o

something off the shelf for today as we do with UORs but you probably then would need to buy something else off the shelf in five years’ time.

Q143 Mr Holloway: An Admiral recently said to me that he felt the best was often the enemy of the good. Do you agree?

General Sir Kevin O’Donoghue: Yes, I do.

Q144 Mr Holloway: That is straightforward! But in this context?

General Sir Kevin O’Donoghue: Yes, I do. I was saying earlier, we need to be clear: do we want something which is 100% of what we thought we wanted five years ago, and will get it in five years’ time, maybe—but then the requirement is changed because the threat changes and the security architecture changes; or do we want something which is 80% fit for purpose and we can get it in six months or a year’s time? Going back to Dr Tyler’s point, you just have to temper what I have said with the size and the complexity of the project. You cannot buy an 80% solution to a nuclear submarine in six months’ time. You really do have to think that through. With some of the less complex equipments, I would agree with you entirely. I think we do sometimes over-specify, and that is where I think you are coming from.

Dr Tyler: One of the things your Admiral would recognise is the fact that we have very much been applying the best is the enemy of the good principle on the major future naval platforms. Carrier went through an extremely rigorous capability trading process to ensure that we were buying what was absolutely necessary, and reducing the technical risk in the project. The MARS Fleet Tankers have been through exactly the same process, and led by an Admiral. We are right in the thick of it, Admiral Lambert and I, with the future surface combatant requirements—applying exactly that principle.

Rear Admiral Lambert: I think we are far better at trading than we were in the past. I think in the past we did put down a requirement which was perhaps the 100% requirement, and it is one of the things probably we have learnt from the UORs, that we do trade across performance, cost and time, so that we get the capability we require within the timescale and within the cost, rather than going for the 100% solution.

Dr Tyler: Something else that is really helping us as well and it should be said is the way that technology has evolved over the last decade or so. The whole way that particular electronic and software technology has evolved is much more towards these open system architectures—the sort of things we enjoy even in our home environment with our pc computers, the so-called “plug and play”. In the past that was not the case. The technology was much, much more rigid which meant your ability to buy something that was the 80% solution initially and upgrade it over a number of years or possibly decades to ultimately be your 100% solution, that was a much, much more difficult thing to do 10 or 15 years ago. Not only have we culturally changed our view on this, but also the technology has become an enabler to allow us to do it.

Q145 Mr Holloway: On the same theme though, say you go for the best value kit; none of us are naïve, there is also the political element in terms of sourcing things like ships in the UK. Do you ever feel that as military officers you could get greater equipment capability for your money if you sourced some of these major projects abroad? You might get more aircraft carriers, for example?

General Sir Kevin O’Donoghue: I am sure we could, but would we then retain the ability to upgrade them throughout their life and maintain them? Not so much the metal-bashing, but the complex mission systems and the weapon systems. If you just buy everything off the shelf from overseas you have got to go back overseas for some of these complex mission systems, and that is not what the defence industrial strategy and the policy is.

Q146 Mr Holloway: And the jobs question?

General Sir Kevin O’Donoghue: If you look at the defence industrial strategy, the principles, it basically said: what industrial capability do we need out there somewhere—not necessarily in the UK—in 15, 20 or 25 years’ time to produce military capability? Then it said: and which of those industrial capabilities could be anywhere, which you could buy off the shelf? Which need to be in a country of our choosing? Which have to be based onshore in the UK? That is what the defence industrial strategy said. That is what we are working to, and that is Government policy. That is the issue we are working to at the moment. You are aware the Secretary of State reassorted those principles with this Committee, or certainly in Parliament, quite recently.

Q147 Chairman: May I ask in open session something which is quite important: who, below ministerial rank, is in charge of the defence industrial strategy?

General Sir Kevin O’Donoghue: Who writes it? Who is leading it?

Q148 Chairman: Who is in charge of it?

General Sir Kevin O’Donoghue: The Defence Commercial Director is leading the revision—DIS2, as we know it.

Q149 Chairman: No, that was not what I asked. Who is in charge of the Defence Industrial Strategy?

General Sir Kevin O’Donoghue: I am not sure I understand the question. Minister DE&S is the lead Minister for it, on behalf of the Secretary of State; but the Department within MoD that is responsible for writing it, if you are talking about the new one, is the Defence Commercial Director. The departments responsible for delivering DIS, which is current policy, is Equipment Capability, ourselves and the S&T community.
Q150 Chairman: Last week Mike Turner, speaking on behalf of the National Defence Industries Council, started an answer by saying, “If we had a defence industrial strategy . . .”, which implied that he, at any rate, and possibly industry in general no longer thought that we did.

General Sir Kevin O’Donoghue: I am absolutely clear that we do and it is on the stocks and that is the one we are operating to.

Q151 Chairman: You would not be the lead person then below ministerial rank who is in charge of the Defence Industrial Strategy?

General Sir Kevin O’Donoghue: Correct.

Q152 Chairman: Is there anyone who, within the Ministry of Defence below ministerial rank, is in charge of the Defence Industrial Strategy?

General Sir Kevin O’Donoghue: The Defence Commercial Director.

Q153 Chairman: You are not talking there about the Defence Industrial Strategy 2?

General Sir Kevin O’Donoghue: Yes.

Q154 Chairman: Well I was not. I was talking about the Defence Industrial Strategy. Is there anyone below ministerial rank who is in charge of the Defence Industrial Strategy 1?

General Sir Kevin O’Donoghue: I am not really sure I understand what you mean by “in charge”. If you mean “delivering to it” because it is now policy, yes, I am; we all are.

Q155 Chairman: What I mean is driving it forward and ensuring that it is actually effective and carried into position?

General Sir Kevin O’Donoghue: Driving forward the current extant policy is the business of the Department and a lot of that falls on my shoulders.

Q156 Chairman: But there is no one overall person in charge, apart from ministers?

General Sir Kevin O’Donoghue: No. If you are looking at the S&T area then the Chief Scientific Adviser or Paul Stein. We have a policy there; we then all implement it. There is an acquisition policy board which will lead that, I suppose.

Dr Tyler: If your question is about how we are taking it forward, the Defence Industrial Strategy really has its tentacles into every aspect of the Department’s business. If you take a part of it, if you take one of the sector chapters, for example, in the DIS 1 and ask, how is that being taken forward?; the answer is that in most cases it is being taken forward by a sector strategy board. Those sector strategy boards I think in virtually all cases have myself as chairman or co-chairman of that board; the Defence Commercial Director is intimately involved in that; so also is the Chief of Materiel; and sitting around that table would be members of the S&T community; members of the front line command; members of the EC; and indeed Admiral Lambert has been sitting on the maritime one for the Maritime Change Programme. Those strategies are being taken forward and actually implemented. I could give you examples across the whole swathe of defence activity.

Q157 Chairman: Does it bother you or surprise you that defence industry seems to think that the Defence Industrial Strategy is now somewhere on a shelf mouldering away and gathering cobwebs?

Dr Tyler: I would love some of the managing directors, for example, in the maritime sector, the armoured fighting vehicle sector, the helicopter sector, or the fixed-wing sector to sit here and say that; because the evidence and their engagement in it has been very great over the last two years since the Defence Industrial Strategy was progressed. Indeed, there is lots of evidence that has come in front of this Committee of exactly the outputs from the implementation of the Defence Industrial Strategy: the partnering agreement with AugustaWestland; the formation of BVT in the maritime sector and the surface ship support project; in the armoured fighting vehicle sector—the work we are doing at the moment in maturing that sector strategy. There is evidence right across the piece, all of which has involved industry to a great degree.

Q158 Mr Jenkin: Is industry expecting too much from it?

General Sir Kevin O’Donoghue: I sit on the NDIC, and industry quite openly and publicly at the NDIC were clear that they did not want DIS 2 published until it could be published in its totality; and that cannot be done until PR09 is complete. At some point we will be able to publish DIS 2. Industry, I think, would have liked it a year ago, or two years ago; but until we have got our mind round the sector strategies and exactly the sort of funding that might be available for the various strategies, industry would rather stick with DIS 1.

Q159 Chairman: We were here last year and we were told last year that the Defence Industrial Strategy 2, although it was expected I think in November last year, could not be published because of the Planning Round 08. We are now in the position where it cannot be published because of the Planning Round 09. Is there ever to be an end to this process?

General Sir Kevin O’Donoghue: I am absolutely clear, the Permanent Under-Secretary has been clear that we will publish DIS 2 as soon as we are able to. Chairman, I really cannot go beyond that.

Q160 John Smith: I would like to go back a little bit on getting this balance right between value for money and adequate frontline capability. Do you think that we will ever get that balance right whilst the boards of our British defence industries are packed with retired military chiefs and retired senior civil servants from the MoD. Do you not agree that there is a conflict of interest in those roles? Do you feel comfortable that senior civil servants and military chiefs move seamlessly from their role representing the interests of the taxpayer to their role representing the sole interest of British companies?
General Sir Kevin O'Donoghue: I would not agree with that. I do not have a departmental view that we would not get the best value for money from industry. I do not actually agree with you because what you are doing is accusing me of something I find not at all correct. Do you not find that cosiness a bit dangerous if you are to get the best value for money from defence industry?

Q165 John Smith: Even if we accepted your explanation as to why you do not think there is a conflict of interest, do you not think this does shatter public confidence in your ability to do the job you are all trying to do? The fact that senior military chiefs, the very top civil servants in the Ministry of Defence, within a very short time of retiring from their well paid and well pensioned jobs in the Ministry of Defence, end up on the Boards of our biggest defence companies?

General Sir Kevin O'Donoghue: The fact that they were what they were originally cuts no ice with me.

Dr Tyler: In fact, if you actually look across the senior executives, if I can use that broad swathe, you will find that the large majority of the senior executives in the companies have not previously been either serving military officers or MoD civil servants. However, I do think it is important that the companies in our industry do actually gain the benefit; and they do gain a benefit by having the experience of those who have been in the military before and those who have been in the Civil Service before. Actually that underpins a lot of the understanding that we have between the MoD and industry. Indeed it is something this Committee has commented on in the past—about the need to have a better understanding between the customer and industry—because that is one of the things that in the past has damaged the relationships and contributed to the poor performance on some of our projects. To a degree, it is a very important feature to be able to have that knowledge within our industry companies and vice-versa. Myself, I originally came from industry; I had a short time in the defence industry, but before that I was predominantly in the oil and gas industry and the commercial shipping industry, and I feel I have brought a lot into the Department through that fertilisation of ideas across the industry and Civil Service boundary. I would encourage it, up to a point.

Chairman: It is certainly true that experience and knowledge should not be the sole disqualification from being involved in industry!

Q166 Mr Holloway: Obviously I agree with you and the Chairman on that point. Yesterday I was in a curry restaurant near here and there was someone from a missile manufacturer of my acquaintance with an Admiral of my acquaintance who is about to...
leave the Navy cosying-up for lunch. Do you agree with RUSI that the procurement budget is under-funded by £15 billion? As an extension of that: are we saying that, in order to keep, say, shipbuilding in the UK, we are reducing the number of ships available to defend the country?

General Sir Kevin O’Donoghue: I do not think you can simply say that the equipment budget is under-funded. Every programming Round it is a question of balancing aspirations, requirements and the amount of money available.

Q167 Mr Holloway: That is under-funding, is it not?

General Sir Kevin O’Donoghue: Every government department, I suspect, would love buckets more money, but there is not buckets more money. So we have to tailor the money that is available to what is really required and not the “nice-to-haves” and the “highly desirables”. It is really going back to your point earlier: let us get down to the 80% of what is really required and not the best being the enemy of the good.

Q168 Mr Holloway: My question is: are we not tailoring it to the domestic political requirements in terms of, say, keeping an industry like shipbuilding going, rather than the defence requirements of the country?

General Sir Kevin O’Donoghue: In the way we procure equipment, we are certainly doing it in the way the Defence Industrial Strategy says we should do it; and that is government policy, so that is what we are doing.

Rear Admiral Lambert: During the Planning Round we do look at the priorities in capability terms; and it is the highest priorities which get brought back first. It is not just to keep a sector going that we put it to the top of the priority list; it is the defence requirements of the country that have the highest priority.

Mr Jenkins: I think the concept of calls for extra finance for defence expenditure is great; and I am one of the people calling for extra finances; but I do not think it sits well when we have got in the other place people standing up and calling for extra finances when three former Chiefs of Defence Staff were in the pay of defence companies, which they did not actually state. I think that gels uneasily with the public out there. With regard to the concept about hulls, maybe we could get the hull made abroad but it is what is fitted in the hull that is important; that is where the money is, and that certainly could not be fitted abroad because we need to fit that ourselves.

Q169 Chairman: I see that you are nodding, Dr Tyler, and I think that is sufficient answer because that was largely a comment and we must not get into a debate but ask some questions. I am going to ask some questions about this short examination of the equipment programme. How short is “short”?  

General Sir Kevin O’Donoghue: If you are asking when will the announcement be made, I think the Secretary of State said that he hoped to make announcements before Christmas.

Q170 Chairman: Are you involved in that?

General Sir Kevin O’Donoghue: Yes. Our involvement in DE&S is to advise on costs, as the options change, and industrial implications.

Q171 Chairman: Do you advise on something that we discussed with industry last week, namely the issue of whether programmes should be cut in an entirety or moved to the right, stretched out? Do you advise on that?

General Sir Kevin O’Donoghue: I advise on the costs of doing either; but these will be options. I advise on the industrial implications of doing either.

Q172 Chairman: We were told by industry—and you may not want to answer this question, you probably will not—that the expectation was that programmes would be stretched out rather than cut. Would that be your expectation?

General Sir Kevin O’Donoghue: That it certainly one of the options.

Q173 Chairman: I thought you would not!

Rear Admiral Lambert: If I may add, that is a trade in time, and we talked about trading earlier—trading performance, cost and time with all programmes. There are times where one will trade time to reduce cost; and it is one of the trades that is open during every Planning Round.

Q174 Chairman: Does trading time usually reduce costs, or does it usually add costs towards the end?

Rear Admiral Lambert: It may well add costs towards the end. We have to look at the totality of it. It may reduce cost in a particular year, or years. It may increase costs over a complete cycle. It is one of the traits that we have to consider when we are looking at the totality of the programme.

Q175 Chairman: Your concern at the moment is costs now, is it not?

Rear Admiral Lambert: It is always one of the concerns. Costs now and whether the whole programme is affordable over the long period of time.

Q176 Chairman: To what extent might you fall into the category of saying, “We’ve simply got to have this programme in the budget still”, and the fact that it is going to cost a lot more in, say, 2012, because of the actions we take to stretch it out now, is just a burden that has to be borne.

Rear Admiral Lambert: This is something we go through during every Planning Round and then it is really a matter of priorities for the capabilities we require. If it is a “must have” for UK defence then it will have to be given the right priority.

Q177 Mr Jenkin: Future Lynx still has not gone through Main Gate. We seem to be spending money on it. Is that the most efficient way of buying this aircraft?

General Sir Kevin O’Donoghue: Yes, it has gone through Main Gate.
Q178 Robert Key: General, the MoD Annual Report and Accounts 2007–08 said that the short examination would focus on two issues, one was bearing down on costs and the other was “rebalancing the equipment programme to better support the frontline”. What does that really mean “rebalancing”?  

General Sir Kevin O’Donoghue: To better support the frontline in current operations. The balance is always here. We have to support the frontline on current operations. We must not lose the seed corn for the future. Have we got the balance between those two correct?

Q179 Robert Key: What does it mean for longer-term equipment programmes, and our ability to fight in future conflicts?  

General Sir Kevin O’Donoghue: That is what I am talking about: the seed corn for the future. We must not lose the seed corn for the future. We might not need as much equipment in a particular capability area now; but if we are going to need it in the future we must not lose it in totality. We have to keep that expertise going, the development, the research and the ability for soldiers, sailors and airmen to train in that capability area so we can use it in the future to the degree that we need to use it in the future.

Q180 Robert Key: Do you think the defence manufacturers understand that?  

General Sir Kevin O’Donoghue: Yes, Yes, I think so. It does not sit necessarily happily, I think, with some of the defence manufacturers who like big, long order books stretching out for many years; but I am afraid life is not like that at the moment.

Q181 Robert Key: On 18th November the Chairman of the Defence Industries Council, Mike Turner, said: “If you read any document that MoD puts out it talks absolutely clearly about current operations. We must not lose the seed corn for the future”. What then says about the future equipment programme is highly questionable. There is no commitment. It talks about having to consider the future equipment programme—the equipment examination. There is no commitment.  

General Sir Kevin O’Donoghue: Aircraft carriers, nuclear submarines, Successor, these I would suggest are the future commitment—not current operations.  

Dr Tyler: He might want to review the evidence.

Q182 Robert Key: He might want to give us a different answer. The Chief of Defence Materiel (Air) has reportedly said that he is concerned about the challenge of getting the balance right in supporting current operations and giving adequate attention to the longer-term programmes. Do you share his concern?  

General Sir Kevin O’Donoghue: I go back to what I just said: yes, I think we need to guard very carefully the long-term. It is easy to spend all the money that we have got on current operations. We have to guard the long-term. I think in the case of air I would share his concern entirely on air support and strategic air.

I have already said that. With the Typhoon, Eurofighter, Joint Strike Fighter—I think with the fixed wing fast jets we are guarding the future there. I do not exactly know what he was referring to. If he was referring to strategic air then I would share his view.

Q183 Mr Jenkins: Being outside the loop we have to peer in from a distance and through a murky glass sometimes, I have to admit. You have just said we spend all our money on current operations. Just how much of our current operations are supported financially from the contingency allowance, and how much are supported from the MoD? How do you find all your money being dragged in that direction when I thought we had been given an assurance that it should not be?  

General Sir Kevin O’Donoghue: If you look at soldiers’, sailors’ and airmen’s’ pay, for example, that is paid from the defence budget; we do not get that from the Contingency Vote. The equipment that they have already got—because it is part of their unit equipment table, or it is part of the normal war reserve when that goes out—that is part of the normal Defence Vote. If the equipment needs upgrading, electronic countermeasures, different radio fits, communications and so on, that is part of the Contingency Vote. I am not sure I can give you an answer in straight cash or percentage terms, but what is paid for out of the contingency is what is extra that is required to fight that operation.

Q184 Mr Jenkins: To my recollection we had about £6 billion a year spent on procurement of defence equipment. I do not know if that is the same ballpark today, but depending on how many people put their claims in for that procurement we had a profile, and I could never establish how much over that £6 billion we had got planned, and therefore were stretching projects to come and fit within the £6 billion. Are you saying now that maybe even that £6 billion is no longer safe and that has been scooped up for current operations?  

General Sir Kevin O’Donoghue: No. A very good example would be the example I have given you. An armoured vehicle that is deployed out on operations; an armoured vehicle that is part of the Royal Armoured Corps, for example, or part of an armoured infantry battalion; soldiers’ pay; the cost of a vehicle; the cost of maintaining the vehicle is paid for. If we need to put extra bits on for that particular theatre entry standard as it goes out, and as we have to upgrade those as it is in theatre for a number of months or years, the latter is paid for from the contingency fund.

Q185 Mr Jenkins: The £6 billion is still in place, more or less?  

General Sir Kevin O’Donoghue: Yes, absolutely.

Q186 John Smith: On this question of getting the balance right between frontline commitments now and our future strategic programme, is there any evidence that—that given the intensity of our frontline operations and the duration of time, which is far
greater than anybody I think really predicted to operate on two fronts—that is having an impact on the lifespan of the equipment which could affect the strategic programme and create capability gaps? I will give you an example. You mentioned the Harrier and withdrawing the Harrier for obvious training and the ability to be able to commit to other operations; but is there an issue of the life of the airframe on the Harrier; and of course the incoming Joint Strike Fighter? Are we creating gaps unintentionally; but are we creating gaps because of this frontline?

**Rear Admiral Lambert:** I covered the airframes earlier. The hours that are being flown are below that as predicted. The length the airframe can last is as predicted. It is not reducing that length of time. I cannot say about the armoured fighting vehicles, but I have not seen any evidence of that.

**General Sir Kevin O’Donoghue:** We will need to look at that. An armoured fighting vehicle, if it does more track miles in a year than we planned, you need to put new tracks on, new engines, new running gear and so on. There could be a fatigue life to the hull and that we will need to explore. Again, I am not aware of any.

**Dr Tyler:** One of the things you have to bear in mind here is that, when you look in the forward programme, we have got a mix there of things you could envisage, subject to theatre requiring them, being deployed on the sort of operations we have today. For example, the A400M would be a capability that in due course there might be a requirement in theatre for; and of course that is a strategic successor capability; it is a capability that we have currently got use for in theatre. On the other hand, a nuclear submarine directly supporting Afghanistan, it has possibly some role but you would not see that being a capability you were justifying on the basis of current operations. I think in our future programme we have got a mix of both. That is exactly the balance we are seeking to achieve on a continuous basis—not just this year through the equipment examination and Planning Round but we do this every year as we look across and try and get this balance between the things we need in the short-term and the things we need in the medium to long-term.

**Q187 Mr Jenkin:** Is this rebalancing not the final admission that the Ministry of Defence cannot make ends meet; it cannot do current operations and the SDR capabilities set out in the various White Papers; and the Ministry of Defence has made a choice (perhaps a rational one) to support the frontline operations at the expense of longer-term capabilities; or adding risk to what we might need for some future unnamed event, we are going to have less than we planned to have in the SDR, or it is going to come later because we cannot make the figures add up?

**General Sir Kevin O’Donoghue:** This is the debate we go through at every Planning Round. It is not a unique occasion. At every Planning Round the aspirations that sit out there in the frontline are invariably greater than the budget that is available. As I was saying earlier, a Planning Round is all about determining what is actually required and what fits in the budget. By the end of the Planning Round those two come together.

**Q188 Mr Borrow:** The MoD Annual Report and Accounts 2007–08 talks about the short examination focussing on “bearing down on cost increases to equipment programmes”. What exactly does that mean? How will it work in terms of reducing costs, and does it mean that the MoD is considering the cancellation of those projects with a history of escalating costs?

**General Sir Kevin O’Donoghue:** One way of reducing costs would be to cancel; one way, as the Admiral said, is to trade time. There are a number of ways of trading costs. A third is to trade the requirement; whether it is the totality of the requirement, or a portion of the requirement will depend on what that requirement is. There are a number of ways of reducing costs.

**Chairman:** You did not get an answer either!

**Q189 Mr Crausby:** The Committee wrote to the Ministry of Defence requesting a memorandum as part of our Defence Equipment inquiry, and we asked for an estimate of the extent to which the equipment plan was under-funded. We got a memorandum but we did not get an answer, in that they did not provide an estimate. I just wondered if you could help with a figure because other people provide figures. What is your estimate of how much the equipment plan is under-funded by?

**General Sir Kevin O’Donoghue:** Going back to what I have said before, that is an issue that comes out in every Planning Round. It is not a question I can answer. I would suggest the figures you might have picked up from RUSI and various other places are perhaps a tad ill-informed. Those people are not part of the internal Planning Round that goes on every year.

**Q190 Mr Crausby:** Someone has to have a guess in the end. Mike Turner at last week’s Defence Select Committee did have a go. He said we would need an extra £1.5 billion a year in order to keep the plan effectively on track. Over 10 years that is £15 billion. Do you recognise that figure as grossly over-estimated?

**General Sir Kevin O’Donoghue:** Where did Mike Turner get that from? Is that what he believes BAE Systems, when he was BAE Systems, would have needed, or what? I am unclear where that has come from.

**Q191 Mr Crausby:** He is speaking on behalf of the Defence Industries Council. He told us last week that an extra £1.5 billion a year was needed for the defence equipment budget. He does not see that from the point of view of just BAE Systems but the whole budget.

**General Sir Kevin O’Donoghue:** Interesting comment.
Q192 Mr Crausby: Is there no way we could get some kind of feel for this?

General Sir Kevin O’Donoghue: I think you will get a very clear feel once the PR09 Planning Round is through. This is what we are working towards.

Q193 Chairman: When do you expect the PR09 Planning Round to be finished?

Rear Admiral Lambert: Spring of next year.

General Sir Kevin O’Donoghue: It has to be finished around the spring because it is from the Planning Round that the control totals are set, and those we need before the start of the financial year.

Q194 Chairman: I remember that the number of troops in Basra was going to be reduced to 2,500 from the spring—that was rather earlier—so around the spring, you would say?

General Sir Kevin O’Donoghue: It should. I would like it to be set before the start of the financial year; if the programme goes according to plan that is when it will be set. I have known it in some years to be somewhat after the start of the financial year.

Q195 Mr Jenkin: It is not one planning round; it runs into another because the issues from one planning round simply are not resolved, and they therefore run into the next planning round.

General Sir Kevin O’Donoghue: I am not sure I would entirely agree with you. This year we were set control totals; I will come in on control total, or just below it. So I had some control totals. I had some outputs to deliver, I will deliver those outputs and I will come in on control total. Next year, at the start of April, I will get given different control totals and a different set of outputs from the equipment capability customer, or from the frontline commands. Those I will deliver.

Q196 Mr Jenkin: But the unfunded problems from one planning year are simply carried forward to the next year.

General Sir Kevin O’Donoghue: Yes. Some of them, of course, are aspirations. I think it is sometimes dangerous to try to cost aspirations as opposed to costing requirements, and that is where I think some of the external commentators are, perhaps, getting confused.

Q197 Mr Jenkin: I totally agree with you. I do not think we should cost a wish list, but I think we should cost a needs list.

General Sir Kevin O’Donoghue: Yes.

Mr Jenkin: Our difficulty—and you notice we keep probing—is that everyone in this room knows that our needs list is greater than the resources available, to be honest. We do all the fine things about pushing to commit and we know that our frontline capability is first-class and they deserve everything they get, but please help us to help you on occasions by giving us an indication—or someone before they leave office and speak from the other place—while they are in office, by saying: “Look, yes, we are a little short of our requirements at the present time”, because we do not mind taking up the baton on your behalf and fighting in this place to make the Government see that we do seriously need extra money to see our long-term requirements and procurement of equipment to make sure we can meet all these, and we do not put our frontline troops at greater risk in the future. I will not ask you to give the figure and I know that while you are in that uniform you are never going to say it.

Chairman: Brian, you are talking to the Government.

Mr Jenkin: I understand the position they are in, but really someone should start saying: “Look, it is not a wish list, it is a needs list.”

Chairman: Recognise the difficulty.

Mr Jenkin: I recognise the difficulty, Chairman.

Q198 Mr Holloway: It is a needs list. I think Lord Drayson said that the reason there was never a fully competitive process, for example, specifically for Future Lynx was because of time constraints. Is that really the way to be doing it? Should we not, if we are trying to get the maximum for the money, be looking at every possible option rather than stuff, perhaps, at the political level?

General Sir Kevin O’Donoghue: We did for Future Lynx, and I think I have already said if you are looking for a helicopter which can be the battlefield helicopter as well as the Royal Navy helicopter, then that is the best value for money.

Q199 Mr Holloway: There was not a fully competitive tender for this, was there?

General Sir Kevin O’Donoghue: There was certainly a fully explored analysis of all the options there were out there. There has been done several times.

Q200 Mr Holloway: With quotes from the other suppliers?

General Sir Kevin O’Donoghue: I do not know that they were quotes in that formal sense.

Q201 Mr Holloway: Would that not fit in to getting the best value and the best equipment for our troops?

General Sir Kevin O’Donoghue: There was not another supplier, if I remember correctly, that could produce both a Royal Navy helicopter and a battlefield helicopter on the same platform, so if you are not careful you finish up with 20 of those and 30 of those, and then the whole thing does get more expensive through life, because you have two different supply chains and so on. Looking at the through life cost is what we are trying to do now rather than just an off-the-shelf initial purchase.

Q202 Mr Holloway: Is Future Lynx the ideal thing for the land environment?

General Sir Kevin O’Donoghue: It is exactly what is required, as the man who sets the requirement, yes, absolutely.
Q203 Chairman: That was a “yes”?  
Rear Admiral Lambert: That was a “yes”.

Q204 Mr Jenkin: I am very sorry to press you on this difference between what is a requirement and what is an aspiration. It seems to me that that is a very movable feast and you can decide something is an aspiration until you decide it is a requirement, but, actually, SDR set out a whole lot of capabilities that were regarded as requirements, and they are being delayed. Are they not?  
General Sir Kevin O’Donoghue: Yes, and some of them, no doubt, are delayed for good reason. I would take BVRAAM, for example, which is being delayed by a conscious decision to delay it because the threat we had thought would materialise at the time we thought it would materialise has not, and the existing equipment, the existing weapon system, we have can cope with the requirement. So although that was a requirement some years ago and the timescale was set, it proved not to be required in the timescale. SDR was, when, 1998? Quite a long time ago. Things do change, and one needs to have the agility to change rather than, I would suggest, going back to something that was set in concrete from quite a long time ago.

Q205 Chairman: Is this a passionate argument for a new Strategic Defence Review?  
General Sir Kevin O’Donoghue: From me?

Q206 Chairman: Yes.  
General Sir Kevin O’Donoghue: I am quite happy to follow whatever defence review is extant at the time.

Q207 Chairman: Can we get on to what was described as your memorandum in early November, which came out in the Financial Times? Do you acknowledge ownership of this?  
General Sir Kevin O’Donoghue: Yes. That has come from the Ministry of Defence.

Q208 Chairman: You said in that memorandum: “No business cases were to be put to the approving authority for approval. Projects that have already received approval are not to incur financial commitment, except for various exceptions.”  
General Sir Kevin O’Donoghue: I am sorry, I thought you were talking about the HCDC inquiry.

Q209 Chairman: I am not talking about the memorandum from the Ministry of Defence; I am talking about the memorandum that appeared in the Financial Times, which appeared to be a bit of a moratorium.  
General Sir Kevin O’Donoghue: It is certainly a commitment regime. You are absolutely right, it is a commitment regime.  
Mr Jenkin: Commitment regime?

Q210 Chairman: How long do you expect this commitment regime to last?  
General Sir Kevin O’Donoghue: I think it will last until we are clear on PR09—would be my expectation. What it is doing is looking, against a list of criteria, at those things where if we do not have to spend money now, because the requirement is not still as high a requirement as some other areas, then we will not. That is the decision we are making. By definition, if some things are high priority other things must be a lower priority. That is really the discussion we are going through as these projects come forward for review.

Q211 Chairman: So even if it were the right thing to do, the absence of money means you cannot do it.  
General Sir Kevin O’Donoghue: Yes. The answer is yes, in that we do have to spend money on the things that are of a higher priority and not things that are of a lower priority. So, yes, if that was the statement you were making then you are absolutely correct.

Q212 Robert Key: Chairman, can I ask the General: who has decided on those priorities and why have they changed?  
General Sir Kevin O’Donoghue: No, the priorities have not changed, as such. There are priorities within this commitment regime. As we are running up to PR09 and trying to fit the requirements into what we believe to be the available budget (we are pretty sure we know what the budget is; the CSR period is fixed), we are just making sure we do not spend money on those things which are lower down the list of priorities.

Q213 Robert Key: General, could you explain the origin of this term “commitment regime” because it is not something with which, I think, we are familiar?  
General Sir Kevin O’Donoghue: I am not sure I can, actually. I do not know where it has come from, to be honest.

Q214 Robert Key: Just thought it up on the spur of the moment?  
General Sir Kevin O’Donoghue: No, it pops up every year or so. I have to say, at the end of each year, as I am coming towards the end of each year, and it normally starts at AP6 (Accounting Period 6), if I am to come in on my control total then I have to look very carefully with, actually, the Chief Operating Officer and the Equipment Capability customer to say: “It looks as though I am running for an under-spend”, or “I am running for an over-spend”. I then have to trim my rate of expenditure to make sure I come in on control total. That is just an annual way of doing business.

Q215 Robert Key: We can all understand that.  
General Sir Kevin O’Donoghue: That is what this commitment control regime is. It just happens that this year it got in the Financial Times—most years it does not.

Q216 Chairman: So you do this every year. do you?  
General Sir Kevin O’Donoghue: I certainly manage what I am spending money on to come in on or below control total every year.
Q217 Chairman: Is it particularly tight this year?

General Sir Kevin O'Donoghue: There or thereabouts. It is what I am paid for—to make sure I do not over-spend.

Q218 Chairman: We know you are paid for it, General.

General Sir Kevin O'Donoghue: This is routine. Every year I make sure that I do not over-spend.

Q219 Chairman: Is the evidence that you are giving to this Committee that this is a routine year in defence procurement?

General Sir Kevin O'Donoghue: No, that was not what I was saying. What I was saying was that every year what is routine is that I have to balance what I am spending to make sure I come in on control total.

Q220 Chairman: That, of course, is routine, but is it routine for you to send a memo like this?

General Sir Kevin O'Donoghue: Did I last year? I think I did. I do not know. I either send a memo out or my finance director sends a note out saying: “We have now reached the point in the year where we have to make sure that we are going to come in on control total. We discuss it at my management board every month. What is unusual this year is that it has appeared in the newspapers.

Dr Tyler: It is a standardised process that has been used in the past. Indeed, we have actually been even further standardised this year, and is something I remember vividly from operating in the commercial world as well. All businesses that run on annual cycles have to make sure that they are balancing their books on an annual basis, and, as you said, this year it happened to escape into the media, but we could probably table memos from previous years which were saying much the same thing.

Chairman: So it is all perfectly normal.

Q221 Robert Key: If this entirely routine exercise has for the first time got into the national press, has the Ministry of Defence instigated a leak inquiry?

General Sir Kevin O'Donoghue: I have not instigated a leak inquiry, no.

Q222 Robert Key: Has anyone else?

General Sir Kevin O'Donoghue: Not that I am aware of.

Q223 Robert Key: Do you think they should?

General Sir Kevin O'Donoghue: No, because it was not a classified document; it was an unrestricted document and it went out to all my two stars and it will have gone down to the project team leaders. I am pretty sure it was in the advice to industry that this is what we were doing. It is not a big deal. It is something that I do every year and have done ever since I was made Chief of Defence Logistics. So it is a normal process.

Q224 Mr Jenkins: I understand that, and we should do the same thing and keep on budget lines, but it was early November when you said, effectively: “Look, stop any spending on any project in the department with exceptions.” If it is quite normal to do that in early November rather than February, which we used to have, in what month would you send it out that would cause alarm to you? If it was sent out in June, for instance, would that be an alarming situation?

General Sir Kevin O'Donoghue: No, I start this at Accounting Period 6, which is six months into the year, because if you leave it much later than that and you do want to stop expenditure then you might have left it too late, and you need to review the projects you have not spent money on that fall outside the criteria and the date by which you have to make a decision if you are not going to spend money. It is a routine way of the way I do business.

Q225 Mr Jenkins: So these would all be in the pipeline at the start of the financial year, and they would all go through on the same day?

General Sir Kevin O'Donoghue: No, no, no. They are in the pipeline; they are virtually all pre-Initial Gate or pre-Main Gate. Pre-Main Gate?

Dr Tyler: Yes, or in the support programme.

General Sir Kevin O'Donoghue: Or in the support area.

Q226 Mr Jenkins: So it is just a way of holding a six-month moratorium on your projects, then?

General Sir Kevin O'Donoghue: It is a six-month review, and at the review a number of projects go through because they fall within the criteria, and a number of projects do not because they fall outside it, and that is what I need to do to come in on budget.

Dr Tyler: Every month from the first month of the year we are forecasting what our year-end outturn is going to be. Actually, if we were able to do it in June that would demonstrate how good our forecasting was, because the better you can forecast the earlier you can put the note out and implement these sorts of measures. Actually, it is quite positive that we have managed to be doing it at this time of the year and not in January or February, which I think would then start to look a little bit like panic.

Q227 Mr Jenkins: I think you were winning up until then, but on that one I have some doubts. I think I would have doubts about saying: “We are very successful, and if we can stop all financial commitment in June that would be a success”.

Dr Tyler: But we are not stopping all financial commitment, not even slightly. The vast majority of the things go through the commitment regime because they align with the priorities, and they are funded. This is about stopping a minority of activities.

Q228 Mr Jenkins: It says here that the projects that have received approval are not to incur financial commitment.

General Sir Kevin O'Donoghue: Without coming through this review.

Dr Tyler: This process.

Q229 Mr Jenkins: “Exceptions to that will only be considered if they are set by a certain period”.
25 November 2008  General Sir Kevin O'Donoghue KCB CBE, Dr Andrew Tyler and Rear Admiral Paul Lambert CB

General Sir Kevin O'Donoghue: Indeed.

Q230 Mr Jenkins: So you go by an exceptions rule rather than a general rule?

Dr Tyler: No, they are tested against a set of six criteria. These are projects that have already been approved, but they are being tested against six criteria and a judgment then made about whether we need to spend the money absolutely now or whether or not there is an option to delay expenditure—and, in one or two cases, not expend at all, depending on the case.

Q231 Chairman: We are asking these questions against the background of industry having told us last week that the procurement programme was in limbo; that the MoD's budgetary situation for the equipment programme was paralysed, and it suggests that this is perhaps a little less routine than you are giving the impression of today. What do you say to those representative people from industry who clearly do have that impression?

General Sir Kevin O'Donoghue: We are continuing to spend an awful lot of money with British industry and worldwide industry, so I am not too sure quite where they get that from.

Q232 Chairman: You may be spending the money but are you making the decisions?

Dr Tyler: We must be, if we are spending the money.

General Sir Kevin O'Donoghue: If we are spending the money—quite—the decision has to be made to spend the money.

Q233 Chairman: But those decisions were made sometime ago.

General Sir Kevin O'Donoghue: No, no, no. If I may, Chairman, I am absolutely not going to tell you which projects I am talking about, but we had 10 projects through the commitment control review last week, and nine went forward to be spent—to be approved, but they are being tested against six criteria. These are projects that have already been approved, but they are being tested against six criteria and a judgment then made about whether we need to spend the money absolutely now or whether or not there is an option to delay expenditure—and, in one or two cases, not expend at all, depending on the case.

Q234 Mr Jenkin: May I ask a very specific question, because it is the impact on the longer term which I keep asking about. Why have you suddenly decided to extend the life of the Type 23s, so that we will finish up with some ships in service that are virtually 30 years old by the early 2020s? Is that not because you are, basically, planning to delay Future Surface Combatant, for example?

Rear Admiral Lambert: We are looking at a series of options during this planning round, as we did last planning round. One of the things we did do during the last planning round is to look at quite a lot of our equipment in a through-life capability management perspective, rather than just when do we buy new kit. So one of the things we did last planning round was to make sure that the end-of-service life of our ships fitted precisely with the in-service life of the new frigates that we hope to have in about 10 years’ time. No other decisions have been made.

Dr Tyler: Bear in mind that a Type 23 in 10 years’ time will look absolutely nothing like a Type 23 on the day it went down the slipway—the capability has been continuously upgraded and new equipment added to it. Indeed, what we want to see is a sort of seamless transition between the current classes of frigates and the new Surface Combatant. Indeed, a lot of the equipment will be installed and de-risked on the Type 23 frigates before being moved over on to the Surface Combatant, and that is what through-life capability management tells you should be doing.

Q235 Mr Jenkin: We already have an 18-year gap between the laying down of the last hull of the Type 23s and the possible in-service date of Future Surface Combatant. Is that going to get longer?

General Sir Kevin O'Donoghue: We have to look at this, if I may, as a capability. Projects come and go but if the capabilities are required (and I do not think anyone would doubt that a frigate-size Royal Naval vessel of some sort was a requirement), the answer then is how best do you meet that capability? Do you best meet it by extending the life of an existing capability and upgrading it—as Dr Tyler says, it will look very different from when it was launched—or do you best meet that capability by bringing something new in? This is the way we should be doing business: looking at how best to meet the capability requirement and not being arbitrary about: “We said it would last 10 years so it mustn’t be allowed to last longer than 10 years”—or whatever the figure is.

Chairman: We will now move to another specific programme that we have mentioned before, which is FRES.

Q236 Mr Jenkin: We have now ordered 700 armoured vehicles for current operations, which is a very welcome, if rather belated, addition to protected mobility in theatre. Where does that leave FRES and what timescales are you now working to?

General Sir Kevin O'Donoghue: We are still in discussion with GDUK on some commercial issues with FRES UV, and it would be very improper for me to talk about that while those commercial discussions are still going on.

Q237 Mr Jenkin: These 700 extra armoured vehicles—and we have got a bewildering variety of types of armoured vehicle now, creating its own complexity—presumably, there is some hope that, taking this very practical, non-doctrinaire approach, these vehicles will come on to the main inventory after these operations and, therefore, allow the delay of FRES?

General Sir Kevin O'Donoghue: There will still be a requirement for FRES. I am quite clear about that.

Q238 Mr Jenkin: Assuming we know what it is now.

General Sir Kevin O'Donoghue: Indeed, and I think we are pretty clear we know what it is.
Q239 Mr Jenkin: It is an APC.

General Sir Kevin O'Donoghue: Yes, but—

Dr Tyler: A part of it.

General Sir Kevin O'Donoghue: There is a lot more to it than just being an APC.

Q240 Mr Jenkin: But that is the main bit of it.

General Sir Kevin O'Donoghue: Yes. The vehicles that will be bought under UOR are required for current operations in theatre now, and that is what we are doing. The FRES family of vehicles is still required, and will come in in due course, and I am really not prepared to go into details while we are in the middle of a commercial discussion.

Q241 Mr Holloway: General, a friend of mine in the Army put it to me that with FRES the analogy is we are going to a party in about 2020, so we go to a tailor and we ask for a suit to be made in the fashion that is relevant for a party—we know not what kind of party—in the materials that will be there in 2020, except we are planning it now. Is that preferable to getting stuff in 2020 that may be a couple of years out of date, rather than having something that was planned a decade earlier?

General Sir Kevin O’Donoghue: That is an interesting illustration. I am not sure I quite agree. What we must do when we buy any bit of equipment is buy it with that stretch potential. We do not know what the environment will be that we are going to fight it in, and that is what this equipment is for, in 10 or 15 years’ time. In a very simplistic way, I would say, about any land vehicle, when we buy it now it has got to have three things: it has got to have 30% more power than we think its needs now, it has got to have the ability to drive 30% more weight than we are currently planning, and it has got to have 30% more space, because we are bound to want to put more things inside it. It is a stretch potential. We do not know what the environment will be that we are going to fight it in, and that is what this equipment is for, in 10 or 15 years’ time. In a very simplistic way, I would say, about any land vehicle, when we buy it now it has got to have three things: it has got to have 30% more power than we think it needs now; it has got to have the ability to drive 30% more weight than we are currently planning, and it has got to have 30% more space, because we are bound to want to put more things inside it. It is a stretch potential. We do not know what the environment will be that we are going to fight it in, and that is what this equipment is for, in 10 or 15 years’ time. In a very simplistic way, I would say, about any land vehicle, when we buy it now it has got to have three things: it has got to have 30% more power than we think it needs now; it has got to have the ability to drive 30% more weight than we are currently planning, and it has got to have 30% more space, because we are bound to want to put more things inside it. In a simplistic way, that is the sort of thing we should be buying now—to come back to your point—because we do not know what the party is going to be like whenever we take it to war to fight it. So we have to be able to upgrade it—open architecture, incremental improvement as we go through—but let us buy something that has a potential for the future, not something which is perfectly right for today but will not have that potential for the future.

Chairman: About two years ago we did an inquiry into FRES and we said that it was a sorry saga of indecision. This came from a period of decades when the Army had been trying to buy an armoured fighting vehicle. It was an old project when I was a Defence Minister—and I am old.

Mr Jenkin: Tracer.

Q242 Chairman: They were predecessors even to Tracer—and there was Boxer and MRAV and all sorts of variants—and now it seems as though we are back to the drawing board again. What is going on?

General Sir Kevin O’Donoghue: I do not think we are back to the drawing board again. We have run a competition and we are where we are. We are now discussing—

Q243 Chairman: We are all over the place.

General Sir Kevin O’Donoghue: We are discussing with the provisional preferred bidder some commercial arrangements, which is why I am not prepared to go into detail. I would just not accept that we are all over the place.

Q244 Mr Jenkin: Is there not a very difficult problem that you have to contend with, which is if we had ordered one of the predecessors of the current iteration of FRES we would have ordered a vehicle that was too lightly armoured and too small for operations in Iraq and Afghanistan, as they have turned out to be?

General Sir Kevin O’Donoghue: We may have done, yes.

Q245 Mr Jenkin: Is not the answer to that, actually, that maintaining the flexibility of a more off-the-shelf solution and a less bespoke, tailored option, is, in the case of armoured vehicles—there is a very strong case for that?

Dr Tyler: I think it is the opposite, is it not? Exactly the opposite. What you do not want is buying a vehicle that, essentially, is role-specific or theatre-specific or operation-specific: what you want is a vehicle that has got the ability to be used across a whole range of applications and tailored according to the needs of that particular day by reconfiguration, adding new types of armour—hence the reason you need weight margins—new types of electronic equipment in system and open architectures to fit different types of sensor. That is the sort of vehicle that you want for the future because you do not know what the future is going to be.

Q246 Mr Jenkin: That, really, is the best being the enemy of the good and practical, is it not?

Dr Tyler: I do not think it necessarily is. I think the best being the enemy of the good is where you buy the vehicle on day one with, like a Swiss Army knife, absolutely everything packed on to it from day one. Our focus needs to be on buying an intrinsically flexible vehicle which we can then upgrade and adapt according to the circumstances in the future. That itself is easier said than done. I think this is where sometimes the understanding of the complexity of these vehicles comes in, because these vehicles themselves are very small pieces of equipment, relatively speaking, with an awful lot of trading that has to go on, in between their mobility requirements, their ability to carry capability, their ability to have protection, and they are an intricate balance between all of those factors. If you are trying to get a flexible vehicle for the future that is actually quite a difficult thing to do, and it is worth getting it right.

Q247 Mr Holloway: When I was a lot thinner in 2001, I went out to Germany to command a Warrior platoon, and we were the first people to get it. I was acutely aware that what it was designed for, which was mass, armoured engagements on the German plain, was no longer the case, just as this vehicle was arriving. How is FRES going to be any different?
General Sir Kevin O'Donoghue: Take Warrior. Look at Warrior on operations at the moment—an outstanding vehicle. That has had the capacity to be up-armoured, to have—

Q248 Mr Holloway: We have not needed it in the numbers that we ordered. We invested a huge amount of money in it. How many are we using in Afghanistan?

General Sir Kevin O'Donoghue: I thought you were talking about the capability of a particular FRES. I am not sure I want to go into that, but enough.

Mr Holloway: A fraction of the total.

Q249 Chairman: Dr Tyler, on what you were talking about in answer to Bernard Jenkin, is not, in fact, what has happened that we have bought large quantities of, for example, Mastiff, which has essentially made the FRES programme unaffordable because all the money has been spent on the Mastiff?

Dr Tyler: Not at all. For starters, the Mastiff has been funded substantially out of the reserve as an urgent operational requirement, so it has not been coming out of the same budget at all. The other thing is that the Mastiff does not come close to meeting the FRES requirement. We really are talking about two completely separate things here: one is deployment of particular vehicles to meet a particular role in a particular operating theatre; the second, the FRES programme, is about providing the Army with a medium-weight capability for this party that we do not know quite what it is going to look like in 2020.

Q250 Chairman: The Ministry of Defence has not come close to meeting the FRES requirement either, has it, because Lord Drayson wanted the FRES programme to be in service in 2009, did he not?


Q251 Chairman: I think his original aspiration was 2009, but he was an optimistic man. We are not seeing anything approaching 2015 or anything like that, are we?

General Sir Kevin O'Donoghue: What we have now is a current operation which requires armoured vehicles. In my view, we have done exactly the right thing, which is buy the armoured vehicles as UORs, virtually off the shelf, added to them, and so on, and put them into theatre. That is absolutely right. What we now need to do is make sure that there is a medium-weight armoured vehicle out there for the Army that we can buy which will meet a number of contingent operations. That is what we are now doing.

Q252 Mr Jenkin: And the ISD?

General Sir Kevin O'Donoghue: We never declare ISDs until we have signed the contract, if you remember.

Chairman: That was a really forlorn hope! Defence inflation.

Q253 Mr Jenkins: I asked the industry last week about defence inflation, and when they answered I went back to them and they suggested they were going to go away and have a look at it. Professor David Kirkpatrick said that defence inflation is running at our normal national inflation plus 3%, and I do not know why. It is beyond me. I looked at it and asked the industry why, and I think it has now got them scratching their heads. Why are we paying more for defence equipment?

General Sir Kevin O'Donoghue: I think that is a slightly different question. The Kirkpatrick article, I think, is a very interesting one, and it is attractive but it is a bit thin on fact. I understand the financiers in the Ministry of Defence are looking at the whole business of defence inflation, which we are interested in when we see the result. I think we just need to be fairly careful about what is input inflation and what is output inflation. The cost of steel went up hugely—50%. I think—and then came down again; aluminium oxide went up, and I do not know whether that has come down again. Input inflation does go up and down. On the other hand, we then use those inputs to produce an output, and the output (coming back to your second point) is actually, very often, more expensive than a similar output 20 years ago. On the other hand, it is very much more sophisticated, and it has to be more sophisticated because the threat is greater. I am not answering your question—and I do not intend to—but there is a lot of thought that has got to go into this, I think. It is a very interesting question, but I do think we need to think this through very carefully.

Q254 Mr Jenkins: I like your honesty—"I have no intention of answering your question!" I will put another one to you: that is the same sort of answer as the industry gave me, and if the price of fuel or price of anything goes up, it goes up in the real world as well. So I am not on about the cost of inflation, I am on about this additional cost of inflation that is peculiar to the MoD. Then they come up with “small batch”. No, that is set in the original high price that the MoD pay, not the inflation rate. As for the technology argument, believe me, under your procurement programme by now you should just about deliver me a Mark I Cortina, which will last me 30 years and be brilliant, but the industry has moved on tremendously since then—tremendous technology advances and, guess what, the cars are actually cheaper! When I go into my house, or people’s houses now, we have got these big, flat-screen televisions and they are cheaper—in fact, they are cheaper than we used to buy a CRT tube for—

Dr Tyler: If I can say, if you were to look at the cost of delivering the effect and the effect that is being delivered, you would find, I would contend, negative inflation. In terms of the amount it costs us now to deliver a unit of effect, given how much we have pushed the technological barriers to deliver the effect—which, at the end of the day, is what this is all about—I think you would actually find inflation is probably negative.
Q255 Chairman: Anyway, you have said, General, that defence economists in the Ministry of Defence are working on this.
General Sir Kevin O'Donoghue: That is my understanding, yes.

Q256 Chairman: You are looking forward to seeing what they achieve.
General Sir Kevin O'Donoghue: I am indeed.

Q257 Mr Holloway: Is not one aspect of defence inflation that manufacturers are themselves putting up prices, and if there was more competition between suppliers might the inflation rate be somewhat less?
General Sir Kevin O'Donoghue: No. I do not think the inflation rate would be less. Certainly—I do not know the proportion—a lot of what we buy we have competed.
Mr Holloway: Apart from Future Lynx.
Chairman: I do not think Adam Holloway is keen on Future Lynx. Moving on to A400M.

Q258 Mr Borrow: The programme is already delayed two years in terms of in-service date, but Jane's Defence Weekly mentioned a couple of weeks ago that there were further hitches in the power plant and that was producing further delays. Are you expecting further delays above the two-year delay, and how much?
General Sir Kevin O'Donoghue: No, I am not sure the two-year delay is declared, is it? The company certainly declared a nine-month delay. I think we now expect it to be a two-year delay. I think that is where we are. I am not sure they have actually declared that.

Q259 Mr Borrow: So you are still working on the in-service date?
General Sir Kevin O'Donoghue: No, I am working on an in-service date of at least two years’ delay. That is what I am working on.

Q260 Mr Borrow: That is 2011 as opposed to 2009.
General Sir Kevin O'Donoghue: Indeed.

Q261 Mr Borrow: In terms of the problems you have currently got, are you expecting that to have any further impact on your projected in-service date?
General Sir Kevin O'Donoghue: Yes, yes.

Q262 Mr Borrow: Are you able to give any guidance to the Committee?
General Sir Kevin O'Donoghue: No, none whatsoever and I am waiting for the company to tell us what the new delivery schedule will be. Of course, here we are not on our own; there are seven nations involved in this. I am in almost weekly discussion with my national armament director colleagues from the other nations to see what it is exactly we are going to do about this. All of us need the capability but we cannot wait forever. So what is it that we, together with the company, are going to do to deliver the capability that we require, is the debate that we are having.

Q263 Mr Borrow: There is a phrase in your MoD memorandum which says: “We will remain adaptive to emerging information on the A400M programme” (which is what you have just explained).
General Sir Kevin O'Donoghue: Yes.

Q264 Mr Borrow: Does that mean that you will be considering, as you have touched on earlier, leasing or procuring off-the-shelf vehicles from elsewhere, were these further delays in the A400M programme to be more than just a few months? Is that part of the mix of measures that you are looking at?
General Sir Kevin O'Donoghue: We are already considering what we will do when we know what the schedule is going to be. So, yes, we have to get our plans together to see what we will do if, as you say, the A400M slides off further to the right.

Q265 Mr Borrow: What is the sort of timescale you are working on in terms of having to make a decision to do something rather than wait for the A400M to come on stream?
General Sir Kevin O'Donoghue: We are running through the options at the moment and we will need to make decisions. As I say, what I am waiting for is a schedule of delivery from the company, which is what we do not know yet. I think I said right at the beginning that I think they have said a nine-month delay. I think that is what is declared at the moment. When we know what the delay is then we will need to know what sort of options we need to look at.

Q266 Mr Borrow: The key date for the MoD is getting that schedule from the company.
General Sir Kevin O'Donoghue: Just so.

Q267 Mr Borrow: At that point you can make a decision in terms of what option or mix of options you need to consider.
General Sir Kevin O'Donoghue: Just that.

Q268 Mr Borrow: Have you got any hint from the company yet as to the date when they will be able to give you that schedule?
General Sir Kevin O'Donoghue: No, and I genuinely do not have a date, but I will be disappointed if it were more than a few months. Very disappointed.

Q269 Chairman: Would you be surprised?
General Sir Kevin O'Donoghue: I think I might be surprised because there are a number of milestones (which I am not prepared to go into for commercial reasons) coming up, which I think will encourage the company to reach a view on the delivery schedule sooner rather than later.

Q270 Mr Jenkin: What are these hitches?
General Sir Kevin O'Donoghue: Hitches in the aircraft?

Q271 Mr Jenkin: Yes.
General Sir Kevin O'Donoghue: There are some challenges on the engine.
Q272 Mr Jenkin: Has it actually flown with the specified engine yet?

General Sir Kevin O'Donoghue: No.

Q273 Mr Jenkin: What is your confidence level that you will meet these deadlines?

General Sir Kevin O'Donoghue: The test engine is on a C-130 test bed at Marshalls. I was there last week looking at it. I have got every confidence that will fly soon, so the flight test process—

Q274 Mr Jenkin: What is happening to the unit cost of A400M?

General Sir Kevin O'Donoghue: No change. This is not about risk. Let me clarify, there could be a cost of capital issue.

Q275 Mr Jenkin: Explain, please.

General Sir Kevin O'Donoghue: Well, the more we have capital tied up without having received the asset, the more it costs us, over a length of time. So there could be a cost of capital issue, but it is not at our cost that the company are putting things right.

Chairman: Joint Strike Fighter. Robert Key.

Q276 Robert Key: General, give us all a Christmas present. Since we asked you last time, in January, are you any clearer about the unit cost of a Joint Strike Fighter?

General Sir Kevin O'Donoghue: No, I do not think I am, am I?

Dr Tyler: We have got transparent visibility of the costing models that are being used in the United States, and in the programme office there, on the unit price of JSF. The information is confidential because we have not yet signed any production contracts with the company, but what we do get visibility of is the way that cost is tracking with time. At the moment, it is reasonably stable and the Admiral and myself were over in the United States last week at the JSF Executive Steering Board, where we were able to see that first-hand.

Q277 Robert Key: Chairman, I think that might be an early Christmas present, because back in January, General, you said it would be foolish to suggest a number without knowing the price. You clearly do have some idea of the price now. In that case, can you now tell us how many JSFs the UK is planning to buy?

General Sir Kevin O’Donoghue: At the moment, and this is still a decision-making process going on, we are looking at buying three, which are the Operational Test and Evaluation aircraft.

Q278 Robert Key: Given the continuing uncertainty on the programme, are you still running an option of a marinised Typhoon?

General Sir Kevin O’Donoghue: I do not think there is any uncertainty on the programme. We are going through a series of milestones. The SDD phase was eight years? Twelve years. We are coming towards the end of that. The OT&E programme was planned for two years but I think that has been extended to three. So the programme is there. We will or will not buy these three aircraft and that is a decision that the Ministry will have to take in the New Year. We will then see how that OT&E programme runs, as the Admiral says. That will tell us a number of things: does the aircraft do “what it says it does on the tin”? Do we have the operational sovereignty? Do we have the technology transfer that we want? There is a programme to procure aircraft which goes out in the future. One of the great advantages of this procurement programme is that we do not have to buy them all up front to create an attrition reserve because we are a very small part of what the Americans are buying; we can buy them as we need them. So, I think, to say there is not a programme is not right. Decisions have not been made on the totality of the programme, would be fairer.

Q279 Robert Key: There is a novel way of planning procurement. I suppose. That will be, obviously, the next Christmas present. Back on 12 December 2006 Lord Drayson announced that he had received the necessary assurances from the United States on technology transfer on the JSF programme. The Ministry of Defence memorandum for this inquiry states (and I quote): “The UK continues to work closely with the US to secure the commitments it requires with regards to operational sovereignty.” Is technology transfer still an issue on this programme?

General Sir Kevin O’Donoghue: No, I do not believe it is. You can define “operational sovereignty” any way you want, but if you define it as the ability to use the platform and its weapons system and its ISTAR systems in the way we, the UK, wish to at the time and place of our choosing (that is the definition that makes some sense), then I am quite clear that the technology we need to be able to do that is being transferred to the timescale that was originally agreed. I am happy that that is happening. We need to continue to monitor it, we need to continue to watch it to make sure that that programme is adhered to, but, no, I am satisfied.

Rear Admiral Lambert: It will be tested through the Operational Test and Evaluation programme. We are on the timeline that we expected to be on at the moment, but the real test of it will be during the OT&E phase.

Q280 Robert Key: Is a marinised Typhoon still an option?

General Sir Kevin O’Donoghue: That is not being looked at, no.

Q282 Robert Key: What discussions have you been having with the French about the possibility of purchasing a French aircraft that could fly on the French aircraft carriers and the British aircraft carriers?

General Sir Kevin O’Donoghue: I have not been having any.
Q283 Mr Jenkin: Would we still consider buying the non-STOVL version if the STOVL version was not available?
Rear Admiral Lambert: At the beginning of the process we looked at the capability requirement needed for both carrier strike and for our future combat air capability, and the option that met the bill was STOVL. We revisit it every so often to make sure that we have got all our figures right and the requirement right and the answer still comes up as STOVL.

Q284 Mr Jenkin: So would we develop STOVL on our own account if the Americans did not want to develop it?
General Sir Kevin O'Donoghue: The carriers are not fitted for, but could be fitted for, the carrier variant.

Q285 Chairman: Was that a yes?
General Sir Kevin O'Donoghue: No, it could be—if STOVL went, which I think is your question?

Q286 Mr Jenkin: Yes, that is what I am asking.
General Sir Kevin O'Donoghue: Then carrier variant must be an option.

Q287 Mr Jenkin: You mean the non-STOVL version?
Dr Tyler: There are three variants, you understand? There is the conventional take-off variant; there is the carrier variant, which is for catapults and traps, and then there is the STOVL variant. Our choice is resolutely on the STOVL variant, and at the moment there is very, very strong support for that in the programme. Indeed, the STOVL part of the programme is going extremely well; it has already made several flights and it will be hovering for the first time very early next year. So, technically, that is absolutely on track. So our extant planning assumption is absolutely to buy the STOVL variants to go on the carrier. If there was some seismic change in the programme, like, for example, the Americans decided not to support the STOVL, then we may need to go back and revisit our planning assumptions, but there is no sign of that—in fact, to the contrary.

Q288 Mr Jenkin: Would we consider developing our own STOVL variant?
General Sir Kevin O'Donoghue: Oh, I think that would be no.
Dr Tyler: I think that would probably be prohibitively expensive—breathtakingly expensive to do that on our own.

Q289 Mr Jenkin: So a carrier version as opposed to a marinised Typhoon?
General Sir Kevin O'Donoghue: Yes. Both would be options but actually carrier variant, I would suspect, would be—
Rear Admiral Lambert: We will look at all the various options that are available, and that is something we would do routinely.

Q290 Chairman: And the aircraft carriers that we are building would be big enough, would they, to take the carrier version?
Dr Tyler: Yes, absolutely. One of the assumptions on the carrier design was that the carrier’s flight deck needed to be of a sufficient length that, should you wish to, you could convert. In fact, the space underneath the flight deck has actually been left in order so that should you wish to in the future fit the catapults and the traps, which sit immediately under the flight deck, you would be able to do that. In fact, there are designs which actually show how that would be fitted in the event that you wanted to change the carrier over to a conventional take-off on the carrier. You might want to do that for any number of reasons; it was not just uncertainty around the JSF programme per se, it was in order to keep that option open.

Q291 Mr Jenkins: That is the option the French have taken with their carriers. Can I ask for some clarification? We have made a financial commitment to the Americans as part of the production costs of this ‘plane, have we not?
Dr Tyler: Yes.

Q292 Mr Jenkins: When you said we are going to buy three—I know that was not a serious answer—I thought that is one for each aircraft carrier and one onshore. I think that is rather an expensive launching pad for one ‘plane. Did we not have a commitment that we have an option to take 50 off the production line at any point in time we wanted?
General Sir Kevin O'Donoghue: No. The figure in the original documents, I think, was a requirement for 150.

Q293 Chairman: Up to 150, which I always thought was a rather meaningless phrase.
General Sir Kevin O'Donoghue: As I say, at the moment we have no commitment to any. We will need to make a commitment next year, or not (depending on what the decision is), to buy the three aircraft for the Operational Test and Evaluation. Subsequently, we will need to make commitments progressively to buy more aircraft from various blocks of production that the Americans will produce.
Dr Tyler: At the moment, of the eight participant countries in the JSF programme I do not think a single one has yet gone through its governmental approval, including the United States of America, who are unable to do it until after the OT&E phase. By their law they are unable to do so. So, at the moment, there is a planning assumption, which the whole programme is operating to, in which every nation has said: “This is the profile that we believe we would require our jets in”, but it is only a planning assumption on the part of any nation until it has been through its approvals process. Like us, several of the nations, including the United States, will not make that commitment until after the OT&E is completed.
Mr Jenkins: I thought there was, more or less, an option where we could opt to pick up to 50 out of the first run any time we wanted to. How many 'planes are required to put on board both our carriers?

Q294 Chairman: I think it is 36 per carrier.

General Sir Kevin O’Donoghue: On a carrier, yes.

Q295 Mr Borrow: Just to go back to technology transfer. When Lord Drayson came back from Washington and said he had got the agreement, many people were suspicious that there may be more difficulties than was anticipated. I was pleased by your comments that things were going smoothly. I would just, perhaps, like some confirmation that the technology transfers that were assumed to be agreed in December 2006 are the same technology transfers which we are seeing taking place and expect to take place in the future. There has been no change in the sort of technology transfers we are accepting now, compared with those that Lord Drayson was expecting when he came back.

General Sir Kevin O’Donoghue: No. There was an agreement at government-to-government level, and that programme is running.

Rear Admiral Lambert: All the information does not come all at once; it takes a long period of time and we are on the timelines for it.

Q296 Mr Borrow: As a Committee we went through the processes and detail, and I accept there will be a process as different bits of the programme—

Dr Tyler: It would be fair to say we have at least as much confidence that we are on track as we did at the time when Lord Drayson came back with that agreement.

Q297 Chairman: We will finish there. There are several things on which we will write to you to ask questions about that are more appropriate for written answers than for oral questions. I feel as though I am halfway through a meal here, because of the brief examination of equipment, and we do not know where we are with that. However, we will look forward to having the Minister for Defence Equipment and Support in front of us in a couple of weeks’ time. In the meantime, gentlemen, thank you very much for your evidence this morning and for answering some of our questions.

General Sir Kevin O’Donoghue: Chairman, thank you.
Tuesday 16 December 2008

Members present:
Mr James Arbuthnot, in the Chair
Mr David Crausby
Linda Gilroy
Mr Dai Havard
Mr Adam Holloway
Mr Bernard Jenkin
Mr Brian Jenkins
Robert Key
John Smith

Witnesses: Mr Quentin Davies MP, Under Secretary of State and Minister for Defence Equipment and Support, General Sir Kevin O’Donoghue KCB CBE, Chief of Defence Material, Lieutenant General Andrew Figgures CBE, Deputy Chief of the Defence Staff (Equipment Capability), and Mr Amyas Morse, Defence Commercial Director, Ministry of Defence, gave evidence.

Q298 Chairman: Minister, good morning. There is no need to introduce your team, unusually, because, apart from you, Minister, they have all been in front of us before. This is a delayed evidence session from last week because of the announcement that was shortly to come out, which did come out on Thursday, and so I hope that we can get some answers that we could not possibly have got last week. Could I begin, Minister, by asking about the short examination of the Equipment Programme, which we were told would be completed “within weeks rather than months” and certainly before Christmas. In view of the Written Statement that came out on Thursday, does that mean that the short examination is now complete?

Mr Davies: Well, thank you, Chairman. Can I first of all apologise for my voice. I hope that it does last the course; I trust that it will. To start off on a slightly sombre note, which I think it is right to do in the circumstances, sadly, we had another fatality yesterday in Afghanistan, bringing to 133 the total losses we have had in that theatre. I mention it both to pay tribute to the individual and to make clear to his family that we are thinking of him, and indeed them, but also because it is the sombre background to all our proceedings and to all the decisions that I take in my present job. To move to the equipment examination, as you know, I have had my present responsibilities since the beginning of October, as has the Secretary of State, and we arrived when the equipment examination had already made some progress through official channels, but I am not sure that it had actually reached the previous set of Ministers, and so it was necessary for us to take a careful look at it and decide what shape we wanted it to have. That no doubt prolonged things a little bit. I believe now that it is an examination which has achieved its purpose, and, as I see it really, there are two essential purposes to this particular exercise, and it is a very useful and indeed necessary exercise to go through. One has been to clarify in our own minds priorities and particularly to distinguish between the essential and the less than essential, what I tend to call externally (and my colleagues will be more than familiar with my use of the phrase) the “must have” and the “nice to have” categories. The second thing is to strike the right balance between the short-term, immediate operational needs that we face with the current threats that we are facing, and the longer term requirements for the broad capability for our Armed Forces that enables us to have reasonable certainty of being able to respond to a range of threats, none of which of course can be predicted at this point. We need to retain that essential element of flexibility and diversification of the means of response for the future, so we do not want to sacrifice that to the short term entirely. We have to strike a balance, which is why you notice that we are continuing with a whole range of programmes, including submarines, combat aircraft, air superiority aircraft, and so forth, which very obviously do not relate to the present needs of theatre, although we have made a number of adjustments which are particularly influenced by the immediate operational needs that we have. The FRES programme and the rebalancing within the FRES programme would be a good example of that. To answer your question is it completed; yes, but do understand, and I know, Chairman, that you will know this extremely well and I think members of your Committee will appreciate this immediately, there is no such thing as a definitive, final certainty in this matter. That would not be a responsible way to proceed. We can never be certain of what is going to happen in terms of the evolving threat and we can never be certain what is going to happen in terms of evolving technology, so we have to be prepared to be flexible. The sort of exercise that we have been undertaking will not be the last, and it should not be the last in my view, and we should continue to be alert and flexible and take the responsible decisions that we need to take at any one time.

Q299 Chairman: Okay, thank you very much. I was remiss at the beginning because while you, quite rightly, drew attention to the death in Afghanistan yesterday, and also brought us in mind of the previous deaths that have happened this week and over the course of the entire campaign, and you were quite right to do that, I also should have said at the beginning welcome to the Committee because this is your first appearance in front of us, and to do it so soon after you have got into office may be difficult, it may not be. I do not know, but you have come with a cast of thousands to support your appearance, so welcome to all of you. As you rightly say, this is not the final word in the equipment examination. In the statement itself it said that there would be further
announcements made as a result of the Planning Round 2009. What sort of announcements do you expect to make? Do you expect there to be major changes in the equipment programme as a result of Planning Round 2009, in the spring perhaps?

Mr Davies: We made that statement to provide, as I say, for the necessary flexibility and to recognise that these matters are uncertain and we have to continue to keep them under review, not because we have in mind any specific new, dramatic announcements.

Q300 Chairman: So you do not at the moment envisage cancellations or delays to be announced in the spring? You were just announcing that to give yourselves some flexibility?

Mr Davies: We made that statement to give ourselves flexibility, and of course when I say flexibility I cannot exclude anything, but there is no hidden agenda here, I am not concealing from you some dramatic decision which we are about to come out with and which we have, for some reason, decided not to include in the equipment examination. The equipment examination is what it says it is: we are engaged in the exercise that I have just described, nothing more than that and nothing less than that.

Q301 Chairman: If industry is in search of clarity, is industry going to be able to get a bit more clarity in the spring or earlier than the spring?

Mr Davies: This is, as I say, a continuous review by us of our priorities, of what we feel we can afford immediately, what we cannot afford immediately, but we would like to have over the shorter or medium term, and what perhaps we think is no longer necessary. There is also this necessary discipline and process. Industry always wants the maximum degree of clarity and we would like to give industry as much clarity as we can, but we cannot give industry clarity at the expense of that essential flexibility and we cannot predict the unpredictable. I think industry understands that and certainly it has been my habit so far in the last two and a half months to try and keep closely in touch with industry and to be as transparent with them as possible about the issues that we face, and the decisions we need to take, and why we are taking them.

Q302 Robert Key: Minister, one of the aims of the short examination was “rebalancing the Equipment Programme to better support the frontline”. The Written Ministerial Statement said “the work to date will bring the defence equipment programme more closely into balance”. It would be very helpful if you could just explain a little more what you mean by this “balance” and what is “rebalancing”?

Mr Davies: As I have just explained, Mr Key, as I see it, there are two balances that need to be struck. You could look at this, if you were mathematically inclined I suppose, on the basis of a matrix and draw out a matrix, and no doubt you could produce an equation if you wanted to, but I see it really as looking at two balances and the essence of my job is contained in making sure that those balances are optimised. As I say, one is the balance of priorities, what we really must spend money on immediately, what is less essential, what is merely desirable, and of what is desirable what we should plan to purchase at some point and perhaps what we do not need altogether. There are elements of all of these things, as a matter of fact, in the equipment examination. The second is the right balance between the immediate requirements of the operations that we are engaged in and the need to maintain, as I say, the long term and to nurture and to improve steadily the long-term defence capability of the nation so that we are able to meet a range of potential threats, which, by definition since the future is uncertain, one cannot predict. What I do not want to do is put myself in the position of John Nott who decided to focus entirely on immediate Cold War threats and wanted to get rid of the carriers just a few months before the Argentinians invaded the Falklands. I do not think that he can be faulted for not predicting that the Argentinians were about to invade the Falklands; no-one could have a predicted that. I think he might be faulted because he did not sufficiently respect the principle of diversification. He was perhaps too inclined to put all his eggs in one basket. We do not want to do that and I have already explained that we are not doing that and, as you have noticed, we have not cancelled any major long-term programmes which do not have anything to do with the immediate operational requirements. There might have been some people who thought we would do that. There might have been rumours to the effect that we were going to do that. We have not done that and we would not want to do that.

Q303 Robert Key: Coming back to 2008, why did the programme become unbalanced?

Mr Davies: Simply because there are always financial pressures and, as we know, it is inevitable in life I suppose when you are operating at the frontiers of technology that you cannot predict exactly what the cost is going to be of resolving certain technical problems, so you do have the problem of cost overruns because when you are involved in an operational theatre, as you know just as well as anybody in this room Mr Key, it is impossible to predict the evolution of any particular threat. Every armed conflict that we get into—and that has been the case throughout history and always will be the case throughout history—presents its own sui generis kinds of characteristics and particular requirements that we need to meet it, and those requirements evolve, and we analyse the threat better the longer we are involved in it. New requirements emerge, so what you start off with, which you think is a clear description of our defence capability and requirements and you start to put some prices against those, some cost estimates and so forth, you find, even after a few months, that you want to look at it again and you want to see again whether you have got the right order of priorities. You may well find that the cost estimates add up to something rather more than you have in your
I feel that I have got really quite a good working relationship with him. He is an extremely experienced businessman, as you know, and always a very interesting person to talk to.

Q304 Robert Key: That is a very interesting answer. What is the process within the Ministry of Defence for ensuring that the programme remains in balance because, presumably, nobody wants to go off in a particular direction and then come to a shuddering halt and have another inquiry into why it has become unbalanced? What is the mechanism for keeping it in balance?

Mr Davies: There are several mechanisms. One is we have a commitment control regime at the present time to try and make sure that nobody signs off a cheque or signs a contract which has the effect potentially of threatening something which might have a higher priority in the programme later that year. We have introduced this new discipline and I think that is a sensible tool to have in any organisation. I come from a private sector background, as you know, and that would be a normal control mechanism in any private sector organisation. Then we have had this year, a kind of exceptional thing, the equipment examination, but I am not sure that it should be necessarily an exceptional thing. Though I do not think it needs to be something which is quite so dramatic, or apparently so dramatic and so explicit as what we have had this year, I intend to do something of that kind every year. I think it is sensible to do it internally. I have set up myself a new committee and all the officials and Generals who are on this table with me this morning are part of that, and one or two other people as well, including the Chief of the Defence Staff, which is specifically looking at longer term priorities, so that we are trying a little bit ahead of time now to see how our priorities might be evolving and what kind of new requirements we might be faced with. I did not need to introduce my team because you know them well and you know that General Figgures is in charge of anticipating capability requirements. We are trying to take that into account and look at some of the financial consequences of that a little bit earlier in the system than previously we were.

Q305 Robert Key: That will come as welcome news to the private sector who, in the shape of the Defence Industries Council, complained to us that they believed the Ministry of Defence was focusing too much on the short term. I hope very much that you will be telling the Chairman of the Defence Industries Council all about your new committee and what it is going to do.

Mr Davies: We do keep in touch with the Defence Industries Council and the Chairman comes to see me from time to time, and I see him on various occasions, as you can imagine, and although I have only been doing this job for two and a half months, I feel that I have got really quite a good working relationship with him. He is an extremely experienced businessman, as you know, and always a very interesting person to talk to.

Q306 Chairman: The answer to Robert Key was really yes.

Mr Davies: The answer indeed, with your flair for succinctness, Chairman, was yes.

Q307 Mr Jenkins: Minister, you actually mentioned a mathematical matrix. Does your Department have one and is it possible that we could get a copy because I have been trying for years to get my hands on a copy of this matrix?

Mr Davies: I did not know that it was a concept that anybody else had actually thought of. It was a throwaway line. When you have two balances, you can clearly produce a matrix if you want to. I have not actually produced one and no one else has produced one, and I do not see any reason unnecessarily to mathematise the decision-making process in the way that you have picked up. What I said was really a rather light-hearted kind of remark, not to be taken too seriously, but certainly you could produce a matrix if you wanted to. It would not be a very complicated matrix because, as a matter of fact, it has only got four variables in it.

Chairman: Moving on to the aircraft carriers, Vice-Chairman David Crausby.

Q308 Mr Crausby: In early July the MoD announced that the contracts would be placed for the new carriers, and we assume that the MoD only makes announcements of that kind when everything is in place and all the ducks are in a row effectively, and yet last week, in your Ministerial Statement, only five months later, you announce that the in-service date for the new carriers is likely to be delayed by one to two years. What has changed so dramatically in five months? Exactly when are the two carriers now expected to enter service? Can you tell us something about the lives of the current aircraft carriers and will they be extended, effectively, to fill any potential capability gaps?

Mr Davies: Mr Crausby, there are two questions there and they are very reasonable and very sensible questions. Can I just say first of all that I have been doing this job for two and a half months, as I have just said, and I have not wanted to spend too much of my time getting involved in historical research, so exactly what was in the mind of who, at what particular time in relation to the ordering of the carriers over the last few years is not something that I have actually investigated. There was a time of course when the JSF would have had a potential in-service date, not a formal in-service date because we have not been to Main Gate on it, and would have had an expected entry into service rather earlier than is currently the case. I pay very great tribute, by the way, to our predecessors and to Des Browne, who signed that particular contract, for wanting to make progress with it at the earliest possible opportunity, and it is enormously important that he did so because these are tremendously important defence
assets for the nation and will be for a long team in the future. However, for whatever reason, the particular dates involved in the contract which was signed last July were ones which, when I looked at them, I realised could actually be extended with no loss to the defence capability of the nation at all. If you like, it was a kind of free hit. We find ourselves under a certain amount of financial pressure. The last thing I wanted to do was to delay programmes which are really essential in the short term, either for operational reasons or for other reasons, but this was an opportunity in fact to re-profile our spending plans in a way which involved no defence costs, but simply made the delivery date of the carriers rather more rational, and reduced the gap between both the launching and the in-service date of the carriers and the arrival of the JSF aircraft to fly on them, so that is the decision we took. As you rightly say, what we are doing now is extending it by roughly one year. We have not come up with a formal in-service date yet but we will no doubt be doing that fairly shortly. We have said that we are delaying the first carrier, the Illustrious, by about one year, so instead of an in-service date of 2014, it will be 2015 and, without me stating what the formal in-service date is, if I add one to 14 I have come up with an unambiguous answer that no-one will contest.

Equally, the second carrier, the Prince of Wales, would be extended again by approximately two years, that would have been from roughly 2016 to 2018. The second question you ask is what does that mean for the existing three carriers. The Invincible is already at some notice in fact; Ark Royal will probably be withdrawn from service before too long, in the course of the next few years, and we will need to have Illustrious certainly remain in-service until it is quite clear that the Queen Elizabeth has passed her sea trials and that her aircraft complement, whether they are still Harriers or JSFs at that stage, are fully worked up and operational. The object of investing in two carriers—let me be clear about this—is to make absolutely certain that the country at any one time can launch one of them with a proper force of aircraft on her, so that is the important thing, and that we will always achieve. We are looking again at the issue as to whether or not it is sensible to extend Illustrious’s in-service period and, if so, whether that would involve cost of any kind or whether it would not. Illustrious’s to provide a slightly greater degree of overlap. I am quite confident that things can be done and the central principle will be preserved and conserved and respected: that the country will always have at least one carrier with a full complement of aircraft which can be deployed in defence of the nation.

**Mr Davies:** I can give you an unambiguous yes to the first of your questions. It is exactly the intention to carry on with the Harriers until they are replaced by the JSFs. The second point you have raised, will there be further delays to the JSF, you will understand, Mr Crausby, it would not be responsible for me to come here and to give you a personal guarantee that there cannot be any delays to the JSF programme. You would think that I was slightly crazy if I said such a thing. I can tell you that the recent news on that front is encouraging. As you know, basically it is an American programme, and we are an important part of it, in fact we are the most important ally in terms of our commitment to that programme, and we have come up with, as you know, a $2 billion contribution to the development costs of that and we are very close to it. The Americans keep us in close touch and the recent news about the development programme has been encouraging. This is a new fifth-generation aircraft. Of course it is perfectly possible—I had better touch wood with both hands—that something unforeseen could arise, so I cannot give you the kind of personal guarantee that you require.

Q310 Mr Crausby: Will that affect the carriers in any way?

**Mr Davies:** No of course not because that would mean that we would have to take measures of various kinds to make sure that we extended the life of the Harrier. Anything is theoretically possible in this life, but I really do not think that anybody involved in this programme expects there to be really serious delays of the kind that you might be suggesting which would mean that we would have a real lacuna in our defence capability in this area. The schedule forward for the JSF is that early next year (I trust) I shall be asked to take a decision on the purchase of three operational testing and evaluation aircraft. Of course since I have to take a decision, I have to take the decision on advice in the light of the circumstances at the time. I cannot give you some formal promise that I am going to take a positive decision. You can perhaps draw your own conclusions from what I am saying about our commitment to the programme as a whole. If I sign that contract, we shall then find that a couple of years further down the line we get those aircraft. We will need to test them to exhaustion. We will need to make sure that we are absolutely happy with them. Of course our American allies are doing the same thing, with rather more testing and evaluation aircraft. We will then be able to start placing orders for the production aircraft—

Q311 Chairman: Minister, can I ask for briefer replies please. I think you have already answered the question.

**Mr Davies:** The answer to Mr Crausby’s first question is unambiguously yes. The answer to the second question, which is do I anticipate some delay and some problem in the JSF programme, is no, in the sense that there is nothing specific that I am particularly worried about at the moment, but I have
said already, and I must make that proviso or that reservation, I cannot guarantee the future and I cannot give a personal guarantee that nothing untoward will ever occur; that would be absurd.

Q312 Robert Key: Minister, that is encouraging news but when CDM was last asked how many JSFs there would be, he said it depended how much they cost. Are we building these two aircraft carriers on the basis that we might or might not be able to afford 10, 20, 30 or 40 JSFs? What is the answer to this? How many JSFs do you anticipate will be ordered if you decide to go ahead and order them?

Mr Davies: This is going to be difficult for me to answer in two words.

Q313 Chairman: Something like 53 would be in order.

Mr Davies: Can I say that I start from the other end. First of all, we have to decide what we want these carriers for. We want these carriers to carry as much punch as possible. Therefore, I ask myself how many force elements at readiness we need on this carrier. Let us say we need 36 force elements at readiness on this carrier. We then have to decide how many aircraft we need in our fleet in order to generate 36 force elements at readiness. I cannot give you today an exact answer to that. It depends upon the serviceability of the aircraft; it depends on the operability of the aircraft; it depends on how much flying time we have; how often we have to service these aircraft. We do not know that. That is part of the purpose, by the way, of buying these operational testing and evaluation aircraft. We shall then know rather better. I cannot tell you whether we need to provide for attrition or at what stage. If the production line remains open until 2030 we shall not need to buy any aircraft to provide for potential attrition. If the Americans are about to close the production line, we shall jolly well have to buy rapidly a lot of spares and some aircraft to provide for attrition. I cannot answer your question. In a way, your question, to my mind, comes from the wrong direction. We have said that we do not expect to buy more than 150 aircraft in all and I think that remains a reasonable best guess kind of description of the position for the moment, which is a very early moment in the programme. I do not know how many words that was, Chairman, probably rather more than your limit!

Chairman: Lots!

Q314 Mr Crausby: You said the decision would be at no cost and it was an easy decision in that sense.

Mr Davies: I said no defence costs, Mr Crausby, no costs in terms of our defence capability, that is the point I made.

Q315 Mr Crausby: What about the financial cost then? Has industry been consulted on that? Have they provided an estimate as to what the extra cost would be by delaying the carriers? How much will it cost, if anything, to extend the lives of the current carriers?

Mr Davies: The answer to your first question is they have provided an estimate and we have discussed these matters, but these are purely internal estimates. That is why I am not going to give them to you today because such estimates are not robust. If you publish them in public, they develop an importance which one should not attribute to them, and then you have to revise them after a few weeks or a few months and everybody accuses you of changing your mind or getting your calculations wrong.

Q316 Chairman: As you have actually done with the contract for the carrier itself?

Mr Davies: In the case of the contract for the carrier itself, Chairman, clearly there was a contract, but when you sign a contract, there is a defining moment. What we are talking about now is a series of discussions with the alliance which is producing the carriers, and we have discussed figures along these lines, yes. They are commercially sensitive, by the way, and they might even be market sensitive in certain cases, so I certainly cannot say what they are. In terms of any cost of continuing slightly longer with Illustrious, the point I made earlier on, that is not a matter which we have focused on yet and not a matter I think we need to focus on at this particular juncture.

Q317 Mr Crausby: So it will need a new contract. Is that resolved?

Mr Davies: No, we do not need a new contract because the existing contract provides for a sufficient degree of flexibility, but we will be signing protocols with the ship builder, with the alliance, to implement in practice what we have negotiated with them in terms of a new schedule for delivery times.

Q318 Mr Crausby: Can I ask some questions then about how the delay will be managed by industry, because all you have really said is that the in-service date will be extended. How will that happen? Will it be that the programme will be slowed down or will the carriers be completed and then held up? Has that been considered?

Mr Davies: No, there is no question of completing the work on the existing schedule, and then just stopping everything and downing tools and everybody going away for six months' holiday; nothing of that sort, no. I do not think one can do visual aids on an occasion like this but if you could imagine a kind of graph, with pound signs on the vertical axis and a time series on the horizontal axis, you would find that the fixed costs of ship-building activity, which in this case is in carriers, would be pretty much fixed right across the bottom. There would be design costs right at the beginning of the contractual phase, which would fall away fairly sharply. There would be materials, which would rise gradually and reach a peak, and there would be labour which would reach a considerable peak and fall away. If you contract the process, in other words if you have a shorter time to delivery, those peaks, particularly the labour peak, are quite high. If you
extend the period of delivery, then that peak, in terms of labour cost, which is mostly met by overtime and by contract labour or by short-term hirings, is not the permanent staff or the permanent employees of the shipyards concerned, can be flattened somewhat. If you can visualise flattening that peak, that does not in any way cause any structural unemployment.

Q319 Mr Crausby: So we can be assured that there will be no job losses?
Mr Davies: That has been my concern all along, Mr Crausby, and that has been a fundamental element in our discussions with the alliance, and I am satisfied that we shall achieve it on that basis, yes.

Q320 Mr Crausby: And what about the loss of specialist skills, are we assured—
Mr Davies: There will not be any loss of specialist skills because, as I have explained, all we will be doing is flattening that peak, which would be met partially by overtime and much more by contract labour or by short-term labour. That is not the sort of labour which carries the specialist skills. I can repeat to you what we are trying to do is to produce a solution which makes sense in financial terms. It has no defence costs to the nation. We are not losing a solution which makes sense in financial terms. It can be flattened somewhat. If you can visualise flattening that peak, that does not in any way cause any structural unemployment.

Q321 Mr Jenkins: Minister, when you talk about areas of defence certainly, not just in defence equipment and support, in the case of the carrier—
Mr Davies: I do not mean the carrier, I am broadening it.

Mr Davies: I am going to ask General Sir Kevin to come in on this because he of course is managing the Defence Equipment and Support organisation and sees the impact of these changes in exchange rates the whole time. There are some projects where clearly we have a contract which is denominated or partially denominated or is exposed to dollars or euros, so inevitably we find ourselves in a situation in which we are not immune to exchange rate fluctuations. Indeed, that is one of the aspects of the defence budget, taking the whole budget, the operational as well as the equipment and support budget, which often makes it quite difficult to predict even a few months ahead exactly what our financial position is going to be. Kevin, would you like to say a few words about that?

General Sir Kevin O'Donoghue: That is absolutely right. We try to place contracts where we can in sterling and then the contractor/industry bears the exchange rate challenge. Some of them are in euros and some of them are in dollars. You may have seen the second quarter report from the Ministry of Defence for this year. There is a potential cost overrun/cost increase in projects and that is virtually all due to the exchange rate in this current year.

Q322 Mr Jenkins: It was a comment, just to let you know that we are aware exactly what the curves represent.
Mr Davies: All I can say, Mr Jenkins, is that it is quite sensible, it seems to me, to make sure that we schedule our expenditures in such a way that we are able to meet our in-year financial restrictions, and if we can do that, as I say, without damaging our defence capability, then that is something which responsibly we should do.

Q323 Mr Holloway: Some of this feels a bit like an MBA master class! In that vein, have exchange rates made any sort of difference to the maths of your major projects?
Mr Davies: Exchange rates are a problem in certain areas of defence certainly, not just in defence equipment and support. In the case of the carrier—

Q324 Mr Holloway: I do not mean the carrier, I am broadening it.

Mr Davies: I am going to ask General Sir Kevin to come in on this because he of course is managing the Defence Equipment and Support organisation and sees the impact of these changes in exchange rates the whole time. There are some projects where clearly we have a contract which is denominated or partially denominated or is exposed to dollars or euros, so inevitably we find ourselves in a situation in which we are not immune to exchange rate fluctuations. Indeed, that is one of the aspects of the defence budget, taking the whole budget, the operational as well as the equipment and support budget, which often makes it quite difficult to predict even a few months ahead exactly what our financial position is going to be. Kevin, would you like to say a few words about that?

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Q325 Mr Holloway: What sort of figure is that?

General Sir Kevin O'Donoghue: I think it is about 60 million.
just enunciated in the smart acquisition philosophy. There was no element of that in the carriers decision at all. We have not run into technical problems. It is nothing whatever to do with that. We have not because they thought the design was so good. It is you know, the French Government also bought job, I think, and came up with something which, as you know, the French Government also bought because they thought the design was so good. It is nothing whatever to do with that. We have not found that there were any inadequacies at all—is that right, General?

General Sir Kevin O'Donoghue: That is right.

Mr Davies: --- In the design which we carried out. We spent a lot of money at the front end exactly in line with smart procurement, so we explicitly followed the principles that you have just very lucidly set out and reminded us of. It was a quite different issue, the issue that I have described already, where I looked at the whole financial profiling to see whether that was really rational in terms of the optimum expenditure of our defence budget this year and the coming two financial years, and that is the basis on which I decided that we should re-profile those expenditures. It was nothing to do with technical problems at all.

Q327 Chairman: Minister, a final question on carriers. You are talking in terms of re-profiling the money. If you look at it from the point of view of industry, they need to work out how to keep teams together. As I understand it, there were two phases: the design phase and the production phase. Is there going to be now, as a result of last week’s announcement, any gap between those two phases and how, if there is, are they going to keep those teams together? If there is not, are those teams stretched out going to be viable?

Mr Davies: Let me try, as I am trying to do throughout this session, Chairman, and be as helpful to you as I can on that. FRES was conceived back in the 1990s as—and let me use this perhaps rather more understandable language—a future family of new armoured vehicles. It is family because the idea was that there should be maximum elements of commonality in the actual vehicles, and that would lead to savings, to financial or economic synergies but also to training synergies, so that someone who had been trained on one vehicle could get into the cockpit of another with minimal additional training and feel happy in operating the systems.

Q328 Chairman: Will those teams be viable if they are stretched out in the way that you have explained?

Mr Davies: Indeed they will, and I think I have already explained in my description of the graph that I have tried to project verbally that the core skills will continue to be fully employed. This whole issue has been the subject of detailed discussions between ourselves and the companies concerned.

Q329 Chairman: Okay. I want to move on to FRES, but I want to do so in the light of your interesting observation that because you have only come on board in the last two months, there is no responsibility for what has gone before. You are answering for the Ministry of Defence here. I wonder whether you could tell us what the initials FRES stand for?

Mr Davies: Yes, Future Rapid Effect System. I am sorry that it sounds rather complicated. It might be easier to say “new generation of armoured vehicles”, but sometimes we have strange names in the defence business.

Q330 Chairman: In view of the decisions of last week, do you think that is an appropriate name still?

Mr Davies: I have inherited these terms, Chairman. I have had a number of things to focus on in the last two and a half months and so I have not regarded it as one of my personal priorities to go round renaming things: it might cause more confusion. I do sympathise with you in the difficulty, which I am sure is not unique to yourself, in understanding why we sometimes have these slightly complicated names.

Q331 Chairman: Can I read a sentence from our report on FRES which came out nearly two years ago: “This is a sorry story of indecision, constantly changing requirements and delay.” That is something clearly with which your fellow minister, the Minister for Veterans, agrees because he was member of the Committee that produced that sentence. Do you agree with it?

Mr Davies: Chairman, I never accept or reject statements which I cannot read in context. I think I should need a little notice in order to be able to read the context in which you say this in order to be able to accept the particular language which you have quoted.

Q332 Chairman: Well, in those last two years things have not got better for FRES, have they?

Mr Davies: Let me try, as I am trying to do throughout this session, Chairman, and be as helpful to you as I can on that. FRES was conceived back in the 1990s as—and let me use this perhaps rather more understandable language—a future family of new armoured vehicles. It is family because the idea was that there should be maximum elements of commonality in the actual vehicles, and that would lead to savings, to financial or economic synergies but also to training synergies, so that someone who had been trained on one vehicle could get into the cockpit of another with minimal additional training and feel happy in operating the systems.

Q333 Chairman: Okay, you have abandoned that maxim of elements of commonality, have you not, because of the procurement process that has been going on for the last two years?

Mr Davies: Perhaps I could explain what has happened. We had a family of vehicles; we still have a family of vehicles. Initially, we thought that the FRES utility vehicle was probably the priority, and we proceeded on that basis to first of all go out to tender for design contracts and then to negotiate and to award the preferred bidder, or provisional preferred bidder status as it turned out to be.
Q334 Chairman: Can we come on to that, please. How has that worked exactly? In November last year you down-selected from three to three.

Mr Davies: Three to one, yes. Oh, in May this year—

Q335 Chairman: No, in November last year you invited three different potential bidders—

Mr Davies: Precisely.

Q336 Chairman: --- to produce their binding undertakings, I think. You knew that one of them, which was General Dynamics, was non-compliant in terms of intellectual property; is that right?

Mr Davies: Not entirely right. General Dynamics always made clear that they had a different concept than we did as to the role they wanted to play. We made clear that their concept was not ours and their concept was not the basis on which we were going to let the contract. They decided however to bid, making it quite clear that they had a different concept. The basic different concept, as you say, related to the fact that they wished to continue to have the intellectual property and they wished to be responsible, if they got the design contract, for the development and manufacturing, or at least to have a share in that. That is a perfectly understandable business approach and we had complete respect for it. They nevertheless decided to go on bidding when we had not accepted that approach.

Q337 Chairman: So you accepted in November that they were bidding on that basis?

Mr Davies: Yes, that is right. We thought if they get the preferred bidder status maybe they will come round to agreeing to work on the principles of the contract.

Q338 Chairman: What on earth was the basis for thinking that?

Mr Davies: We left it open to them, it was up to them to choose.

Q339 Chairman: But you chose them when you knew that they were not prepared to give up the intellectual property.

Mr Davies: Not at all, we did not. Chairman, what we did was we gave them provisional preferred bidder status, and we made it clear to them that we were making it provisional because confirmation of their status was entirely contingent on our agreeing on commercial terms that would be acceptable to us.

Q340 Chairman: So what were the negotiations that happened between November and May?

Mr Davies: I do not know that there were negotiations between November and May. What happened was the bids came in between November and May and bids were being prepared, and we selected the General Dynamics bid, but we said, “We cannot give you preferred bidder status because we have not agreed on the commercial framework within which we are going to operate with you, so we cannot make you the preferred bidder, we will make you the provisional preferred bidder, and we will see now whether we can agree on a commercial basis for going forward with this business which is acceptable to both of us.” We failed to do that. There were a number of discussions going through the summer with them. I will ask Mr Morse, who was involved in these discussions, to say a few words in a few moments about it to fill in what I am saying, but on the basic principle we were absolutely straight with them and transparent throughout—and they would not for a moment, I am sure, deny that—and they were absolutely straight and transparent with us throughout. I am glad to have the opportunity to confirm that in case there is any doubt in anybody’s mind. It is perfectly reasonable for one of two adult parties to say, “We would like to work with you on this basis,” and the other party to say, “Well, we would like to work on a different basis.” You proceed to go through the technical design and so forth and discuss other matters, but leaving aside for a moment the commercial framework within which a contract would ultimately need to be signed. That is the principle. We then spent several months after May seeing if we could reconcile our concept, our perception of how we wanted to go forward with General Dynamics. I can explain to you why we took the line we did if you want me to go into that.

Q341 Chairman: What I would really like to know is why, knowing that they had this issue over intellectual property in November, they were chosen as the provisional preferred bidder in May without that issue having previously been cleared up?

Mr Davies: I think it is very sensible, Chairman. It is perfectly possible, we could have said—

Q342 Chairman: You think the decision in May was sensible?

Mr Davies: Yes, I do think so.

Q343 Chairman: Even though you have abandoned it now?

Mr Davies: Absolutely, Chairman. It is perfectly theoretically possible for us to have said at the beginning, “Sorry, unless you now sign up irrevocably and say you accept our commercial framework, we will not entertain your bid. We will not look at anything you send us. We will not even confirm that in case there is any doubt in anybody’s mind.” One could have said that but I cannot for the life of me see why it would have been in the interests of British defence procurement to have taken that line.

Q344 Chairman: Because you have taken it now.

Mr Davies: No, no, no, on the contrary, we have simply said, “Your perception of the commercial arrangements are not the same as ours. By all means, if you want to, go on bidding and then we will resolve the matter later on, but if you do not want to bid now because you know where we stand on these matters, that is your choice as well.” They chose freely to go ahead and bid. We respected that decision. We looked at their bid. It was accepted conditional on subsequent agreement on commercial terms. Having postponed the commercial discussions, because that
is the way the company wanted to play it (and we saw no reason why we should not play it that way, and everybody was being completely honest and transparent with everybody else) we then tried, in good faith, to see if we could reach agreement with them commercially in the course of the summer, and we failed to do that. Both sides, with no ill-will, in total transparency and with good faith decided then that we did not have a basis on which we could proceed commercially. That is the position we found ourselves in last month.

Q345 Chairman: No ill-will? Are you paying General Dynamics any amount of money to keep their teams together?
Mr Davies: Going forward we have not made any commitments at all, Chairman. We are considering how to proceed with the utility vehicle now. We could not do the deal with General Dynamics, and I think we were right not to do the deal with General Dynamics, on General Dynamics' terms. We have to be quite robust about this in defence procurement. We have to be quite careful about how we deal with people. We have to make sure that we get the full benefits of competition or, if we cannot get competition, we have sufficient cost discipline in the system to protect our interests or protect the interests of the taxpayer, and General Dynamics understand that.

Q346 Chairman: Are you considering paying General Dynamics an amount of money to keep their team together?
Mr Davies: We are considering going forward on a number of possible bases. We are committed to this project. We are committed to providing the British Army with a utility vehicle. It will not come forward for us ourselves to decide how to go forward and to prepare our positions for discussions with eventual contenders for the design and manufacture of the vehicle.

Q347 Chairman: Do you think money rather than work would keep a General Dynamics team together?
Mr Davies: Chairman, I have not had these discussions with General Dynamics. It is premature to ask me questions like that. I do not know how we are going forward. I do not know who we will be discussing this matter with going forward, but we have said to General Dynamics, and I can repeat it now to you for the benefit of the Committee if you like, that if we go forward with this project as we are intending to do, we would welcome bids from General Dynamics on whatever basis we feel we can invite such bids in the future. We have not taken any decision as to such a basis and I cannot predict what that basis would therefore be. Obviously you are very interested in the details of this—and I quite understand that, it is a very important project—and, if I might, I would ask Mr Morse to add anything that he thinks is relevant so as to give you as complete a picture of this matter as we can.

Q348 Chairman: Mr Morse, is this the most disastrously managed programme in Ministry of Defence history?
Mr Morse: I am not in a position to make that relative judgment, Chairman, and you would not really expect me to, I am quite sure.

Q349 Chairman: So that is not a no?
Mr Morse: No, it is a statement that I cannot answer the question.

Q350 Mr Havard: It will be a Christmas number one!
Mr Morse: If you would like me to comment on the discussions with General Dynamics, I am willing to do that, of course. I was involved (not on my own) in having discussions over the last months with General Dynamics.

Q351 Chairman: When did you begin? When did you become involved in it?
Mr Morse: I personally became involved in those discussions in July, I think it is probably true to say. There had been previous continuous engagement with them by our teams, but I became involved with another senior official in October. We met and we had very frank discussions on both sides. I think both sides tried to explore ways of being flexible and seeing if it was possible to make this thing work to our mutual satisfaction. As it turned out, the group had a very clear view of their business philosophy. Did they have such a clear view or was it clear to us just what that view was at the beginning? Perhaps not.

Q352 Chairman: Why was that not clear because had they not been making it clear for several years?
Mr Morse: I think it was really a question of how we were communicating. I think it was really a question of how we went forward and to prepare our positions for discussions with eventual contenders for the design and manufacture of the vehicle.

Q353 Chairman: In other words, you thought that you could tell them to do something that they had been telling you they would not do?
Mr Morse: No, I do not think that is a fair characterisation of it; I really do not. I think we had had much more engagement than that, but when it came to the final decision, they took a particular line.

Q354 Chairman: That was the line that they told you they would take in November.
Mr Morse: No, that would be very much overstating it. They indicated a reservation at the beginning. We had good reason from our earlier discussions to believe that it might be possible to develop a solution to our mutual satisfaction. As it turned out, that did not happen, but it was not because we had not
thought about it or had not tried to make sure the discussions had a good chance of success; actually we thought they did.

Q355 Chairman: Why?

Mr Morse: And, by the way, I think they thought they had a good chance of success as well. I am not talking around the point at all, Chairman. What I am describing is we had a commercial negotiation with them and we entered into it in a belief that there was some common ground that we could establish. That was not an unreasonable expectation, to be quite frank. I am not going to go into every single commercial detail. I do not think that is appropriate because we are hoping, as the Minister has said, to do business with them in future, but it turned out that, although every effort was made to work out something between us, that was not possible. Sometimes that happens in negotiations.

Mr Davies: Chairman, perhaps I can just summarise this by saying that I am quite confident (although of course I only came on the scene relatively late in the day) that there is nothing whatever in the story to the remotest discredit of either party involved. Both parties had different concepts of what they were prepared to do in terms of establishing a commercial relationship. Maybe both parties thought that the other party might change his mind; that is natural, you cannot exclude that. That actually did not happen and we both recognised that our positions at the end of the day were not reconcilable. As Amyas Morse has just said, we both hope that in future we will be able to do business in different contexts, and if there is some sort of new competition, some opportunity to get involved in the UV, as I trust there will be, we certainly hope that General Dynamics UK will want to be a candidate for that. I have discussed the matter with Mr Wilson, the Chief Executive of General Dynamics and with Lord Levene, the Chairman of General Dynamics, and I am quite confident that they share my perception of that and they would endorse what I have just said. There is no skin off anybody’s nose in this particular context. That is life, that is business. People have different perceptions of how they want to resolve a particular business problem; they cannot resolve it and so they decide to walk away from that particular deal on that particular day.

Q356 Mr Jenkin: Meanwhile, British Aerospace have announced that they are reviewing the existence of their Land Systems unit, so there is the prospect that we will actually lose the capability of building armoured vehicles in the UK altogether. Does that matter?

Mr Davies: Mr Jenkin, I think you have got to make quite clear what is being suggested and what is not being suggested. What we set some store by is having prime contractors in this country available to us with the design authority for their particular products. We are not concerned really with whether they subcontract or sub-manufacture particular elements of their armoured vehicles in South Africa, or Sweden, or somewhere else; that is perfectly acceptable to us. We do not take a simple-minded, protectionist approach to that. What we need to have is a relationship with the prime, a relationship with the design authority. We need to have someone who can take responsibility not only for producing the vehicles we want, but for upgrading them, for maintaining them, for subsequent technology insertion, and that we and they (they being directly dependent on us in a contractual relationship) are masters of the relevant technology. That is what we require and that is what I believe we will continue to have going forward.

Mr Jenkin: I think that was a “no, it does not matter”.

Q357 Mr Havard: FRES was going to be a family of vehicles. You talk about the utility vehicle, and that is what you have just been talking about. I need to try and get a picture of what vehicles are going to be available. We have Mastiff, Bulldog and Jackal, we have all these other vehicles being bought, so we are acquiring a family. That is not a family that is necessarily coherent in the sense of spares and all the other things, but nevertheless a collection of vehicles, and within that is Warrior. A lot of these new vehicles are going to replace these things. You talk about the utility vehicle and you were also talking about the specialist vehicles. Apparently they are going terribly well. What is in the specialist vehicles? Is there an engineering variant? Where has that gone? You are talking about the scout vehicles certainly. Where is the direct fire vehicle? Where does Challenger fit in with FRES? Where is the system of systems? Essentially, a family is a collection of disparate individuals; it is not a system; and it is not a strategic view, in my opinion, so where has the strategy for mobile armour gone in terms of how you are contracting for FRES?

Mr Davies: Mr Havard, there obviously is some confusion here because I did not suggest, and would not suggest, that all the armed vehicles you have listed—and you have listed about half the armoured vehicles in the British Army—are all part of a particular family in the way in which I defined it. That of course is not the case. It might be an idealised version of something which you might dream of but that is never likely to be the case. After all, Challenger 2 derives from the 1970s; the Warrior derives from the 1980s. It is still a very, very fine vehicle and we are upgrading it, by the way, that is one of our current priority programmes that we are bringing forward.

Q358 Mr Havard: I am aware of that.

Mr Davies: Some of the other vehicles that you have mentioned have been procured with modifications but procured off-the-shelf, very rapidly, because they are best adapted to the—

Q359 Mr Havard: I am aware of that as well, but my point is how does this make a coherent, strategic approach to all of the other procurement activities
that you have in relation to providing armoured vehicles on the ground, maintained in a consistent fashion?

**Mr Davies:** Right, well, the coherence lies in having the widest possible suite of weapons for commanders in the field to choose from. You have just yourself given a whole list of vehicles, some of which may be five tonne, some of which, if you go up to Challenger 2, for example, go up to 70 or 80 tonnes, and for Warrior perhaps half of that figure, so you have got a very, very wide range of vehicles which commanders can draw on, taking into account the particular circumstances in which they need their operational capability.

**Q360 Mr Havard:** I am aware of all of that but that brings with it a logistics burden as well, does it not, because you have got to supply a lot of parts and different people and different training and different ways of operating. Where has that gone because I thought this was going to be a system of systems that integrated with Network-Enabled Capability? The strategic view seems to have gone in the bin because of expediency.

**Mr Davies:** If expediency means rapid reaction to immediate, pragmatic requirements, then expediency is a good and necessary thing and something which I regard as a virtue in this matter. If you like to use the word expediency in the way that I have defined it, we have expediently and pragmatically, and I think very sensibly and effectively, procured off-the-shelf and very rapidly precisely the vehicles—

**Q361 Mr Havard:** I am not contesting the fact that we have got operational requirements and we bought these vehicles; that is not my point. You are setting out your view of what the strategy should be and what the procurement policy is going forward for enabling people in the Army to have these types of vehicles.

**Mr Davies:** Yes.

**Q362 Mr Havard:** It seems to me that for whatever reason you have not got a plan to actually get back on track with that because all the time all I hear is we are going to patch up what we have got, we are going to buy more operational requirement vehicles and so on; if that is the case then let us do that in a consistent way and let us forget about building a utility vehicle, let us buy somebody else’s and let us amend them then, because that is what you are doing day to day.

**Mr Davies:** Mr Havard, I hope that you are not suggesting, because obviously I would not go along with you if you were suggesting, that when we have an urgent operational requirement in theatre instead of buying the capability which we need—

**Q363 Mr Havard:** No, that is not what I am saying at all. You are avoiding the question.

**Mr Davies:**—as urgently and as rapidly as possible we should go back—

**Q364 Mr Havard:** There is no coherent plan it seems to me and I have not heard you come out with one yet. You tell me that the specialist vehicles thing is going swimmingly well, I have absolutely no idea what that means because I was told something similar about the utility vehicle in the very recent past. Is there going to be an engineering variant, when is the Scout vehicle coming along, how is it going to work and when is it going to work?

**Mr Davies:** Mr Havard, so far I have not been able to finish a single sentence, but if you—

**Q365 Mr Havard:** You make them so long you see and you divert first of all—I do not want completeness, I want an answer.

**Mr Davies:** I am going to try and give you an answer but the main obstacle so far to my giving you an answer if I may say so has been the fact that you prevented me from completing my sentences. But there is an engineering vehicle, which is Terrier; there is a reconnaissance vehicle which is one of the really urgent requirements that we are going forward with as rapidly as possible. From the political and financial points of view we are going to produce this reconnaissance vehicle with the maximum despatch. There are only, therefore, technical issues about the speed with which this can come into theatre and I will ask General Kevin to say a word or two about that in a second, it is enormously important. We have to strike a balance here; I go back to my business of balances. We have to do what we can for the theatre, for the operational requirements, as rapidly as we can. We have been fortunate enough to find off the shelf, with some modification in some cases, but a very rapid modification, a series of armoured vehicles and protected personnel vehicles which really do correspond extraordinarily well to the specific requirements of this insurgency in Afghanistan. We have purchased them and you know about that.

**Q366 Mr Havard:** I do.

**Mr Davies:** That does not mean to say we are neglecting the long term major structural requirements of the British Army and that is why we continue to be committed to the FRES programme as well, so there is no inconsistency between the two, there is a large element of pragmatism and expediency and I think those things are very desirable in the circumstances. Would you like me to add anything on that?

**Q367 Mr Havard:** Before you start, are you going to give us a date for when it will be happening?

**General Sir Kevin O’Donoghue:** We are almost ready to go out to industry to seek bids for the Scout vehicle. I cannot give you a date because until you go out and ask industry what sort of timescale they will require to deliver something I cannot give you a timescale.

**Q368 Mr Havard:** But you are about to offer it out soon.

**General Sir Kevin O’Donoghue:** Soon.
Q369 Chairman: Minister, can I read out a sentence that you have just said to us because it struck me as so extraordinary that I want to pursue it. You said, in answer to Dai Havard’s point, “The coherence lies in having the widest possible range of weapons that commanders in the field can rely on.” Surely that wide range of weapons is precisely the thing that destroys the coherence.

Mr Davies: Coherence is not something we pursue for its own sake, just for the sake of neatness and having a nice inventory that looks good on paper, coherence is what we want to have where the capabilities of the various vehicles are complementary so that you can move across a spectrum, going from heavier to lighter, going from greater firepower to less firepower, going from faster to not so fast, for difficult terrain, less difficult terrain, so that you have the widest possible scope for choosing the vehicle that you really need for that particular operation. That is what we are trying to give commanders in the field and that is what I mean by coherent so that each particular platform relates to the others in the sense that it is complementary, it is not if you like duplicating the capability of the other one, it is expanding the full range of capability available to us. I would like if I might, Mr Arbuthnot, just to ask General Figgures to say a word about this whole issue—because he is responsible after all for equipment capability—and how we see our future requirements in the armoured vehicle and protected vehicle area.

Q370 Chairman: General Figgures.

Lieutenant General Figgures: Thank you, Chairman. If I could perhaps address my remarks to this question of the family of vehicles; yes, Mr Havard is quite right that when we set out on the concept phase of this we anticipated that we would have one common chassis on which we would build our various subsystems to reflect the requirements for each function. Further work suggested that this perhaps was not going to be the solution, but we would perhaps have to run with two chassis types, we would achieve our commonality and the logistic coherence that he describes through having common subsystems and this would be part of a network-enabled capability. Whilst it is sometimes to use analogies, effectively the network-enabled capability is rather like the nervous system in the body, so if we were thinking about teeth, it would be the nerve in the tooth, so we would have the common network which would be implemented right across these “FRES” vehicles although they would have different chassis systems. We would attempt to have common generators where appropriate, we would have common radios, we would have common electronic counter-measures, we would have where appropriate to reflect the function of the vehicles common subsystems in terms of sighting and so on. So that is how we were going to achieve it, although because the chassis did not look precisely the same did not mean that we were going to give up this original idea but we were going to optimise it, there were trades and balances in this. Coming on to Mr Havard’s point about the functions that each of these parts of the family were going to deliver, yes, the utility vehicle would carry an infantry section but there would be a command vehicle, there would be a vehicle in which we would put our communications, there would be a vehicle perhaps in which we would put our electronic support measures, there would be an ambulance vehicle, there would be a vehicle in which we mounted the anti-tank guided weapons and fire support weapons. The question we then had to ask was how much variation was tolerable, indeed affordable, in doing that. Equally, on the specialist vehicles from which we were going to get the reconnaissance vehicles, yes, we would have a close reconnaissance vehicle, we would need a formation reconnaissance vehicle—they may look very similar but their internal sensor fit and so on might be different, there would be a command variant, there would have to be an ambulance variant to support it. That is how we propose to do it, so whilst it may appear without the necessary supporting detail that we have thrown all our good ideas out of the window, we have not and of course it is not without some difficulty that you can get people to supply all this. I hope that clarifies it.

Mr Havard: They have not got a clue what they want.

Q371 Chairman: This difficulty has been going on for decades now. One of the main issues is getting the Ministry of Defence to decide what it actually wants.

Lieutenant General Figgures: If I may, Mr Arbuthnot, capability (which I plan) is a relative notion; you cannot stand still in time because the enemy has a vote in this and I think in a previous session with this Committee we have addressed this issue of how capability has to change, the fact that our original view with respect to FRES was that perhaps it had to be proof against kinetic energy rounds in preference to chemical and improvised explosive devices. Our experience in Iraq and Afghanistan has demonstrated that we have got to shift that balance. That is an increasingly complex requirement to meet, and we have found—our allies have found—that you cannot necessarily buy these things straight off the shelf and, indeed, these urgent operational requirements to which the Minister refers have had to have some considerable modification to what comes out of the factory gate.

Q372 Chairman: Okay. We ought to move on from FRES because we have probably spent quite enough time on it. Vector: is Vector unable to take the weight? Is it unable to operate on rough terrain? Does it keep breaking its axle?

Lieutenant General Figgures: I will pick that up if I may. Vector was introduced as you know, as an urgent operational requirement. Yes, we have had some problems with it, yes it is a combination of all up weight, cross-country performance and, like many of these things, you do not get a perfect solution, and so that is why we are constantly looking ahead in terms of protected patrol mobility
and the utility vehicles necessary to support it to see what other options there are. Some of these solutions have not been perfect.

**General Sir Kevin O'Donoghue:** You produce a solution for the requirement of the time; the requirement changes as the threat changes, as the security architecture changes and you need to produce something else. Quite rightly, Chairman, there is only so much weight you can put on a particular chassis and when you reach that weight limit you either have to have something bigger and more powerful or you have to have a different form of protection, which it would be inappropriate to go into, but things change.

**Chairman:** Moving on to the Future Lynx programme, Adam Holloway.

Q373 **Mr Holloway:** Minister, with reference to the capability that is being filled by Future Lynx you referred earlier today to “simple-minded protectionist approaches” and also to the “full benefits of competition”. Do you think that you are getting the full benefits of competition in this particular programme?

**Mr Davies:** This is a partnership programme, Mr Holloway, as you know. These are two broad categories and there are hybrids between them.

Q374 **Mr Holloway:** I can understand that.

**Mr Davies:** It is reasonable to distinguish between classic competitive contracts—where we simply go to the market and say this is our requirement, we get in bids and we negotiate the price and sign a contract—and partnership arrangements where we actually agree with a particular group of manufacturers, or perhaps one manufacturer in certain cases—and probably this is appropriate in areas where there is quite a high technical risk—that they will work on reducing the risk, they will take some of the risk, we will take some of the risk, we will typically have a target price with incentives for doing better than that, penalties for doing worse than that, so that we share the risks right the way through. This falls into the partnership area. I did actually look at competitive solutions and you might be interested in this since you raise this matter. Maybe I horrified certain people when I asked for a study on this subject, but I did say we really need Future Lynx, is there perhaps an off-the-shelf solution here. I asked for a small study to be done looking at Black Hawk—Black Hawk of course is a workhorse for the US Army that has been around for a long time—because I wanted to have a check as it were against the other proposal that we should go ahead with Future Lynx. I was persuaded, Mr Holloway, that actually Future Lynx was the right solution. First of all I was persuaded that we needed the same helicopter, the same basic structure of helicopter for the naval and battlefield roles and, secondly, I was persuaded that actually we did have a good deal. I was actually quite surprised at how expensive the Black Hawk solution would actually have been. Like other people coming fresh to this particular field one tends to think that as the Americans have these very long production runs automatically their prices are going to be cheaper, but I am not sure that actually American defence procurement is always quite as efficient as it is sometimes made out to be and sometimes what you might think plausibly would be the position does not turn out to be. I am therefore very confident that we have gone down the right road here and that we are going to get the right capability, and it is one that of course is directly engineered, really specified for the particular requirements of the Royal Navy and the British army.

Q375 **Mr Holloway:** Your written Ministerial Statement referred to the even greater operational capability; how many of these aircraft are you settling on, what will they cost and when will they be ready?

**Mr Davies:** Let me take those questions in order. The answer to your first question is about 60, the answer to the second question is that we do not know, we have not decided, we are discussing this matter with the company. We do not produce in service dates until we have actually got through Main Gate and we are some way away from doing that, so I cannot answer that.

Q376 **Mr Holloway:** Roughly.

**Mr Davies:** We do not want to lose any time on this but there are some technical issues to be resolved. I do not know, Kevin, whether we could have a stab at that. As a matter of principle, Mr Holloway, we either have in service dates or we do not; we do not have in service dates until we have been through Main Gate and I am always very reluctant to give my personal estimate as to what an in service date might be before we have even looked at Main Gate because we do not necessarily know all the variables which are going to determine the answer to that question. I am cautious about it, but if General Kevin wants to make a stab at something I am very happy for him to do so.

**General Sir Kevin O'Donoghue:** We are through Main Gate, Minister, on Future Lynx.

**Mr Davies:** We have not placed the amended contract yet.

**General Sir Kevin O'Donoghue:** We need to now discuss with the company exactly when these aircraft will come in.

Q377 **Mr Holloway:** Roughly.

**General Sir Kevin O'Donoghue:** I need to come back to you on this.

Q378 **Chairman:** Could you explain this principle of not giving in service dates until you have gone through Main Gate?

**Mr Davies:** The point is that until we have gone through Main Gate we have not had the negotiations with the company, we have not fixed on the price, we have not fixed on the terms of the contract so we are in a very bad position in order to be able to say what it is. We are hoping it is 2014, January 2014.
Q379 Chairman: The principle of not announcing in service dates until you have gone through Main Gate obviously does not apply in this case where you have gone through Main Gate, but if it is to reduce the uncertainty—which we saw remained even though you did go through Main Gate with the aircraft carriers—what is the point in preserving this principle that you do not give industry an idea of when they need equipment to be in service by?

Mr Davies: We may well give industry that idea; when we are having discussions with industry about almost any project the timing comes into that because we need to take into account the technical risk, we need to get their assessment of what the technical risk is, of how long it will take to resolve it. We obviously tend to have a requirement that means we want the capability available as soon as possible but there is a dialogue on that matter, Mr Arbuthnot. It is not always very sensible, while we are having that dialogue with industry, to make a public statement about these things because it pre-empts some of the discussion with industry. There may also be cases where there is a trade-off between price and delivery time and we do not want to lose the flexibility of our commercial negotiations.

Q380 Chairman: But that is precisely what you did with the aircraft carriers.

Mr Davies: In the case of the aircraft carriers it was not a competitive contract of the kind I have just described, it was one of these sort of partnership contracts.

Q381 Chairman: That makes a difference, does it?

Mr Davies: It can make a difference, yes; it can certainly make a difference.

Q382 Chairman: We will move on to one other set of aircraft issues, the A400M aircraft: are they going to have full defensive aid suites?

Mr Davies: The answer is yes.

Q383 Chairman: All of them?

Mr Davies: The ones that we are employing in theatre, certainly, because we make it a principle that we do not fly troops, personnel, indeed civilian personnel—even ministers, though that may be controversial—into theatre without defensive aid suites. The only aircraft we fly into theatre without defensive aid suites would be aircraft not owned by us and carrying freight not human beings.

Q384 Chairman: So you might be buying some A400Ms that do not have full defensive aid suites on the basis that they would never fly anywhere into danger, is that right?

Mr Davies: Mr Arbuthnot, we need to take that decision nearer the time. We are sadly—sadly—some way from an in service date for the A400M. That itself is a difficult matter at the moment on which we are focusing, so we are some way down the road from deciding that. I have just given you the general principle and it is a very important general principle. In so far as we were clear that some A400Ms would not need to fly into theatre maybe we would not need to fit the defensive aid suites, but we would have to take a view as to whether it would be sensible to have some aircraft, maybe just for training purposes, where we did not need that. It is a decision we have not taken yet.

Q385 Chairman: So the answer to you might be having some A400Ms without defensive aid suites is a yes.

Mr Davies: It is possible.

Q386 Chairman: The fuel inertion system that is currently being fitted to the C130s and others, is that going to be put into the A400Ms?

Mr Davies: The same principles apply to the fuel inertion system and also to—because you are probably about to ask me about that too—to the explosive suppressant foam.

Q387 Chairman: I was.

Mr Davies: Yes. The same principles apply in all three cases because obviously the three cases are very analogous and the same issues arise.

Q388 Chairman: What about the Chinook helicopters that have just been made available to go to Afghanistan, will they have the fuel inertion system?

Lieutenant General Figgures: They have the pannier tanks, the piano hinges and they have got self-sealing tanks so the business of catastrophic failure through fire would appear not to be the same as on a large fixed-wing aircraft; there is a balance of risk there, but we constantly review where to strike that balance. If we felt as a result of this constant assessment that it was necessary to do it we would have to do it, although again we may not do it in quite the same way. Currently we believe we have reduced the risk sufficiently through the self-sealing tanks and the fact that they are on panniers outside. When you have an enforced landing the tanks fall off and so reduce the danger of a catastrophic fire.

Q389 Chairman: Was it a balance of risk that decided the Ministry of Defence not to fit explosive suppressant foam into the Hercules that came down?

Lieutenant General Figgures: I think that was the judgment of those concerned—and I cannot speak for them because I was not there when these things were considered.

Q390 Chairman: What makes you think you have got this decision right?

Lieutenant General Figgures: Because I am certainly conscious of the requirement to review this and carry out the necessary risk assessments and carry out the necessary trials to see that we have reduced it to as low as reasonably practicable.

Q391 Mr Havard: Before we move on can I just ask briefly about the A400M. If it is not known as to when the A400M is coming we have a problem with heavy lift in the meantime. Are we going to see
substantial refurbishment of the C-130Ks, are we going to buy more C-17s, are we going to bring forward the air tanker programme, have you got any clue what we are going to do?

Mr Davies: Mr Havard, you are asking a very pertinent question, a question which is very close to my heart and which I reflect on every day. We do find ourselves in a difficult situation with the A400M, I cannot tell you exactly what the latest delivery schedule is—we are expecting it more or less daily from OCCAR and we do have a big problem, we do have a big gap in the air bridge. As I said, I cannot even say how long it is going to last because we do not know what the delivery schedule for the A400M is. I have had conversations with Monsieur Gallois and I have expressed myself as forcefully as I know how on this particular subject, but that does not necessarily produce any aircraft overnight. The answer to your question is that all of the options that you mention are real ones that we will be looking at. There may be one or two others which you have not mentioned which we are also looking at, and the air bridge is an absolute critical imperative for us. That is my attitude to it.

Q392 Mr Jenkin: Looking at the overall affordability of the equipment programme you will be aware that we have had numerous representations suggesting that the Government’s stated programme is actually unaffordable, but now that you have completed this short equipment review can we take it that all the capabilities set out in the Strategic Defence Review—the additional new chapter, the 2003 White Paper and so on—this is now an affordable programme?

Mr Davies: Yes, the equipment programme is an affordable programme. We have had to make an adjustment about exactly the pace with which we are bringing certain things forward and, as I have already explained, some of the priorities are being increased and others are being set back a bit. We will always have this, Mr Jenkin, we will never have a situation in which everything can be afforded today, of which there are no changes in year—that just would not be a natural situation to be in—but I believe that the equipment examination exercise has relieved an awful lot of pressure, let me put it that way. As I said right at the beginning of our proceedings I am not concealing from you any decision that we have taken which is a dramatic major decision in which we are about to announce some further delay or cut or indeed any cut in a programme, so I would hope that we would only have to cut programmes if we really decided they were not really necessary, really essential, in the defence interests of the nation.

Q393 Mr Jenkin: In the Winter Supplementary Estimates you did reduce the net provision of defence capability by RIR1 by £950 million. That is a cut, is it not?

Mr Davies: No, it is not a cut. The defence budget and the defence control environment equipment and support budgets are increasing in real terms the whole time so we are spending more money in real terms. There is no suggestion at all—you look surprised but I assure you that is the case, there are no cuts at all here, no cuts.

Q394 Mr Jenkin: No cuts at all?

Mr Davies: No, we are not cutting defence expenditure, no.

Q395 Mr Jenkin: That is not what I asked. I asked in your Winter Supplementary Estimates—this is presumably what rebalancing means, that we are cutting investment in future capability to support current operations. That is the new mantra is it not?

Mr Davies: The word “cut” is the word that I am resisting.

Q396 Mr Jenkin: It is in brackets, it is negative, there is the number, £950 million.

Mr Davies: If the word “cut” appears there it would (a) surprise me very much and (b) it would be some sort of mistake because it would not be an accurate description of the position. Rebalancing means changing the priorities; bringing some things forward; pushing some things back. That is what we do, that is what we will continue to do the whole time I am sure.

Q397 Mr Jenkin: The Government’s defence policy has not changed.

Mr Davies: The defence policy has not changed, no.

Q398 Mr Jenkin: Can you explain—I am looking at the out of service dates and in service dates of helicopters over the next 10 years—at the moment we have 520 helicopters in the Armed Forces overall, including the US helicopters; according to your Parliamentary answers, by 2020 we will have nearly 215 helicopters in the British Armed Forces. How possibly would we be able to support the tempo of operations that we are currently supporting on less than half the number of helicopters?

Mr Davies: Mr Jenkin, you are a considerable defence expert and known for that in the House and you know the answer, I suspect, that I am about to give you. It would be absolutely crazy to equate numbers of helicopters with helicopter capability. A lot of the helicopters we have got in that list which you have just mentioned will be old helicopters, Gazelles and so forth, whose moment, with great respect to that particular airframe, has passed. Some of the new helicopters we are bringing on stream are vastly more capable than their predecessors. Compare the Apache, for example, with the previous battlefield helicopters we had. There has been an enormous increase in our helicopter capability. I am glad to say that in Afghanistan from March last year to the latest figures I have seen, which would have been in October or November, we increased our helicopter capability in Afghanistan by 37.5% and there will be another 25% increase in the coming year, so this is what we are talking about.
Q399 Chairman: Do you know how you did that?
Mr Davies: Capability and firepower, number of hours available.

Q400 Chairman: So you flew the existing helicopters harder.
Mr Davies: We are bringing them into service—no, not at all, we have introduced a lot of new helicopters. Another thing which has not come out so far—I am slightly proud of it because it is something which I took initiative on in my first week or two in my present role—is that we are re-engining some of the existing Lynxes so as to make sure they are available in Afghanistan on a 24-hour, 365-day basis, which they have not been up to now. That is very important and that is going to come through as an urgent operational requirement to be delivered in the course of next year. There is a whole range of areas where we are increasing genuine helicopter capability. The stories are very upwards and onwards ones, the story is getting rid of old-fashioned helicopters—quite rightly—obsolete helicopters, helicopters that are much less performing and replacing them with the latest helicopters and helicopters with the specification that we require to do the job.

Q401 Mr Jenkin: Helicopters are also essential for protected battlefield mobility.
Mr Davies: Yes.

Q402 Mr Jenkin: Commanders in both Iraq and Afghanistan have consistently complained they are not able to get enough helicopter hours, not for hitting things, just simply for flying people around. By 2020 we will have a total of 14 Chinook helicopters in the entire British Armed Forces. How will that possibly be enough unless we are going to envisage conducting military operations on the scale at which we currently conduct them?
Mr Davies: Mr Jenkin, I do not recognise your figures but we are introducing an additional eight Chinook helicopters which have been specifically refurbished to provide for the lift role for which we want them, the battlefield tactical lift role which you just identified correctly as being so important. We have just bought six Merlins from Denmark and we will be deploying those in the most useful fashion possible as soon as we possibly can. We are bringing in a lot of highly capable helicopters, we are investing in helicopters the whole time and I have just given you the figures.

Q403 Mr Jenkin: How many helicopters are you planning that we have by 2020?
Mr Davies: I do not know that we have an actual figure for that but if we do I dare say my colleagues will help me with it. Have you any idea what the figure will be?
Lieutenant General Figgures: You mentioned Mr Jenkin Chinook and you mentioned 14.

Q404 Mr Jenkin: 14 by 2020.
Lieutenant General Figgures: I think we shall have 48 by 2020.

Q405 Mr Jenkin: That does mean considerable life extensions beyond the out of service dates that you currently announced.
Lieutenant General Figgures: Indeed.

Q406 Mr Jenkin: So we are going to be flying older and older airframes because we will not order any new helicopters.
Lieutenant General Figgures: Chinook is a robust airframe and we have plans to upgrade the cockpits, we have plans to have a universal fleet so we have 48 of a similar standard, we have plans to up-engine it and of course to keep its defensive aid suites, communications, weapon fit and so on to match the threat. Chinook actually is a very good example of the through life capability approach which we have taken to get the most out of the fleets we own.

Q407 Mr Jenkin: I have put down questions to ask for straight answers on this and it is only by piecing together a jigsaw that I am able to put together any figures at all. Could I ask the Minister in future, if I put down a question, to maybe provide the Committee with the information that you have there and maybe we would have a more intelligent discussion about what these capabilities are.
Mr Davies: Mr Jenkin, I appreciate your questions and we do try to give the correct answers. I am quite confident that I have never given you an answer, never given you an answer—let me say this twice now—

Q408 Mr Jenkin: You the Government.
Mr Davies: -- which suggests that we will only have 14 Chinooks in 2020. I do not know where that came from; it cannot possibly have come from any answer which I gave because I can assure you that if somebody presented me with a draft answer of that kind there would be an immediate inquiry in the MoD as to how we could possibly be proposing to do any such thing. I do not know where that figure came from but it certainly did not come from us, it certainly did not come from me in a Parliamentary answer.

Q409 Mr Jenkin: I think you will find that in order to get more than 14 helicopters you will need to adjust some out of service dates that you have already published. The General is nodding.
Mr Davies: You are making all kinds of assumptions.

Q410 Mr Jenkin: I am making assumptions on the basis of answers the Government has given me.
Mr Davies: You are making assumptions that we do not either refurbish or upgrade or buy a single new helicopter between now and 2020. I have no idea why you think such an assumption is correct.

Q411 Mr Jenkin: What is the lead time on buying new Chinook helicopters?
Mr Davies: Mr Jenkin, I repeat, I appreciate your questions and I repeat there is always a well-informed interest in our proceedings and it is extremely valuable for us to have people who take a close interest in things like that. There is, however, clearly a mistake involved in the assumption of 14 and I think you have had that confirmation now from General Figgures. General Figgures has been able to give you a very different figure—the difference between 14 and 48 I am sure you will agree is a material difference.

Chairman: Moving on, Linda Gilroy.

Linda Gilroy: Minister, following the Pre-Budget Statement the Chief Executive of the SBAC said “It is a disappointment that the Chancellor has neglected to include an injection of much-needed funds for the UK defence industry. This oversight is disappointing given the contribution that this industry will make to the UK’s economic recovery, a contribution that could be even greater still if the Government had included it in the stimulus package.” How disappointed were you that there was no injection of funds for the UK defence industry in the Pre-Budget Statement?

Mr Davies: First of all, Mrs Gilroy, I have to say that I think the Government very adequately indeed is funding defence, and the effort we have made has been most impressive, not only the core defence programme which is increasing the whole time as I have already said—the defence budget as a whole is increasing by 1.5%, equipment and support are doing extremely well in that context, but also there is the UORs and, as you know, we are expecting to have UORs of £635 million in the course of the coming financial year and that is in addition to the very substantial amounts of money we have provided for the latest batch of protected vehicles, for 700 new PPVs for Afghanistan, which was announced last month. That is a record we can all be very proud of. What I think you are questioning is about the fiscal stimulus package. Let me go into that a little bit because there may be some misunderstandings here. It goes without saying, Mrs Gilroy, that like every defence procurement minister in the world I imagine I am not in the business of turning down new money; if it comes to me I am very happy to put it to very, very good use.

Linda Gilroy: Did you actually make the case for more?

Mr Davies: Let me explain to you about that. If you want to go in for a fiscal stimulation package, which of course the Government is—and I think you and I agree—doing entirely the right thing about, then we really need to achieve three criteria. First of all you need to have spending which feeds through very rapidly into consumption—in other words you cannot use Crossrail, for example, because by the time you have all the planning inquiries—

Chairman: That would be good.

Mr Davies: The second thing is that ideally to use your money for maximum impact you need to spend it on goods and services which are labour-intensive rather than capital-intensive in their manufacture so that the benefits flow through into pay packets rather than into rewards for providers of capital—banks and shareholders and so forth who would inevitably have a very high propensity to save and a low propensity to consume. Ideally you need those wages to flow through to people who are relatively low-paid. That is not the case with defence; defence is capital-intensive rather than labour-intensive.

Chairman: Perhaps I could be allowed to just answer the question.

Mr Davies: Minister, can I suggest you please do your utmost to answer the question and to say then “I will explain why that is” if you like. In this case, when Linda Gilroy asks you “Did you make the case?” you can say, “No, and I will say why it would have been a bad case to make” or “No, and I wish I had”, or some other answer but do please try to answer the questions that we put rather than explaining everything all around the houses before you actually answer the question.

Chairman: I think you have answered that question. Linda Gilroy.

Mr Davies: Mr Arbuthnot, I am trying to enable the Committee to understand why actually defence is not an obviously efficient target for counter-cyclical fiscal stimulation, which is the question I was asked by Mrs Gilroy. The third factor is leakage into imports. There is quite a high leakage into imports in defence, inevitably, and that is not the case, for example, if you are repainting schools or putting new roofs on schools.

Chairman: I think you have answered that question, Linda Gilroy.

Linda Gilroy: Can I just take that up, based on the region that I represent part of, where we have one of the biggest aerospace industries possibly in the whole of Europe in terms of defence employment, estimated to be about 40,000 with
100,000 indirectly dependent and a very long supply chain reaching right down into Cornwall from the more obvious places where the aerospace industry is sited in the region with a presence from all four primes. Are you saying to me that before the Pre-Budget Statement—and people are still trying to work this out—there is sufficient in the way that you have reconfigured the defence budget to enable that supply chain to be maintained?

**Mr Davies:** Yes, I believe there is.

**Q419 Linda Gilroy:** That is a very straight answer and a short answer. Can I move on to research spending then because that puts the other angle on it. I am sure you will have read the exchange that I had with the Permanent Under-Secretary on the fears about the cuts in the defence research spending and the way in which that can impact on the long term capability and keeping ahead in that capability. Has defence research spending been cut; if so by how much and in what specific areas?

**Mr Davies:** We have not made an announcement about that in the equipment examination. The matter is under review. I would say, Mrs Gilroy, that we obviously do not spend money carelessly, we spend money on research spending because we are very conscious of the benefit we can get from that. We are seeking to balance that, but the Defence Technology Strategy said that the military advantage achieved at any one time depends upon the research and development investment being made during the previous 25 years. What estimate are you making of the impact on the UK’s future military advantage from the cut in defence research spending?

**Mr Davies:** I cannot quantify that. The important thing is to use the defence research spending as intelligently as possible, for example to try to make sure that as far as possible it is co-investment, so we provide a certain amount of money and we persuade perhaps the private sector to provide some more money, and we therefore leverage our own particular budget. Clearly, some expenditure on research is absolutely vital; no one is suggesting we should get out of the research business but, equally, we cannot say ab initio a priori that spending money on research is more useful than spending money on anything else. I do not think that would be a fair thing to say. This is something which cannot be immune from our examination from time to time as to whether we are getting the priorities right.

**Q420 Linda Gilroy:** There are obviously tensions and you set out at some length earlier on how you were seeking to balance that, but the Defence Technology Strategy said that the military advantage achieved at any one time depends upon the research and development investment being made during the previous 25 years. What estimate are you making of the impact on the UK’s future military advantage from the cut in defence research spending?

**Mr Davies:** I cannot quantify that. The important thing is to use the defence research spending as intelligently as possible, for example to try to make sure that as far as possible it is co-investment, so we provide a certain amount of money and we persuade perhaps the private sector to provide some more money, and we therefore leverage our own particular budget. Clearly, some expenditure on research is absolutely vital; no one is suggesting we should get out of the research business but, equally, we cannot say ab initio a priori that spending money on research is more useful than spending money on anything else. I do not think that would be a fair thing to say. This is something which cannot be immune from our examination from time to time as to whether we are getting the priorities right.

**Q421 Linda Gilroy:** Can you confirm to the Committee that you are making some estimate of what the impact is—whether it is a 7% cut or not—of whatever cutback there is in the defence budget?

**Mr Davies:** Let me put it more positively: we always try and make an estimate of what the value is potentially and what the return may be from any particular defence research spending that we make. If we have to cut something then we obviously decide what is a negative return, what are we sacrificing, we try to be as robust about these things as we can.

**Q422 Linda Gilroy:** When do you think we can expect to have greater clarity about what exactly will be in the defence research budget?

**Mr Davies:** I once again say, Mrs Gilroy, there is no hidden agenda here and it is not as if I am withholding some announcement which I am conscious of but for some reason I do not want to make it before this Committee. That is not the case at all, I am simply saying that we will be reviewing our defence research spending. When I say reviewing that does not necessarily mean cutting, but we are looking to make sure—as we will be doing on all our equipment and support programmes—that the current spending accurately reflects our present notion of what the priorities ought to be.

**Q423 Linda Gilroy:** You would not at this stage agree with the Chief Executive of SBAC when he told us that defence research spending has been cut by 7%—it has been cut.

**Mr Davies:** I do not know what the baseline is on which he is making that statement. If you actually look at research spending over the last five or six years you see it is an up and down figure, sometimes it goes up and sometimes it goes down. It has been roughly in the area of £550–£650 million for a number of years.

**Q424 Linda Gilroy:** In real terms that is a cut.

**Mr Davies:** In real terms, Mrs Gilroy, the rate of inflation is not very great and depending on what baseline you take you can see that there was a real growth in spending over a particular period of years and it may well be that over that period of years there would be a real terms increase in research spending, so since you have got this peaks and troughs picture what sort of trend you deduce and whether it is a positive or a negative growth rate really depends upon where you take your baseline. If you take your baseline at the low point you will find that there is an apparent growth trend over the subsequent period.

**Q425 Mr Holloway:** I was always pretty useless at corporate finance but can I just pick up on Mr Jenkin’s thing here. You have a table that says “Changes in Resource and Capital Expenditure in the Winter Supplementary Estimate” and it says that Net Provision in Defence Capability is down £950 million and Operations in Peacekeeping going up by almost the same amount; surely what you are doing is you are robbing Peter to pay Paul so you are going down on your future capability in order to fund what you are doing out in Afghanistan or wherever else, so it is a cut.
Mr Davies: No. Mr Holloway, we are not making cuts; as I said we are making changes in our priorities from time to time and I repeat, we have not cut any of these long term programmes and we are very much committed to these long term programmes. So we are not robbing Peter to pay Paul.

Q426 Mr Holloway: What is that then? Sorry, I must be really dim, what is that?

Mr Davies: Let me put it this way—we have already been over this ground—the major re-profiling exercise in the equipment examination was the carriers. We have re-profiled spending on the carriers. I have explained to you already once there is absolutely no element of defence capability cut involved in that at all, it has been possible to re-profile expenditure to take the strain off the coming two financial years without paying any price in terms of the nation’s defence capability. It may seem to you paradoxical that we can achieve such an effect, apparently a free effect, because we have not incurred any cost to our defence capability, but that is the case, that is what we have been looking at. Under no circumstances could you characterise such a thing as a cut.

Chairman: I want to move on to the Defence Industrial Strategy, Vice-Chairman David Crausby.

Q427 Mr Crausby: Who has the overall responsibility for the Defence Industrial Strategy?

Mr Davies: I do as a Minister and Mr Amyas Morse who is here with me as an official.

Q428 Mr Crausby: I would not have needed to ask that question when Lord Drayson was in your position. It was generally accepted that Lord Drayson drove the policy forward and did a tremendous job on it, yet I have to say that the general impression, right across industry and politics, is that the impetus has been lost and the Defence Industrial Strategy has been effectively parked on one side. What do you intend to do about regaining that impetus?

Mr Davies: First of all, Mr Crausby, I think it is a fair characterisation of the last three years since the Defence Industrial Strategy was first promulgated that we have been implementing it; we have been implementing it—I hope you will give us credit for that—in a rather impressive fashion. All these contracts that we have been talking about, the new contract for the carriers, for example, the contract for Future Lynx which we have just been talking about, are all a manifestation of that, so the best thing that can happen with the Defence Industrial Strategy I should have thought was that it should be implemented, it has been implemented and is being implemented and will continue to be implemented.

Q429 Mr Crausby: What about the Defence Industrial Strategy 2? As you have just been saying we understand that Mr Morse is in charge of the Defence Industrial Strategy; can you help us on progress on this, please?

Mr Morse: Certainly. Is that all right, Minister, shall I do that?

Mr Davies: By all means, I will come in in a second.

Mr Morse: The answer is that we have not produced a Defence Industrial Strategy 2 in the timescale we originally planned on doing, and that is largely because industry has said “Look, if you cannot be clear about the sector or the strategy and give us some indication of your spending plans we do not want to move forward with policy and the other aspects of it, we want to wait until things are as clear as possible. So it is not a question that we have held it up and industry did not know what we were doing; we have constantly talked to them. Since DIS1 we have also been in joint working with them on quite a number of policy issues in developing positions on those and also looking at some sectoral issues with them, so there has been quite a lot of continuing work. As to the question can we produce a composite of the whole thing, sectoral as well as policy, they very clearly said they do not want to produce the policy for us and we have gone with that up to now. I agree it has led to rather more of a delay in producing than that we planned originally, but that is where we are. The only other comment I will make is that I do conduct, with other colleagues, a number of discussions with industry—sometimes on easy and sometimes on difficult subjects—and we do so on a very frank and business-like and open basis as far as we possibly can. We call a spade a spade when we have to, and industry increasingly does that as well, and we talk to industry before we do things about what makes sense. We are trying very hard to put this into effect and work with industry more closely. I personally very strongly believe in that close approach and as much joint working as we can manage, coupled with a very tough, demanding regime on showing value for money.

Q430 Mr Crausby: I hear what you say, Minister, that progress has been made on the Defence Industrial Strategy but when we met industry their argument was that the principles behind the Defence Industrial Strategy scheme were “magnificent” but because of the funding problems it was effectively “on hold”. Do you believe that? Are the funding issues in these circumstances limiting progress on the Defence Industrial Strategy?

Mr Davies: No, the two things are quite separate, as I have explained. We remain committed to a very wide range of equipment programmes, we have not cut any essential equipment programmes, and I trust we will not, and industry understands that. They also understand that we have looked again at the priorities and so we discussed that with them in the context of the Defence Industrial Strategy and our partnership with our major defence suppliers. We talked through our views about this during the equipment examination and there were no shocks or surprises for them as a result of that examination so far as the Defence Industrial Strategy is concerned I repeat, I am completely committed to the principles of that Defence Industrial Strategy, the Government are completely committed to those principles, we are
continuing to implement the Defence Industrial Strategy. Whether it makes sense to have a second version of that, Defence Industrial Strategy 2, is a matter on which I am open-minded and I have expressed myself along those lines with industry. In so far as Defence Industrial Strategy 2 gave a greater degree of clarity, a greater degree of investor confidence to industry, in other words in so far as it was more explicit on the sectoral information, on the budgetary information and so forth than the existing one, industry would no doubt be pleased to have it, but if it did not achieve those things—and it might be difficult for us to achieve those things—then there is a great danger having too frequent a re-issue of the Defence Industrial Strategy because it is supposed to be a long-term framework. Lead times in the defence industry are very long so if you suddenly say every two or three years we are going to change the Defence Industrial Strategy that might have a very negative effect on confidence. We are discussing this with industry. I am completely open-minded about what we do about producing some new document or when we produce a new document and I certainly do not exclude doing so.

Q431 Mr Crausby: Let me tell you what the Defence Industries Council said in its memorandum to us. They agreed that steps have been made towards upholding the principles set out but they said “However overall progress has been much slower than industry would have wished.” It is clear that industry are disappointed in the progress that has been made; is industry wrong to be disappointed, are you satisfied with the speed of the progress that has been made?

Mr Davies: Mr Crausby, I come from a private sector background and one is never satisfied with the degree of market that one has, one always wants to have a bigger market, one always wants to have a bigger market share. It would intensely surprise me if the customers of the MoD at any one stage said “Thank you very much, we are quite satisfied with the flow of orders, we are quite satisfied with the defence budget, we do not want any more.” That would not be a natural state of affairs, so I regard it as a very natural understanding of the state of affairs. When they say they would like a bit more money that is perfectly reasonable but they recognise realities, they are getting more money all the time but not, obviously, at the pace that they might conceivably be asking for.

Q432 Mr Holloway: Minister, listening to you it would seem that everything is going brilliantly, particularly in the two and a half months since you took over, but are there any areas where you might think you could have done a bit better or is everything just going marvellously?

Mr Davies: We are always looking to raise our game, of course we are, we are always looking to raise our game in defence procurement, we are always looking to do things better, we are always looking to do things cheaper, to get the capability we need more effectively. We are always looking at new contract mechanisms, new financial disciplines and so forth of that kind. If you ask me if I have any concerns about our ability to deliver the capability which the military need and deserve, then I think my main concern is the one that we have already touched on, which is the air bridge. It is a matter of honest considerable concern; there are no miracle immediate solutions available, this is very, very difficult territory for us but it is something that we are certainly all working on and spending a lot of time thinking about. I do not mean to just leave the issue there, I do not mean to just say there is nothing we can do, that is it. We will I trust be taking some measures and in time of course, as soon as we can announce them, we will announce them.

Q433 Mr Jenkin: Can I just point out that your predecessor but one originally promised us the Defence Industrial Strategy 2 by last Christmas, and then your predecessor promised us in the Spring. Now we have a new doctrine that it might not be necessary to have DIS2 at all, at least it is not necessary to have these documents nearly as often as was originally envisaged. Can you explain what Government policy now is?

Mr Davies: Government policy is as I just enunciated it, which is that we are totally committed to the Defence Industrial Strategy as it exists. That document dating from 2005 is still a very valid document, indeed it is in many ways our sort of road map and that continues to be the case.

Q434 Mr Jenkin: Why did Lord Drayson think it was going to be very necessary to produce a new one and you have decided that you do not need one?

Mr Davies: I cannot answer questions on behalf of other people and I certainly cannot answer questions three years afterwards because contexts change, things change. I am trying to give you, Mr Jenkin, a very frank response and I certainly do not exclude having a new document. As I say, I am open-minded about when that should best be and I am very conscious that there is no point having a document for the sake of having a document, there is no point having a document which is full of general principles and aspirations, the only sort of document that industry is actually interested in—and you will know this as well as I do—is a document which gives a very great deal of clarity and certainty about our purchasing plans.

Q435 Mr Jenkin: What is holding it up?

Mr Davies: What is holding it up is that we have of course had the equipment examination. As I have said, the exercise of looking at our priorities and so forth is not something which is just finished once and for all, there are a number of uncertainties still in the future, there will be for some time, we are engaged in operations where the requirements we have for the front line change and evolve quite rapidly, so we need to maintain—
Q436 Mr Jenkin: What you are saying is that short-term considerations are dominating Ministry of Defence thinking and long-term planning is going out the window.

Mr Davies: No, on the contrary, we have just placed some very long term commitments, long term orders: Future Lynx and the carriers would be two very good examples there.

Q437 Mr Jenkin: Future Lynx went through Main Gate two years ago.

Mr Davies: We have just confirmed Future Lynx, as I have just explained, and that has now given industry a great deal of clarity in that particular business. Mr Jenkin, if I see my way to being able to produce a document which achieves the desiderata of industry then my instinct would be to want to go ahead with it. That is the most I can say to you for the moment.

Mr Jenkin: Which is not very much.

Q438 Chairman: Mr Morse told us that it is the absence of clarity that prevents us from having a Defence Industrial Strategy 2; would you agree with that? Am I paraphrasing you incorrectly?

Mr Morse: What I was saying is that we have a dialogue with industry—and you will have heard this from them I am quite sure—about whether or not we should go ahead with the Defence Industrial Strategy and in producing DIS2 and up to now they have been consistent in saying not unless you can give us a clear statement of sectoral plans on a comprehensive basis. As the Minister has said, the examination has made that difficult.

Q439 Chairman: You cannot.

Mr Morse: Not while you are doing an equipment examination.

Q440 Chairman: The short examination has made that difficult and we are told now that the short examination is over, so that difficulty has evaporated, has it not?

Mr Davies: Mr Arbuthnot, the position is this: as I have just said, it would not be sensible to have a new Defence Industrial Strategy every year, it would be crazy.

Q441 Chairman: This is part of the old Defence Industrial Strategy. It was envisaged in the Defence Industrial Strategy that we would have a Defence Industrial Strategy 2.

Mr Davies: I personally do not think that we should have these documents too frequently, you devalue them if you have them too frequently, I really mean that. I do not think we should have one every year, I do not think we should have one every two years, we should not necessarily have one every three years. I think we need to make sure that when we do have one it is at the right strategic moment when we can say something which is novel, which is original, which is arresting, which is detailed, which is full of sectoral and financial information of the kind that industry wants. As and when we get to that position the advantages of having such a document would be greater than the disadvantages. If we cannot agree those degrees of clarity then I do not think that the advantages necessarily would override the disadvantages and one of the disadvantages might be to devalue the existing document.

Q442 Mr Jenkin: Can I put it to you, Minister, it is very difficult to say anything novel or innovative when in fact the only things you can announce are delays, freezing contracts, putting things back. We all know—let us have a grown-up conversation about this—you have a procurement bow wave and the only way you can take the strain out of your programme is by delaying decisions and delaying acquisition programmes. That is not a very exciting thing to put into a strategy, is it?

Mr Davies: Mr Jenkin, that is a very one-sided view because it is just not a reasonable view. Of course we have put back some things but we have brought forward other things. You have chosen not to mention things we have brought forward like Future Lynx, like Warrior upgrades—

Q443 Mr Jenkin: That was already in the programme.

Mr Davies: But we have brought them forward. It is very important to get the full picture.

Mr Jenkin: It has not been brought forward.

Q444 Chairman: Do you describe what has happened to Future Lynx as bringing it forward?

Mr Davies: I do, Mr Arbuthnot, for the simple reason that there was very considerable uncertainty about this whole programme, there were all kinds of rumours—

Q445 Chairman: Why was there this uncertainty? It was caused by the Government.

Mr Davies: I can assure you that when I arrived in my present office there were a large number of rumours that we were going to cancel this particular programme.

Q446 Mr Jenkin: Why would that have been the case?

Mr Davies: I can never account for rumours, Mr Jenkin, you would be as good as I would be in guessing that.

Mr Jenkin: It is not difficult.

Q447 Mr Havard: Can I ask you then what you say to Lord Mandelson and the Department for Business or whatever it is called nowadays.

Mr Davies: Business Enterprise and Regulatory Reform.

Q448 Mr Havard: Thank you; that is this week anyway. The question, however, about looking at strategic industries in the current circumstances we are going through in essentially the next two but probably five years, they are looking at what they need in terms of sovereignty, for capability in industry, in different areas in different ways. They
must be asking the Ministry of Defence to make a contribution to that discussion; what do you say to them other than the fact we had a strategy, we published it in 2005, mate, you can read that and that is all we are doing?

Mr Davies: I am saying that that particular strategy foresaw a number of areas of sovereign capability and foresaw key partnerships which we would undertake with the major players in those sectors in accordance with that particular strategy.

Q449 Mr Havard: If we are going to have a Government Industrial Strategy (if I can put it that way) you have a Defence Industrial Strategy which has not been revised during that period of time. You are being asked for a revision, are you not, through that process?

Mr Davies: Mr Havard, of course I am only responsible for the defence aspects of our Industrial Strategy but I repeat we are totally committed to that Defence Industrial Strategy and our partners know that. As almost each month goes by we add to the implementation of that particular strategy but we are far from having achieved everything that was foreseen in that Defence Industrial Strategy. That remains a very useful working document and, as I have already said, one of my hesitations about the Defence Industrial Strategy 2—although I do not exclude it at all—is that we do not want in any way to create any uncertainty about our commitment to the Defence Industrial Strategy as it exists.

Q450 Chairman: Your partners know that, do they, because when Mike Turner, who knows a thing or two about defence came in front of us, he said the Defence Industrial Strategy is on hold. He said: “Now I think it is in doubt. We are very pessimistic about the future because we have the DIS, we have the principles, we have the strategy; we do not have the money.” Was he right?

Mr Davies: I quite agree with everything you say about Mike Turner, he is an exceptionally talented businessman and he certainly knows a vast amount about defence and the defence industry. So far as the last comment is concerned that we do not have the money, I have already explained that it would be immensely surprising—

Q451 Chairman: No, but he thinks the Defence Industrial Strategy is on hold.

Mr Davies: If he said that there was all the money there that he would like for his defence industries then it would be an extremely surprising comment, I agree. He did not say that and I do not think any of us should be particularly surprised at the line that he has been taking. As for “on hold”, that term is slightly ambiguous. It may mean valid, still in existence, unchanged, and if that is the characterisation he was giving it that is the correct characterisation.

Chairman: No, it was not the characterisation he was giving it. Adam Holloway.

Q452 Mr Holloway: How does the unexpected, unplanned-for level of violence in Helmand Province fit in with this?

Mr Davies: That is a matter which does give rise to defence equipment and support needs which are very urgent and which we treat as being of the utmost priority. I think I have explained to you in the course of the proceedings so far some of the things we have done about that, that is the reason why we came up with the new package of armoured and protected vehicles in November, another 700 vehicles. Remember we have about 8000 men and women in theatre so we are talking about one new vehicle for every 12 people or so who are actually deployed there. That is a pretty high number of vehicles, I think you will agree, Mr Holloway. Needless to say not everybody employed there in the course of his or her job goes on patrol so there is quite a large number. Other things, like re-engining the Lynx helicopter, that is something that I set the highest personal priority for and I had asked Rolls Royce for a quote on that within almost a few days of arriving.

Q453 Chairman: I would like to come back to the Defence Industrial Strategy, please. Still on what Mike Turner said to us, he said, “It is extremely difficult for industry to plan as we hoped we would be able to when we had a DIS, but that is reality.”

Mr Davies: He said it is difficult to plan when we have a DIS?

Q454 Chairman: “It is extremely difficult for industry to plan as we hoped we would be able to when we had a DIS . . .” That explains what he believes about the existence of the Defence Industrial Strategy, does it not?

Mr Davies: Mr Arbuthnot, you and I are discussing what somebody else feels about this.

Q455 Chairman: He is a rather important person.

Mr Davies: He is a very important person and I do actually speak to him about this. I do not know when these quotes derive from by the way.

Q456 Chairman: It was evidence in front of this Committee which is in the public domain.

Mr Davies: When was that?

Q457 Chairman: Two months ago.

Mr Davies: Ah, well two months ago, that may explain it.

Q458 Chairman: Ah, the Defence Industrial Strategy is right back on course now, is it?

Mr Davies: The Defence Industrial Strategy, in my view, Mr Arbuthnot, has never been off course over the last three years.

Q459 Chairman: I am sorry, 18 November, it is one month. You have revived something.

Mr Davies: I have to say that maybe Mr Turner had not had the opportunity of the conversations we have subsequently had when he gave the answers he
did. It is always invidious to quote the results of personal conversations, even if one does not go into the detailed content of them, but I have to say, and I say it advisedly, I am sure that Mr Turner would not disagree when I say that he and I have had a number of very constructive conversations on this matter and that he does believe that his views are very much reflected in my thinking on this and that we are not very far apart, certainly not in our principles and our objectives.

Q460 Chairman: He said: “... the primes are suffering on the major programmes. We are not flowing down and are unable to flow down money to the supply chain. We have made the point about SMEs in the defence industrial base. Frankly, I do not think we are being listened to.”

Mr Davies: I certainly cannot believe that Mr Turner thinks he is not being listened to.

Q461 Chairman: He says that he is not being listened to.

Mr Davies: He is certainly being listened to by me at the present time and will continue to be listened to. There are a number of issues in the quote you have just given the Committee, Mr Arbuthnot, and one of them relates to how much money there is and I do repeat that Mr Turner would hardly be doing his job as a representative of the defence industry if he expressed satisfaction with the amount of money that is available. I assume that for the rest of time he and his successors in that job will always say they would like to have more money available. It is perfectly natural, perfectly understandable, not a complaint by me at all, it is just a natural state of affairs. So far as the SMEs are concerned, that raises another issue and there are some misunderstandings here. We of course indirectly give business to a colossal number of SMEs and they recognise it, and we often get indirectly some absolutely vital technological inputs from SMEs but we do not actually do in our business that much business directly with SMEs because we tend to work through primes, we tend to work through lead contractors, we tend to want to have one major partner or a consortium of major partners taking the risks as our counterparty to get both the technical and the commercial risks to be borne by someone who has the balance sheet able to bear them. They are responsible for placing sub-contracts and have the subsequent relationship with the SMEs; it does not mean to say that our business is not vital for those SMEs but it does mean that the number of SMEs we have a direct contractual relationship with sounds rather small—it is something like 3% of our business.

Q462 Chairman: Of course that is true but it is the primes that tell us—you would not because you are not in direct contractual relationship with them—that the SMEs are suffering. Are you aware of that?

Mr Davies: I am certainly aware that there is always pressure on us—and this will be true to the end of time—from our major suppliers to provide more money with more programmes and so on and so forth; that is perfectly natural. But I do not think actually, given that these people are realistic, sophisticated businessmen, that in their heart of hearts they think that either they are being unreasonably treated by the Ministry of Defence or that our defence procurement programme as a whole is other than one which is a very substantial one and one which represents a very good basis for doing business in the defence sector in this country.

Q463 Chairman: Except that Mike Turner himself, when he was in front of us, told us: “I tell you now this industry is in decline and unless people pay attention to the budgeting of defence in this country and the defence industrial base we do not have a future.” That may be a bit apocalyptic, but you cannot just dismiss that can you?

Mr Davies: I think everything I have said has reflected what is quite genuine, which is that I have the greatest regard for Mr Turner; he does a superb job as the advocate for the defence industry in this country.

Q464 Chairman: He is more than an advocate for the defence industry, he is a practitioner.

Mr Davies: He is indeed, he has a number of individual roles, but he is actually no longer the chairman of BAe Systems as he was until very recently.

Q465 Chairman: No, but Babcock would do.

Mr Davies: Yes, indeed. But his main role in which he comes to see me actually tends to be not so much about Babcock business but representing the defence industry as a whole. I am always very interested to talk to him about that but I do understand that the role of advocacy of any particular sector does require putting pressure on the major customer to come up with as much money as possible as rapidly as possible; that is the way the game has got to be played. There is no misunderstanding on either of our parts about the role which Mr Turner plays on behalf of his industry, and he does it extraordinarily well and extremely ably.

Q466 Chairman: Should we treat what he told us as being “He would say that wouldn’t he”?

Mr Davies: No, Mr Arbuthnot, in a Committee of this kind where there is a very sophisticated understanding of the sector you make your own decisions about how you discount what is said from the point of view of the agenda of whoever is saying it. I am sure that goes for me too.

Chairman: It certainly will. Thank you very much, Minister, for coming with your team of thousands and for helping us to finish off our report on Defence Equipment. It has been a very interesting session and it has been quite a long one but a very, very important one. Thank you very much indeed.
Ev 64 Defence Committee: Evidence

Written evidence

Memorandum from Nicholas Brunt

1. In this time of budgetary crisis, I hope that your Committee will keep a laser focus on cost effective defence policy. The DIS must move from pork barrel spending in marginal constituencies at tax payers expense, to a rational system with timely purchases of cost effective material.

2. In practice timely and cost effective means “off the peg”. Our Foreign Policy would be in a vastly improved position if we had not wasted so much of our Defence budgets re-inventing the wheel. Our Service People would not recognize their improved lot were they not forced to make do with whatever material the British Arms Industry dains to produce, decades after it was first needed.

3. Your committee would be well advised to take the long running saga of the SA80 to how long, and at what unit price it takes a service person to get their hands on an effective piece of kit. Another more recent case is the Bowman project. I hope Colonel Borton’s courage in speaking out will raise the profile of the Bowman’s failures within Parliament.

4. The budgetary crisis demands sacrifices—better that “sovereignty” goes before capability. We need effective equipment. A Union Jack on every piece is a very expensive luxury.

20 October 2008

Memorandum from EDS an HP company

The Defence Committee has launched an inquiry to examine the MOD’s progress in improving the way it procures and supports defence equipment, and issues about the future equipment programme and the Defence Industrial Strategy. The Inquiry will focus on four main areas, upon which we have given comment:

The progress made to date to develop DE&S into a “fit for purpose” integrated procurement and support organisation.

1. The inquiry should widen its remit to include the wider Acquisition Process of planning, budgeting, reporting, delivery, availability and so on. If this is too large then the focus should be on the entire Through Life Capability Management (TLCM); the cornerstone of the Defence Acquisition Change Programme. This should also include the adverse impact that efficiency measures such as Streamlining in MOD or PACE within DE&S have had on the Departments ability to deliver an efficient and effective programme. TLCM was primarily a cost saving measure with the by-product of formally managing programmes across all Defence Lines of development.

2. Whilst the theory and intent behind TLCM are flawless; the aim to be cost effective and operationally effective through life has been interpreted as saving costs now. Not in future and certainly not across all Defence Lines of Development. TLCM has yet to get off the ground because short term budgetary expediences have scuppered the intent to invest now, in order to save on through life support costs.

3. TLCM has lead to a realignment of responsibilities but without a single process owner; therefore decisions are still based out with a single unifying policy. An option to make DCD the Acquisition Process owner recently stalled; illustrating the current lack of governance which works well at the Director level but loses clarity as wider budgets are merged and harder priorities determined.

4. The achievements made by DE&S have been impressive and the TLCM initiative is to be applauded but we have yet to see the necessary decisive shift in process, approvals, risk, ownership and resources to make the Acquisition and support fit for purpose. Progress on TLCM seems to be blighted by:

   — A lack of a single process owner; an approved and adequately funded Defence Planning Assumptions; and a departmental risk register. Who has the lead—Main Building or DE&S? Where does the power and decision making heart lie—Programme Boards, Management Groups, the extended JCB or DE&S Boards?

   — The split of years 1–4 with 5–10 has reduced the ability for a more coherent approach. Perhaps a better approach might be to split funds between support for current systems and support for their replacements with a handover at acceptance. Nevertheless all managed through Capability Management Groups and the JCB; but this has been muddled by the unclear role of Programme Boards.

   — A Planning Round process which is obstructive to uncommitted programmes, prevents action on many projects for up to half the year and is more expensive in the long run as both Industry and MOD have to keep teams employed throughout the delays of the options process. In the current climate of chronic under funding projects with uncommitted funds only make around four months progress within the year, as their budgets are frozen as monies are reallocated and re-justified during the Planning Round.
— A reluctance to spend the recommended 10–15% of the project budget during the assessment phase. This would encourage spiral acquisition, early engagement with industry partners, reduce gold plating, minimise risk and speed up delivery. It makes little sense to have an assessment phase often measured in years within an IT sector that measures technological life cycles in months. There is not enough demonstration, or developing the capability in the hands of the operators, not enough commercial solutions and too much tailoring and meddling.

— A reduction in IPT manpower has lead to chronic shortfalls in specialist areas such as commercial and scientific support. It widely acknowledged that there is an acute shortage of project managers with wide industrial expertise; yet there is still a reluctance to partner with industry or explore fully the benefits of getting industry to run project teams, although this is still a stated Treasury goal.

— A noticeable shortfall in intelligent Customer Capability. IPTs may know a lot about IT but little about the business it is supporting. There is still poor linkage between the cost of a capability and the cost of the IT to support it.

— A lack of effective delegation to the Capability Management Groups, which would enable innovation and agility if empowered.

— Failure to accept risk in order to exploit technology, react to operational demands and reduce assurance overheads.

— A reluctance to partner routinely with industry as opposed to areas where we have historically done so. Industry has much to offer, particularly in research, innovation and efficient outsourcing, and can help to improve the efficiency and speed of the acquisition cycle.

— An increase in senior management (an additional four 3* officers with 112 supporting staff) an increase in the approvals process, a risk adverse culture, a cut in and a reluctance to delegate. For example a recent approvals process for a project required 76 different signatures.

— The increase in CLS/CFA and PFI contracts has reduced the Departments ability to veer and haul and thus projects with more traditional procurement strategies are hit most.

The extent to which support to current operations is impacting upon DE&S’s performance relating to the procurement of core defence equipment.

5. The division, and lack of money across the process and the fissions within the procurement and programming effort has lead to the same result: a lack of long term coherence and readiness across all DPAs. Bereft of a single process owner and a long term departmental plan it is likely that not only MOD but also industry will be unable to met medium scale reconstitution and large scale force elements at readiness timelines. Current operations are the predominant force in a programme that should be looking out to 10 years and beyond. Thus it has had a disproportionate influence on PR09 with weighting given to current operations, operational support for three years and focused on less than £10 million.

6. Routine procurement is being set aside and although most projects have interdependencies there appears to be no one championing programmes that are not linked to current operations. Nearly all Urgent Operational Requirements(UOR) are taken into core. This is a cost driver and by bringing forward EP funding, runs the risk of creating an incoherent long term, unfunded programme. The impact of the Future Rapid Effect System (FRES) programme is evidence of this. It would appear that £500 million of assessment work is running the risk of being lost as UORs are taken into core. Impact of current operations has lead to a curtailing of the planning round process in order to inform the Pre-Budget announcements in November.

The progress made relating to the “short examination of the equipment programme” announced by the MOD in June 2008.

7. In our view the process was flawed from the outset as it only reviewed what was already in the programme with no additional funding or no strategic direction from the Defence Board. The examination only considered uncommitted resources and some opportunity costs; not the total through life costs. Whilst this work was being done there was established a commitment control regime to stop projects spending and thereby delay delivery. The equipment examination is far from complete and we understand has been unable to realign with PR09.

The progress made to date in implementing the Defence Industrial Strategy and the delay in publishing the updated version.

8. The clarity of the first DIS is in danger of being lost whilst MOD determines what should be in the affordable equipment programme, and the realisation that there will have to be a Defence Review, whatever government is in power in 2010. It was fairly obvious that trying to publish the latest version of the DIS within the midst of Planning Round 09 was always going to be fraught whilst the major political and industrial decisions of the options had yet to be determined. Furthermore the efficacy of DIS was based on
the personal commitment and drive of Lord Drayson; and it will require the same from his successors. The earliest publication date is post the current Planning Round (PR09) in April 2009; but it is difficult to refute the logic that it will be delayed until after the next election and post a possible Defence Review in 2010.

Gap Analysis—Where is MOD Integrated CIS Delivery today?

MOD currently has . . .

Too Much:  Not Enough:  Excellent:
— Bureaucracy  — Unity of Effort  — Operational Staff
— Procedures  — Enterprise Planning  — Tools
— Rules & Regulations  — Streamlined Governance  — Operational Experience
— Roles  — Standard role descriptions  — Localised Knowledge
— Standards  — Commercial standards
— Documentation  — Organisational Integration
— “Local” focus  — Industry collaboration
— Repetition  — Commercial knowledge
— Churn  — Programme Managers
— Risk aversion  — Risk Management

6 November 2008

Memorandum from EADS UK

1. DE&S

EADS believes that remarkable progress has been achieved merging the DPA and DLO organisations in the midst of difficult circumstances strategically and financially. Everyone recognises that when two substantial organisations are merged it takes time to embed a single new culture and way of working. However, to focus only on the difficulties would we believe to overlook significant achievements like signing off the underwriting of the FSTA PFI contract despite extraordinarily hostile financial market conditions.

2. Programmes

While there remain challenges in some programmes, on A400M it needs to be recognised that this aircraft is designed to meet a seriously demanding and much needed requirement for the RAF and European air forces. It will provide a unique and very flexible capability; but it is consequently a very complex machine. For example, this aircraft will incorporate state-of-the-art systems and structure in addition to using power plants designed from scratch specifically to deliver the performance capability demanded by the customers. It was also designed to be as US ITAR restriction free as possible and to create a sovereign ability in Britain and Europe to design create and support serious tactical/strategic lift for our military customers. It is clearly not a straightforward civil Airbus product, and accordingly cannot be approached in the same manner as simply procuring a civil aircraft. We and our suppliers are working intensively with our customers to resolve outstanding issues as well as to mitigate the impact of any delays. We are confident of agreeing a robust way forward.

Taken together, the FSTA and A400M programmes will represent the establishment in Britain and Europe of a major sovereign capability in large strategic military aircraft.

6 November 2008

Memorandum from Unite Amicus Section

This response is submitted by Unite Amicus Section. Unite is the UK’s largest trade union with 2 million members across the private and public sectors. The union’s members work in a range of industries including manufacturing, financial services, print, media, construction, transport and local government, education, health and not for profit sectors.
EXECUTIVE SUMMARY

— Small and medium sized enterprises (SME’s) are a key component for the success and productivity of the defence sector as a whole.
— Unite fully believes the original Defence Industrial Strategy (DIS) has been a resounding success and also believes there is a compelling argument for the swift introduction of DIS2.
— Technological innovation and research and development have changed the face of armed conflict. Technological advantage is the key to providing the UK armed forces with the advanced equipment they require.
— Long term partnering agreements such as DIS offer stability, longevity and pragmatism to relationships between government, industry, workers and trade unions.
— Unite believes Defence Equipment and Supply (DE&S) is not achieving the objectives for which it was created.
— Unite is concerned that there are still delays in DE&S awarding contracts, there is no clear indication that DE&S is achieving value for money for the UK tax payer or maximising economic benefits to the UK economy from the sale of defence equipment abroad.
— Unite also has concerns that DE&S appears unwilling or incapable of making strategic decisions around the funding of defence projects and finalising the procurement process on projects that are linked to the 10 year forward budgets of the department’s 2008 Planning Round.
— Unite believes there are three key components for the new DIS2 to work.
1. The UK must retain and control the Intellectual Property Licences for all equipment purchased.
2. The UK must have a role in the R&D phase of equipment that is purchased.
3. All equipment procured must be manufactured in the UK by UK workers.
— UK government should not be buying key military equipment abroad as a “stop gap” when there are projects such as FRES that have been on the drawing board since 2001 and are now ready for production.
— When the contractor to build Future Rapid Effect System (FRES) is finalised, BAE Systems facilities in the UK should be utilised to ensure UK sovereign capability is not lost forever.

1. INTRODUCTION

1.1 Over the past three decades the UK Aerospace industry has undergone a series of significant changes and strategic re-structuring. The two most important changes have been the rapid globalisation of manufacturing industry and the changes to production and capability in the face of the UK armed forces being involved in two major military conflicts.

1.2 The sector is the second largest in the world and is a significant driver of regional, national and global economic growth and productivity. The industry generates £38.6 billion worth of revenue and exports of £4.34 billion. The Aerospace sector employs a workforce of over 124,000 people and Unite represents around 100,000 workers within the Aerospace industry.

1.3 The sector has a number of large key companies but also has a diverse and strategically important supply chain of small and medium sized enterprises (SME’s). These workplaces are incredibly important to the success and productivity of the Aerospace sector and Unite acknowledges the key role SME’s play in ensuring that the UK Aerospace sector remains one of the largest in the world.

1.4 Also included in the wider defence sector is the Shipbuilding & Repair sector. There are 16,000 people currently employed in the sector and Unite represents more than 7,000 members. The Shipbuilding & Repair sector is an industry of significant strategic importance to the UK, the research and development work carried out within the sector transposes across many other industrial sectors and provides an annual turnover of just under £2 billion per annum.

2. DEFENCE PROCUREMENT

2.2 Unite supports the current partnering arrangements that the Defence Industrial Strategy (DIS) has implemented. There is a compelling argument to be made for the partnering process, inasmuch as it delivers what is needed operationally and, with its long term investment strategy enables a through-life capability that is advantageous to all stakeholders.

1 SBAC—UK Aerospace Survey 2006.
2.3 The capabilities that are needed now are vastly different to those envisaged 50 years ago when the cold war was the greatest threat to UK national safety and security. What this has created is a scenario where it is the technological advantage that is needed by the UK armed forces.

2.4 This level of technological change and expansion has created new ways of working and the creation of new industries and new technologies. Part of this creation has been developed by the small and medium sized enterprises (SME’s) in the sector. This is where the technological innovation is to be found and where there are significant levels of intellectual property and the ability to provide solutions for the big companies that dominate the UK Aerospace sector.

2.5 Long term partnering agreements give stability and longevity to relationships between the MoD, industry, workers and trade unions. The agreement also provides a strategic focus for the sector and allows businesses, especially SME’s, the opportunity to make strong supply chain linkages and make better informed business decisions in terms of investment and staff recruitment, retention and training.

2.6 Unite is clear that the best way forward for the UK defence sector is for a second Defence Industrial Strategy. The first strategy has proved to be a positive and worthwhile plan for the sector. It also meant that a sector which had previously suffered from severe boom/bust economic policy can enjoy the long term economic, industrial and social rewards of the strategy.

2.7 The partnering agreement also provides long term value for money for the tax payer. It gives industry an enduring vision for defence equipment requirements and solutions and also enables UK government the opportunity to plan and invest strategically and operationally in the procurement process.

3. DEFENCE EQUIPMENT AND SUPPORT (DE&S)

3.3 DE&S is responsible for creating a world class integrated procurement and support organisation for the UK Armed Forces. This department is part of a much wider change programme within the MoD and as such works to implement the recommendations of the Defence Industrial Strategy. However, does DE&S achieve what it was created for?

3.4 The remit was to address the fundamental organisational block to achieving a through life approach to acquisition and support. At present it would seem that DE&S is not achieving what they set out to do. The department has no measures in place to assess whether it is getting value for money, or, if in applying the principles of the Defence Industrial Strategy it is maximising economic benefit to the UK tax payer from defence expenditure.

3.5 Under these circumstances the DE&S is clearly not doing what it was set out to do and the consistent problems with delays in investing and awarding contracts is causing serious problems through the whole Defence sector. In these challenging economic times government procurement is a strategic way to ensure the UK economy does not fall further into recession, protects workers jobs and ensures that key skills are retained.

3.6 Unite understands and supports the UK government in its requirement to retain certain critical defence technologies and industries in the UK. This ensures that intellectual property and competitive advantage remains in the UK. However, Unite has concerns that DE&S appears unwilling or incapable of making strategic decisions around the funding of defence projects and finalising the procurement process on projects that are linked to the 10 year forward budgets of the departments 2008 Planning Round.

3.7 Experience supports the claim that delaying defence procurement projects for significant lengths of time leads to substantial increases in costs in the long term. The substantive process of DIS was to alleviate this protracted decision making process and ensure that the need and requirements of the UK armed forces were met by companies and workers that could deliver in a timely fashion the goods and services they needed.

4. DEFENCE INDUSTRIAL STRATEGY 2

4.1 The original Defence Industrial strategy was very much a success story for the UK defence industry, UK workers and for government in procuring goods and services for the Armed Forces.

4.2 Unite believes this tri-partite strategy can be replicated in the Defence Industrial Strategy 2. Only in this way can the long term capability of the defence sector be guaranteed. Unite is very clear, and experience bears this out that delaying projects leads to substantially increased costs in the long term. A clear and coherent procurement strategy is an imperative in ensuring that “best value” for the tax payer is achieved, workers jobs are protected and unique skills and experience are not lost forever.

4.3 Unite supports the production of a new Defence Industrial Strategy because it binds all stakeholders to a long term vision for the sector, provides value for money for tax payers, offers industry the opportunities for innovation and research and development in new technology, design and production. The strategy also allows for the forward planning for investment purposes and allows UK industry to invest in the skills and training needed to facilitate new ways of working and new technological advances.
4.4 Unite believes there are three key components for a new UK Defence Industrial Strategy to work. Firstly, the UK must retain and control the Intellectual Property Licences for all the equipment that is purchased. This allows the UK the right to use, upgrade and overhaul and repair at the discretion of the MoD and is not controlled by other sovereign nation states.

4.5 Secondly, the strategy must insist that the UK has a role in the research and development phase of equipment that it purchases. This is to ensure that as an industry the UK defence sector has the knowledge capability to upgrade and repair the equipment.

4.6 Thirdly, that the equipment procured is manufactured in the UK, this is to ensure that jobs within the sector are not lost and the workers in the defence industry retain the skills, knowledge and experience that is vital to the enduring success of the sector.

5. FRES—FUTURE RAPID EFFECT SYSTEM

5.1 The concept for the new, medium weight armoured vehicle fleet known as FRES was initially drawn up in 2001. A decision on the preferred design was made in May 2008 and General Dynamics UK was provisionally the preferred bidder. Due to continual delays in the awarding of the contract the MoD was forced to provide a “stop-gap” and procured the Mastiff as a short term replacement. This was bought from Italy and Unite believes that the delays that have occurred in the investment and production of FRES are wholly unacceptable.

5.2 The UK government should not be buying key military equipment abroad when there are projects such as FRES on the drawing board. What this requires in order to meet the projected FRES UV in service date of 2012 is a significant contract being placed with General Dynamics UK covering development, construction of a number of prototype vehicles and an initial production batch.

5.3 Unite believes the delays have gone on for too long and it is clearly the decision making processes, which the creation of the DE&S was supposed to alleviate, added to the lack of a firm commitment to investment which is the crux of the problem. Unite believes that once the contract is finalised, General Dynamics UK, who will be undertaking the vehicle integrator and builder role should be required to use BAE Systems facilities in the UK to ensure that UK sovereign capability is not lost forever.

Unite Recommendations

— Defence Industrial Strategy 2 (DIS2) must be implemented as soon as possible.
— Government must ensure that all stakeholders involved in DIS2 are wholly committed to the continuation of long-term partnering arrangements and agreements.
— Unite believes there needs to be a strategic review of the effectiveness of the DE&S and the setting of objectives to ensure the department is achieving its original objectives.
— The DE&S must ensure that procurement contracts are awarded in a timely manner and ensure that the prevailing culture of continual delays is stopped.
— Government must recognise that continual delays to the implementation of defence projects clearly leads to substantial increases in costs to the tax payer—this is not acceptable and is avoidable.
— In any review of the DE&S government must consider the impact on the UK defence industry, UK workers jobs and the wider economy.
— In the awarding of contracts and investment in the UK defence industry government must consider how vital the retention of key skills and experience is to the sector and through–life capability.
— The UK must be allowed to retain and control the Intellectual Property Licences for all defence equipment purchased.
— The UK defence sector must have a key role in the research and development phase of any equipment purchased.
— All equipment procured by the MoD must be manufactured in the UK, using UK workers.
— Government must ensure that the vital investment needed for projects like FRES is forthcoming and implemented in a timely and robust way.
Memorandum from VT Group

1. EXECUTIVE SUMMARY

This memo:
(a) Provides an introduction to VT Group.
(b) Offers VT’s views on the performance of DE&S.
(c) Offers VT’s views on MoD’s short examination of the equipment programme.
(d) Offers VT’s views on progress in implementing the DIS.

2. INTRODUCTION

VT is a leading defence and support services contractor, providing engineering focused, mission critical support to the defence, nuclear and secure communications sectors, supported by a comprehensive specialist training business.

The Group employs over 14,000 people and has an annual turnover of over £1.2 billion as well as a current order book of over £6 billion. The Group is a long-standing supplier to the MOD and operates in a number of countries world-wide, with over one hundred offices, ranging from Cornwall to Northern Scotland, in the UK alone.

In July, as part of the DIS process, VT combined its shipbuilding assets with those of BAE Systems to create BVT, a new UK shipbuilding joint venture.

3. PERFORMANCE OF DE&S

Milestones Passed

Three major programmes with which VT is involved—the Future Carrier (CVF), the Military Flying Training System (MFTS) and the Future Strategic Tanker Aircraft programme—have all been approved to proceed and/or reached financial close. Improvements can and should be made to reduce the time taken to negotiate and approve deals of this sort; this should not obscure DE&S’ achievement in bringing these projects to fruition in the currently testing financial climate.

Impact of Current Operations

VT is a strong supporter of the structural reforms of the acquisition process set out in the McKane Report, including Through Life Capability Management (TLCM), incremental acquisition, the merger of DPA and DLO and more widespread use of longer-term partnering arrangements. Structural changes take time to bed down; more importantly, it is necessary to build a new culture and set of behaviours to support the new structure.

VT is sensitive to the fact that any assessment of DE&S’ performance must be set in the context of the MOD’s current budgetary challenges and the pressure of supporting simultaneously deployed operations in Afghanistan and Iraq. DE&S is in effect running in parallel two very different procurement processes.

There is a widespread consensus that the Urgent Operational Requirements (UOR) process is very effective in delivering quickly much needed equipment and support to the frontline. Over the last three years, VT has delivered equipment and support to the frontline under a number of UORs and can testify that the process works well. Examples include:
(a) Tactical radiation and monitoring equipment.
(b) Construction vehicles for Operation Herrick.
(c) Quick turn-around training for Operations Herrick and Telic.

However, it is self-evident that the UOR process does not sit comfortably with the TLCM approach that is at the heart of the MOD’s acquisition reforms, with the emphasis on considering through-life support implications and costs at the time of the initial capital acquisition.

VT’s view is therefore that the direction of travel is the right one, though the time taken to reach the desired destination takes longer than all involved in the process would like; the challenge is also made significantly more complex by the demands of current operations.
**Development Areas**

In building on the achievements that the merged DE&S organisation has already made, there is scope to focus attention in a number of areas:

— **Clarity on strategic defence priorities and requirements**

DE&S is a delivery agency. Its performance is impacted by other parts of the defence planning process. Priorities and requirements under review or subject to change will have significant implications for DE&S performance against time and cost benchmarks.

Decisions surrounding the equipment programme can often appear painfully slow to industry. This is a function of the scale and complexity of the issues and the number of people who need to be involved in the approvals process. This means that DE&S can frequently be perceived as a “risk averse” organisation where it is better not to make a decision, than to make a decision (however soundly based) and be penalised for getting it wrong.

By way of example, although rapid progress was made by MoD and industry on the size and shape of industry rationalisation following the publication of the DIS in 2005, it took a significant amount of time to reach final agreement on the shipbuilding joint venture, BVT. The MOD’s short examination of the equipment programme should help to clarify priorities and give DE&S a stable framework within which to work (see below).

— **Breaking down the silos**

The merger of DPA and DLO has successfully brought within single Integrated Project Teams the through life perspective. IPTs often enjoy considerable autonomy over the programmes for which they are responsible and their decisions can have major long-term impacts both on industry, and therefore on the activities of other related IPTs. DE&S has recognised the need for a more holistic view; DE&S senior management is also organised to have an overview across areas of capability. Industry has yet to see this translated effectively on the ground. Good examples are:

(a) VT is currently bidding to one IPT for Whole Fleet Management, whilst at the same time re-bidding for the White Fleet contract;

(b) VT is part of the Ascent Team that is starting to implement the MFTS contract, whilst the Group is currently re-bidding for the Tucano training contract, which is a key part of the overall training system; and

(c) the Defence Training Rationalisation is currently being negotiated (with major estates implications), whilst in parallel there is a process to select Regional Prime Contractors (RPCs) to manage the Defence Estate.

There is a tension between the vertical integration (with economies of scope) implicit in one approach and the horizontal integration inherent in the other (economies of scale). The advantage of the vertically integrated model over the horizontal is, for example, where the horizontal model is effective at reducing the cost of providing a building, the integrated model—by being able to take a more holistic view—might be able to do away with the need to provide a building at all. In addition, where programme flexibility is required, the integrated model allows for greater freedom to facilitate change without the cost of re-negotiating numerous contracts.

— **Avoiding duplication**

In any new acquisition process it takes time to build up trust and confidence in a new system. One benefit of SMART acquisition is to clarify and simplify the organisation of procurement. There is a need however to ensure—with greater emphasis on TLCM and greater use of strategic partnering arrangements with industry—that the structures do not become more complicated. There is an opportunity for DE&S to devolve responsibility and to transfer risk to industry for delivering against specified outputs and capability requirements. The value of this approach will be lost if the MOD establishes parallel teams to “mark” the industry teams charged with delivery.

— **Making a reality of Incremental Acquisition**

The theory is there, the practice needs further development. For example, today’s kit should be put on today’s ships; then upgraded/retrofitted as necessary. One major cause of delay, not to mention cost increases, is that platform design is constantly being changed to take account of likely future developments in the systems and equipment that they will accommodate—an issue that the Committee has previously noted in the context of the FRES Programme.

— **Long-term partnering—securing accountability and VFM**

Successful long-term partnering (LTP) arrangements are dependent on objectives being set up front. Because of the long-term nature of LTP, flexibility is essential to accommodate variations in requirements. Both MoD and industry also need to be flexible when it comes to programme implementation. Critically, contracts between MoD and industry need to be robust enough to demand continuous improvement, where savings are debated on both sides of the table as and when the opportunity arises.
4. **The Equipment Programme**

VT welcomes the MoD’s short examination of the equipment programme and looks forward to its conclusion being made known. For the reasons stated above, this review should help the acquisition process by bringing greater clarity to the MOD’s priorities and provide a more stable framework within which industry can plan and invest.

If the capability review is to be effective, it will need to bring requirements and resources into better balance. The current uncertain situation is causing blight on decision-making. There is also an opportunity, if the MOD can define the nature of the challenge, for industry to be part of the solution. For example, BAES and VT identified ways to smooth the spending profile of the future carriers to maintain the momentum of the programme, whilst alleviating the MOD’s budgetary constraints.

5. **DIS Progress**

Industry warmly welcomed the publication of DIS as the most comprehensive attempt in recent years by the MOD to create a clear policy framework to better enable industry to plan ahead and invest.

At the heart of DIS was the recognition of a link between the need for industry to restructure to make itself even more internationally competitive (thereby reducing the burden on the UK defence budget of supporting our defence industrial overhead) and the importance of having visibility of future work and of stable and sustainable workloads.

Industry has responded to the agenda initiated by the publication of DIS. The formation of BVT is a direct response to DIS as part of the Maritime Industrial Strategy (MIS). It was facilitated by the Government’s agreement to proceed with the Future Carrier Programme. If this progress is to be sustained, then focus is required now to pin down the programmes that will follow the future carriers, not least to ensure that we are able to keep together the UK’s design capability.

However, DIS embodies a long-term approach. The short-term requirements of supporting current operations and the need to find immediate savings within the defence budget do not facilitate the implementation of DIS. Industry hopes that the current capabilities review will create the circumstances in which it will be possible for the DIS process to regain momentum and for DIS 2 to be published finally.

7 November 2008

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**Memorandum from the Royal Aeronautical Society**

**Introduction**

1. The Royal Aeronautical Society (RAeS) is the Learned Society for the Aerospace and Aviation community. Based in London, it has a worldwide membership of over 19,000, with over 13,000 in the UK. Its Fellows and Members represent all levels of the aeronautical community both active and retired. Through its various Boards and Committees, it can draw upon considerable experience and expertise in aviation matters. In addition, the Society has over 160 Corporate Partners.

2. The Society welcomes the opportunity to comment on the Defence Committee’s enquiry into Defence Equipment. The Society has confined its submission to the Defence Industry Strategy and the A400 M.

**The Defence Industry Strategy**

3. The Defence Industrial Strategy (DIS), as well as its antecedent, the Defence Industrial Policy (DIP), combined with the Defence Technology Strategy (DTS), constituted an unprecedented review and forward look of the UK defence industrial base and its contribution to UK defence acquisition. There were deficiencies of omission and commission; but these were relatively minor when set against the overall quality of the analysis presented, and the coherence it promised for future relations between industry and the Ministry of Defence.

4. Without wishing fully to review the benefits of the DIS, the Society would like to re-iterate its support for the partnership approach developed by the DIS. In particularly, we commend the MoD for the adoption of a guided weapons research partnership that is designed to help maintain a vital capability in the absence of specific requirements. A similar approach has been adopted to support rotary-wing technology. However, in both cases, capabilities cannot forever be sustained by R&D alone, and the predicted cut in small helicopter procurement would inevitable threaten to erode a UK lead in this sector.

5. The Society commends the rapid progress made in Unmanned Airborne Systems (UAS) that was anticipated in the DIS and the DTS. The efforts on the part of both MoD and industry to develop technology demonstrators in this field should enable the UK to sustain a strong domestic capability that will act as a springboard for future national projects and to play an influential role in international programmes.
6. The DIS promised to be a dynamic document subject to discussion, review and regular updating. Even if this would not approach the annual review of American defence industrial affairs as mandated by the US Congress, there were hopes that a second version (DISv2.0) would be published by early in 2008 at the latest. There was concern that the adoption of long-term partnership agreements centring on traditional prime contractors would penalise the equipment sector, reducing their direct access to the end customer and increasing the risks of abuse by vertical integrated prime contractors. While there is yet no evidence of the latter, there was an expectation that DISv2.0 might address the former.

7. The DIS recognised the importance of sub systems suppliers as the source of much of the innovation in modern weapons, as well as their increasing role as systems integrators in their own right. However, there was concern that the adoption of long-term partnership agreements centring on traditional prime contractors would penalise the equipment sector, reducing their direct access to the end customer and increasing the risks of abuse by vertical integrated prime contractors. While there is yet no evidence of the latter, there was an expectation that DISv2.0 might address the former.

8. Clearly, the changed financial situation and the impact of operational needs on MoD planning have affected original assumptions about the timetable for DISv2.0. Nevertheless, the failure to maintain the momentum and energy associated with work on the DIP and DIS gives the Society considerable cause for concern. Companies, now even more than ever, need some indication of Ministry thinking to set their own budgets and to define priorities. Companies, either UK or foreign, with global footprints may determine that overseas investment should have more attention than here in the UK.

9. The Society is also concerned that the constructive attitudes towards the UK defence industrial base within the MoD, which brought the DBP/DIS/DTS, may weaken. The Ministry does not possess even proportionately the permanent resources available to the Pentagon in the field of defence industry analysis. Fire-fighting current crises, combined with the re-assertion of budget-led procurement strategies may lead to a loss of the long-term coherence that was evident in the DIS.

10. It is worth quoting a recent report from the US Defence Science Board—Creating an Effective National Security Industrial base for the 21st Century; “Creating a vision is key to successful transformation since it guides policy changes and supports plans and actions to transition from the current industrial base to one necessary to meet future military requirements”. Such a vision for the UK was emerging from the DIS process. Better, perhaps, to give a qualified, but updated sense of the future direction of policy than force speculation and pure guesswork on the part of industry.

The A400M

11. In an earlier submission to the Committee, the Society expressed its considerable dismay at the progress with the A400M programme. Our prediction that further slippage was likely was dismissed by industry spokesman as being too pessimistic. It gives the Society no pleasure to see that its misgivings have come to pass. The Society is concerned that a much-needed military capability, as well as potentially a valuable asset in world markets will be subject to further delay.

12. There is little utility in detailing the reasons for the problems with the A400M, save to provide some support for EADS-Airbus’ claim that its commercial freedom to manage the programme has been compromised by the politics of collaboration. Airbus was employed to instil the kind of commercial discipline so often lacking in collaborative programmes. In accepting a fixed price contract, it was prepared to assume a large degree of risk. It now seems intolerable that Airbus must now pay the penalty for decisions forced upon it for national industry policy reasons and for the continued interference from several national procurement agencies.

13. More generally, there were hopes that the A400M would constitute a break with some of the past problems associated with European weapons collaboration. This too has proven over-sanguine. If anything, the experience to date with the A400M has re-enforced negative perceptions of European collaboration and there is a danger that firms with other options, particularly in the US, may look for alternative partnerships that could undermine a European defence industrial community that has delivered benefits, particularly technological, for both Europe and the United Kingdom.

Final Words

14. The Society fully appreciates the need to support the armed forces currently deployed in intense operations. Their safety and security must have top priority in defence spending. However, there is a risk that investment in technology upon which Britain’s armed services will depend upon in the future will be squeezed between immediate operational requirements and the equipment programme. It is essential that funding for technology acquisition be maintained; without adequate MoD support in this area, the UK defence industrial base will decline, UK companies will lose their edge in world markets, global defence companies will not want to invest in the UK and ultimately the UK armed services will lose access to the high quality domestic assets needed to support equipment in the field and to acquire weapons to meet their specific needs.

10 November 2008
Memorandum from Serco

We are pleased to have the opportunity to contribute to the committee’s inquiry into progress made by the MoD in procuring and supporting defence equipment for UK armed forces.

Serco is a leading services company that has been supporting UK defence for fifty years. As one of the MoD’s top 10 suppliers, we are playing a key role in supporting the Front Line Commands, serving as an intelligent integrator of people, processes, equipment and technology to enable more efficient and effective operational support.

We welcomed the formation of DE&S, and are greatly encouraged by early progress in improving relations between the MoD and industry and improvements to the procurement process which, ultimately, serve to strengthen support to operations.

This submission touches briefly on progress made to date in implementing the DIS, but in the main focuses on progress in developing DE&S as a “fit for purpose” procurement and support organisation. The recommendations we make are based on our experience of procurements conducted by DE&S and the DPA/DLO before it. They are intended as a constructive contribution to efforts by the MoD to provide better support to operations through more effective and efficient procurement processes.

The progress made to date in implementing the DIS and the delay in publishing the updated version of DIS

1. DIS 1 touched only briefly upon the importance of service companies in supporting UK defence; we have been actively encouraging the authors of DIS2 to go further in recognising the breadth of industry support—both OEM and service companies—required by the DE&S to achieve its core operational functions. We look forward to its publication in due course.

The progress made to date to develop DE&S into a “fit for purpose” integrated procurement and support organisation

2. We would encourage the DE&S to be more open to the benefits of using industry to help with commercial and business innovation, and implementation of transformational change programmes. Unfortunately, the DE&S budgetary system makes this much more difficult to procure than the procurement of “technology” innovation, for example, but we believe that such challenges can be overcome.

3. Looking at the wider picture, the MoD should consider whether there is a better way of linking its financial planning process to the capability planning process. This is likely to become more important as the “Streamlining” and “PACE” elements of the Defence Acquisition Change Programme are fully implemented. Currently, the financial planning process works well to keep the MoD within its overall spending total at the end of the financial year. However, this is only achieved through enforced in-year savings measures that often have a negative impact on achieving value for money over the long term.

4. We believe that one solution to this would be the implementation of a more effective approach to cost-estimating. The DE&S need to establish quickly its ability to provide their MoD Equipment Capability sponsors with consistent and coherent “cost of ownership” information for all major programmes through life. This can probably only be achieved by mandating Clusters/IPTs to all use the same analysis tools and processes to generate their costing information.

5. Once the DE&S and MoD are confident that consistent costing information is being generated, then the unified customer community will have the management information they need in order to make timely decisions on future programmes. The decisions will not always save the MoD money, but importantly will lead to greater DE&S accountability for programme costs and greater visibility for MoD Centre of the cost implications of their decisions. We firmly believe that DE&S investment in this capability now will save the MoD significant programme costs over the medium to long-term, and represent a huge step forward in reaching an affordable, costed programme for the future.

6. In addition to these recommendations, we have given consideration to a number of other ways by which the DE&S could improve the procurement process to provide better support to operations.

— Focus staff on core operational support activities by outsourcing those activities that do not contribute directly to improving support to the front line, for example commodity procurement.

— Consider engaging industry at the earliest possible stage in the procurement process; early engagement would give industry a better understanding of the customer’s requirements from the outset, and lead to quicker procurements at reduced cost to the taxpayer and to industry; it would also provide both sides with the opportunity to develop a better understanding of risk and risk management.

— Provide industry with affordability criteria at the start of a procurement process; this would serve to improve competition and maximise the chances of an affordable requirement; recognise the cost implications for the MoD and the programme itself by failure to stay within published timelines.
— Review the current process of Competitive Dialogue with a view to improving the pace and governance of the process; the current process involves too many cycles, and tends to drive to a common solution at the expense of innovation and effective protection of IPR; a lack of pace to the process also invites “specification creep” resulting in changes to the requirement which can lead to unaffordable programmes.

— Avoid resorting to Competitive Dialogue as a default procurement mechanism—this can lead to inappropriate and lengthy procurements that could better be handled by a straightforward competition; select the right process for the procurement on a case-by-case basis.

— Accept that non-OEM industry participants, such as support service providers, are capable of managing technical integration; the current stance of DE&S can lead to over-reliance on manufacturers to deliver what are, essentially, service-based capabilities.

— Foster a broader understanding across DE&S of the commercial imperatives that govern a company’s decision on whether to enter and remain in a competitive process; failure to factor those imperatives in to how a process is run can stifle competition, leading to no-bid decisions or complete withdrawal.

— Consider including a company’s past performance in the evaluation criteria on a new programme; this would provide the means to distinguish more effectively between price and value, and make industry more accountable for overall performance against its contractual obligation; evaluation criteria should be made publicly available from the start of a procurement process.

— Take steps to ensure that DE&S procurement staff are encouraged to seek commercial and service innovation from industry, and do not feel overly constrained by EU procurement regulations.

11 November 2008

Memorandum from the Defence Industries Council

The Defence Industries Council is the senior forum for industry to engage with the government over defence industrial issues. Its membership includes nine senior industrialists (CEOs/chairman) from a variety of companies across the sector (including multinationals, primes, mid-tier, SMEs, platform and sub-system, manufacturers, technology and service providers) and the Presidents and Director Generals of the four major UK Defence Trade Associations (ie Society of British Aerospace Companies, Defence Manufacturers Association, Intellect and the British Naval Equipment Association).

The UK Defence Industry employs more 300,000 people throughout the UK and makes an enormous contribution to the nation’s science, engineering and skills base. We train thousands of apprentices each year to which we can offer high quality, value adding careers. It includes world class multinational companies right through to highly successful SMEs—indeed the UK has more SMEs in its Defence Sector than France, Germany, Italy and Spain combined. Our products are internationally competitive and last year the UK was the world’s leading defence exporter capturing a third of world orders worth some £10 billion to the UK economy.

The Committee requested comments on a number of issues:

The progress made to date to develop DE&S into a “fit for purpose” integrated procurement and support organisation

1. Industry welcomed the creation of DE&S as an important step forward which removed the artificial division between procurement and support and therefore should improve the efficiency and effectiveness of the organisation. MOD deserves praise for the expeditious way the transformation was managed and executed. Although the process remains to be completed we recognise and support the efforts that have been made to embed Through Life Capability Management (TLCM) in the heart of the organisation’s structures and processes. We believe the department is heading in the “right direction” even if many remain impatient for greater progress.

2. However it is difficult to judge the overall success of the transformation in the current circumstances. DE&S has, quite rightly, focused considerable attention on support to operations and the overall impact of the MOD’s current financial and programme difficulties have slowed the decision making processes in many areas and slowed progress in the introduction of newer, longer term, acquisition approaches based on the principles of TLCM. Companies may therefore find it difficult to divorce some systematic improvements from the impact of programme delays and may be more conscious of the disruptions caused as a result of reductions and changes amongst their regular contacts in project teams. When the current programme difficulties are resolved it should allow the newly transformed organisation to demonstrate its true capabilities.
The extent to which support for current operations is impacting upon DE&S performance relating to the procurement of core defence equipment

3. We are conscious of the impact Urgent Operational Requirements has had on the workloads of key individuals within DE&S and other parts of the MOD including the Equipment Capability directorates. We hope that the Committee will acknowledge the contribution these teams, and their counterparts in industry, have made to support the Armed Forces in operations. Inevitably there has been some impact on the core programme however, we regard the current financial and budget uncertainties that MOD face more generally as more significant delaying factors.

The progress relating to the ‘short examination of the equipment programme’ announced by MOD in June 2008

4. We understand MOD expects to report on the examination shortly and we are aware that individual companies have been asked to provide detailed inputs on possible consequences of programme decisions. We trust that the decisions to be taken are informed by these consultations, and that their industrial implications are understood fully. Industry would welcome an early read out of outcome of the examination and its implications for projects and programmes in the short term. Prolonged delays or paralysis in MOD decision making will have serious implications for the retention of industrial capabilities and company’s investment planning.

The progress made to date in implementing the DIS and the delay in publishing the updated version of DIS

5. Since its publication in December 2005 there have been many steps taken towards embedding the principles set out in the Defence Industrial Strategy into normal business. There is now a greater understanding and appreciation within Government of the contribution industry makes to delivering defence capability and its overall value to the nations industrial, technological, scientific and economic base. MOD has begun to take steps to embed the concept of TLCM in its processes and culture. A number of innovative long term acquisition arrangements have been agreed which should deliver better value for taxpayers, the Armed Forces and shareholders. These include the agreements and strategies which have been developed for Combat Air, Maritime, Rotary Wing and Complex Weapons. Overall there has been a noticeable willingness for MOD to work closely with individual companies on developing practical and pragmatic solutions to the current difficulties.

6. However overall progress has been much slower than industry would have wished. In part this reflects MOD’s ongoing financial and programme problems but also difficulties progressing some commitments on policy issues ie greater transparency over its plans, clarity over how operational sovereignty would be assessed and how to present, measure and deliver Value for Money. It also needs to reconcile the key roles that the Defence sector can make to delivering wider Government objectives for Innovation, skills and manufacturing.

7. We are heartened that the new Defence Secretary and Minister (Defence Equipment and Support) have already confirmed their commitments to the key principles in DIS and their willingness to work constructively with industry. We hope that we can make progress over the coming months on those outstanding policy issues like transparency etc.

8. We continue to believe the original commitment to provide a DIS which sets out “those industrial capabilities we need in the UK to ensure we can continue to operate our equipment in the way we choose” remains the correct goal. Such a DIS should also fulfil the commitment to provide “overall indicative planning assumptions for each sector” in sufficient detail to enable “our suppliers to make informed decisions”. A retreat from this level of transparency would be a disincentive to company investment plans in the long term.

9. Companies of all sizes still need the clarity for planning decisions that we had hoped DIS v2.0 would provide. However we need to be pragmatic about what it is sensible to publish now in light of the recent financial crisis and when a general election will be held within the next eighteen months. Given these circumstances we do not believe it is the right time to push for early publication of a DIS v2.0 at a time when it may not provided the clarity industry needs to plan with confidence for the long term. We have advised HMG of this conclusion and we hope that the Government will prepare a revised DIS when the necessary conditions are in place. In the interim we believe Government and industry should regard the principles of DIS v1.0 as remaining extant.

10. In summary, we believe that the principles underpinning the Defence Industrial Strategy are alive and well within MOD. There are clearly difficult financial and programming issues that need to be addressed but we believe MOD understands the importance of considering the long term consequences of those decisions for delivering both defence capability and value for money. Indeed we are particularly pleased that the significant contribution that the defence sector makes to the economy, manufacturing and employment is now recognised more widely across Whitehall. The Defence sector can quickly offer long term, value adding employment in key regions, generating further income for the economy and importantly providing the capabilities that our Armed Forces need now and in the future.

12 November 2008
Memorandum from KBM Consultants

1. Performance of DE&S

1.1 Implementation of “Blueprint”: a flawed compromise

1.1.1 The DE&S Blueprint compromised on the recommendations made by Richard Brooks “Future Options” study in the summer of 2007. The DE&S has signed up to the core recommendation of a “Decider Provider” model but has maintained an organisation of such proportion and scope that it cannot help but get involved in “Provider” functions such as programme management, technology management (eg the Future Business Group IPT) and systems engineering activities.

1.1.2 As a direct consequence, industry is confused as to the role that DE&S will play in “Team Defence”: is it a contracting authority or is it a programme management office? FRES (see below) is but one example of where this confusion is causing further delays and increased costs in acquisition.

1.2 Consistency of DE&S Staff

1.2.1 DE&S (and in particular, Steve McCarthy, DG Change) should be commended for the structure of their PACE programme, which provides a robust framework for organisational change.

1.2.2 As the PACE programme has explicitly recognised, changing behaviours remains the biggest challenge. The Defence Values for Acquisition toolkit sets out good positive behaviours and it is commendable that compliance is tested in personal annual reports. However, the incentives to “comply” are not strong enough and there is no mechanism for industry to report examples of negative behaviours. As a consequence, the only people within DE&S that are really changing are those who have volunteered for the “early release” scheme.

1.2.3 The various DG cluster business plans and DE&S Risk Register provide a real indication of the DE&S commitment to change at the middle-management level. If the Committee members were to examine them, they would find too many examples of the (potential) transfer of tasks to industry being used as an excuse to maintain capabilities in-house “in case they (industry) do not deliver”.

1.2.4 In summary, whilst the organisational culture of MoD refers to industry as “contractors” then the success of “Team Defence” will be undermined; the flip side of this also holds true. For DIS to succeed, both Industry and MoD need to change behaviours. In the past, Industry has demonstrated its ability to make such changes; MoD needs to demonstrate that it can do the same.

2. FRES

2.1.1 FRES remains a prime example of how not to manage a complex programme. It is difficult to see how any programme can succeed when it has the following structure:

— An IPT to oversee the whole programme, with its own systems engineers and technical staff, led by a gentleman with precious little previous defence experience and knowledge (he is a railway signals engineer).

— A Systems House (Atkins) that has its own systems engineers and technical staff who are “shadowed” by the IPT and its advisors in dstl.

— A System of System Integrator (Thales & Boeing) that also has its own systems engineers and technical staff, who by all accounts have been through the same learning curve that Atkins went through and is effectively being paid to do the same job (whatever the reasoned arguments of DE&S senior management might suggest).

Further delays and inefficiencies would have been caused by the IPT leader’s long period of absences due to ill health, not valuing the free information from US Manned Ground Vehicles programmes (an element of the Future Combat System covered by a TAA) and general disregard for the Defence Values for Acquisition, in particular, “time matters”, “openness and transparency”, “best being the enemy of the very good” and “identifying trade-offs between performance, time and cost”.

2.1.2 The Committee may also wish to examine in closer detail how Thales and Boeing became to be appointed by the FRES IPT as the SOSI. In the June 2007 DE&S in-house magazine “Preview”, David Gould (the then COO of DE&S) appeared in a photograph opening Boeing’s new office in Bristol. The accompanying text made it clear that it was Boeing’s intention to use this facility to support the FRES programme, which David Gould was clearly supporting. Whilst this seems perfectly laudable now, this article appeared before the FRES SOSI PQQ was issued. The Thales and Boeing team was consequently appointed as SOSI on the strength of their PQQ submission in the Autumn. It is unclear as to why the IPT was allowed to dispense with due competitive process (as laid out in the “Restricted” procurement procedure).
2.1.3 As far as the selection of the FRES Utility Vehicle (UV) is concerned, there is much concern within industry as to whether DE&S ever intended to sign a contract with General Dynamics for risk reduction work. Rumours abound as to the state of the relationship between the company and the IPT staff, which is interpreted by many as stalling tactics by the IPT. If the UV requirement is going to be cancelled (and it is difficult to see how it can be justified in the context of 29 October announcement for new vehicles) then the IPT should be open and honest with all concerned.

14 November 2008

Memorandum from the Ministry of Defence

THE EQUIPMENT PROGRAMME/EQUIPMENT PLAN

1. When is the “short examination of the equipment programme” expected to be completed by? If already completed, when will the results of the review be announced?

As Sir Bill Jeffrey told the Committee on 4 November, we hope to resolve the remaining issues arising out of our examination of the equipment programme over the next few weeks. We expect its results to provide an important input to our 2009 planning round, which will be completed in Spring 2009, but Ministers have undertaken to inform Parliament of significant decisions affecting projects as soon as they are able to do so.²

2. RUSI Acquisition Focus reported in RUSI Defence Systems Spring 2007 that “The equipment plan has been estimated as underfunded by some £15 billion or more over its 10-year period”. What is MoD’s estimate of the extent to which the Equipment Plan is underfunded?

The MOD is conducting Planning Round 09 which will help in ensuring that the equipment plan is realistic, affordable and matched with our priorities for the coming years.

DEFENCE EQUIPMENT CAPABILITIES/EQUIPMENT PROGRAMMES AND EQUIPMENT PROJECTS

3. A list of the Defence Equipment Capabilities. The list to set out the key current and future equipment programmes which currently deliver/are planned to deliver these capabilities

A list of the Defence Equipment Capabilities, setting out the key current and future equipment programmes is at Annex A to this Memorandum.

4. The definition of an equipment programme and an equipment project. Details of the number of equipment programmes and equipment projects which DE&S are responsible for delivering. What assessment has the MoD made of whether the current number of equipment programmes being acquired is (a) affordable and (b) can be managed effectively by DE&S? Is the MoD examining options to rationalise the number of equipment programmes?

Following the Capability Review of the MOD published in March 2007 and the subsequent planning to Streamline the Head Office, a review of how the Department delivers capability was carried out in the first half of 2008. The review was led by the Equipment Capability Customer and included DE&S, the User, the MOD’s Science, Innovation and Technology branch and the MOD Centre; the overall grouping being known as the MOD Unified Customer. During the review, the Department consulted the guidance³ produced by professional bodies such as the Office of Government Commerce (OGC) and Association of Project Management (APM). Based on this consultation, the following definitions will now be adopted:

Projects are unique, transient endeavours undertaken to achieve a desired outcome. Projects bring about change and project management is recognised as the most efficient way of managing such change. Project management is the process by which projects are defined, planned, monitored, controlled and delivered such that the agreed benefits are realised.

Programmes. What constitutes a programme will vary across industries and business sectors but there are core programme management processes. Programme management is the co-ordinated management of related projects, which may include related business-as-usual activities that together achieve a beneficial change of a strategic nature for an organisation.

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² MOD memorandum of 20 October responding to HCDC advance questions on the Annual Report and Accounts 2007–08 (question 14).
³ APM Body Of Knowledge Definitions and OGC’s Managing Successful Programmes.
In the Defence context, programmes are characterised by the following:

(a) Focused on the delivery of outcomes, and therefore the coordinated delivery of all Defence Lines of Development (training, equipment, people, infrastructure, etc), necessary to achieve the required capability.

(b) Usually comprised of several related projects which need to be coordinated in order to manage the dependencies and achieve the required overall outcomes.

(c) Structured such that the capability outcome can be clearly and simply defined and accepted, and the group of key stakeholders is manageable, but not so granular that the adoption of programme management adds no value to the management of the component projects.

(d) Normally be aligned to “Capability Integration Groups” (groupings in the Front Line Commands) to optimise the integration of capability into operational service and the through life management of the capability after acceptance.

DE&S is currently managing some 350 projects at various stages of the acquisition cycle. In addition, there are currently some 300 Urgent Operational Requirements in which DE&S is involved.

As stated in serial 2 above, the question of affordability of the Equipment Plan is being addressed in Planning Round 09. In addition, availability of suitable resources within DE&S to manage the delivery of a project is a key consideration when investment decisions are made. The current portfolio of projects is considered to be manageable, although work to support current operations through the delivery of Urgent Operational Requirements has inevitably required the re-prioritisation of some tasks; this has been done in conjunction with the customer. The effective management and deployment of resources, particularly those with specialist skills, is a key challenge for effective project management. To improve its ability to better manage the deployment of people to meet business priorities, DE&S is introducing Flexible Resourcing. This will improve the visibility of the skills people have, where they are deployed and the tasks on which they are engaged, allowing a more agile approach to the deployment of resources to aid the efficiency of project delivery.

As part of the review of how capability is delivered referred to above, it was recommended that the overall number of programmes should be rationalised to ensure that the benefits of a fewer number of broader programmes could be delivered. In line with this we are seeking to rationalise the number of programmes to approximately 40–50 across the whole of the Equipment Plan. The implementation of this approach is scheduled to commence in early November 2008 with the first tranche of programmes acting as “pilots” for the remainder.

UPDATES ON EQUIPMENT PROGRAMMES

5. A short progress report on the following equipment programmes:

— Astute submarine;
— Future Carrier;
— Joint Strike Fighter (JSF);
— Type 45 Destroyer;
— Future Rapid Effect System (FRES);
— Military Afloat Reach and Sustainability (MARS);
— A400M;
— Nimrod MRA4; and
— Future Lynx.

For the above programmes which have passed Main Gate, the progress report to include:

— The Current Forecast Cost (against Approved Cost at Main Gate).
— The Current Forecast In-Service Date (against Approved In-Service Date at Main Gate).

For each of the above programmes, the progress report to include:

— A summary of the key events/decisions since the Committee last examined the programme4 and the key events/decisions expected in the near future (next six months).

Future Carrier—the progress report should set out the current position regarding French involvement in the programme, including any potential savings for the UK programme from such involvement.

FRES—the progress report should set out the key developments following the announcement on 8 May 2008 that Piranha 5 had been selected as the preferred design to be taken forward to the next stage of the Utility Vehicle programme and set out when the package of work on risk reduction is expected to be completed.

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A400M—reports in the press have suggested that the A400M programme has experienced further delays. The progress report should set out the options which the MoD is considering for bridging the capability gap caused by these delays.

**ASTUTE**

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* Approval only given at 50% confidence level

**Progress Report**

Over the last 12 months, several technical issues have affected HMS ASTUTE’s programme. These included damage sustained to Turbo Generator bearings during testing, replacement of a main coolant pump that was not performing to the required standard and quality issues on some components.

In July 2008, a detailed programme taking HMS ASTUTE through to her In-Service Date (ISD) was worked up between MOD and BAE Systems, encompassing lessons learnt from the test and commissioning programme to date, and incorporating expert advice from across the submarine build and support enterprise, including expertise from Babcock Marine (Devonport) and the US (NAVSEA and Electric Boat). This has shown that the Astute Boats 1–3 schedule will require re-approval by the Investment Approvals Board (IAB), work on which is already underway—a detailed Review Note is planned for early 2009.

As part of the re-approval process, programme reviews are being conducted on Astute Boats 2 and 3 (AMBUSH and ARTFUL) to determine if there are any consequential schedule and cost implications arising from HMS ASTUTE’s delay.

Construction on Astute Boat 4, AUDACIOUS, started in May 2007 under a contractual limit of liability. The intention is to extend this contract in Spring 2009 to cover delivery of AUDACIOUS into service under a target cost incentive fee arrangement. By that time the required £160 million of savings will sufficiently mature to be contained within the contractual price.

Contract for procurement of long lead items for Boat 5 were placed in January 2008. A Review Note is on its way to the IAB in October 2008 seeking permission to procure Boat 5 and long lead elements of Boat 6.

**Key Events/Decisions since March 2008**

— ASTUTE Core Load completed in July 2008.
— AMBUSH—Pressure hull and bridge completed.

**Key Events/Decisions expected in the next six months (to April 2009)**

— Continuing ASTUTE’s test and commissioning programme.
— IAB, Ministerial and Treasury re-approval of the Boat 1–3 programme.
— IAB, Ministerial and Treasury Approval to procure Boat 5 and Boat 6 LLI’s.
— AMBUSH—Starting first phase of testing preparations.
— ARTFUL—Main Propulsion Machinery Package assembly complete.
— Agree Target Cost Incentive Fee contract for AUDACIOUS.
— Start of construction on Boat 5.

**FUTURE CARRIER**

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Key Events/Decisions since HCDC Report on CVF in January 2008

3 July 2008—It was announced in Parliament that contracts valued at around £3 billion had been placed with the newly-formed Joint Venture company (BVT) and the Aircraft Carrier Alliance for the construction of two 65,000 tonne aircraft carriers for the Royal Navy.

Sub-contracts (valued at approximately £400 million) have been placed for the following:

- (placed before contract signature) The modification of Rosyth dockyard, 80,000 Tonnes of Steel, Blown Fibre Optic Cable Plant, Reverse Osmosis Equipment, Aviation Fuel Systems Equipment, Manufacture of Aircraft Lifts. (see bullet points below for further details).

February 2008—Sub-contract placed for the modification of Rosyth dockyard £35 million, (widening entrance etc) in preparation for the assembly of the aircraft carriers.

March 2008—Sub-contracts placed for: Supply of over 80,000 tonnes of steel for manufacture of the two ships (placed with Corus Construction & Industrial/Dent Steel Services Ltd) £65 million, Blown Fibre Optic Cable Plant (BFOCP) (placed with Brand-Rex Ltd) £3 million, Reverse Osmosis Equipment (placed with Salt Separation Services) £1 million, Aviation fuel systems equipment (placed with Fluid Transfer International) £4 million.

April 2008—Sub-contract placed for the manufacture of Aircraft lifts for the two new aircraft carriers (placed with MacTaggart Scott) £13 million.

August 2008—Sub-contracts placed for: Highly Mechanised Weapons Handling System (placed with Alstec Ltd) £34 million, Uptakes and Downtakes Systems (placed with Darchem) £8 million, Air Traffic Control Software (placed with Cobham plc) £5 million, Wholeship Pump Integration (placed with DESMI Ltd) £3 million, Emergency Diesel Generators (placed with Wartsila Lips Defence) £1 million.

October 2008—Sub-contracts placed for Power & Propulsion Systems (£240 million) including gas turbines, shaft lines, propellers, platform management system, power generation and transmission equipment. Thales UK, being responsible for project management and integration, formed a Sub-Alliance and placed sub-contracts with Rolls Royce, Converteam and L3 Communications to meet the Power & Propulsion requirement.

UK/FR Carrier Co-operation—As part of a wide ranging Defence Review, France has elected to postpone the decision concerning a second aircraft carrier until 2011–12. They have already made a series of staged payments (totalling £70 million) in recognition of the investment the UK has already made in the design, with a further payment (£45 million) being dependent on France proceeding to manufacture with our design. In budgeting for CVF, it was always recognised that the final payment was not guaranteed.

Key Events/Decisions expected in the next six months

Order for Goliath crane (which will be installed at Rosyth) to be placed shortly (£15 million).

Central Upper Blocks—Bids have been received, decision due at end of October 2008 (worth £300 million).

Late 2008—Lower Block 01, Pre-fabrication work begins at Babcock’s Appledore yard, North Devon (not to be confused with First Cutting of Steel).

First Cutting of Steel for HMS Queen Elizabeth (CVF01) is expected to commence in early 2009 (mid 2010 for HMS Prince of Wales (CVF02)), this corresponds with the start of production in the main shipyards.

JOINT STRIKE FIGHTER

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Key Events/Decisions since 2007

- First flight of the first development STOVL JSF in June 2008.
- JSF programme is progressing to plan with both the CTOL and STOVL variants completing in excess of 60 sorties to date.
Key Events/Decisions expected in next six months

— January 2009—DE&S will seek approval to purchase three JSF to allow the UK to participate in the Operational Test and Evaluation of JSF in the USA.

Progress on Production, Sustainment and Follow-On (PSFD) Arrangements

The UK continues to work closely with the US to secure the commitments it requires with regards to operational sovereignty. Progress is being made in this area by the UK’s inclusion in the JSF Operational Test and Evaluation (OT&E) development planning, continued presence and increased access of UK SME’s within the JSF programme in the USA and proposals to increase the level of access to JSF information for UK Industry.

### TYPE 45 DESTROYER

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Key Events/Decisions since the Committee last examined Type 45

— April 2008—First of Class DARING successfully completed second set of sea trials, proving propulsion systems.

— June 2008—First test firing of Principal Anti-Air Missile System (Sampson) (PAAMS(S)) from the Longbow test barge off of the French coast successfully completed.

— September 2008—DARING successfully completed third and final set of sea trials prior to Acceptance Off Contract. These trials focused on the Combat System, marking a shift to delivery of the all important fighting capability of the warship.

— September 2008—The Main Gate Business Case for Phase 1 of the Type 45/PAAMS(S) Full Support Solution approved by DE&S Investment Board.

Key Events/Decisions expected in the next six months

— The Main Gate Business Case for Phase 1 of the Type 45/PAAMS(S) Full Support Solution is currently planned to be presented to the Investment Approvals Board before the end of 2008. Ministerial and HM Treasury approval will be subsequently sought.

— The second ship, DAUNTLESS, will begin her first set of sea trials in November 2008.

— The fourth ship, DRAGON, will be launched on the Clyde in November 2008.

— DARING to be Accepted Off Contract in December 2008, and custody of the ship passed from BVT Surface Fleet Limited to the MOD. DARING will then transit to her base port (Portsmouth) and begin 12 months of MOD led trials prior to entering service (expected to be late 2009).

— Second PAAMS test firing from Longbow planned for December 2008.

— Third (and final) PAAMS test firing from Longbow planned for May 2009.

FUTURE RAPID EFFECT SYSTEM (FRES)

Utility Vehicle

On 8 May 2008, the Ministry of Defence (MoD) announced selection of PIRANHA V offered by General Dynamics (UK) Ltd as the preferred design for the FRES (Future Rapid Effect System) Utility Vehicle. Acknowledging that there were significant issues to be resolved during negotiations, the MoD took the step of making General Dynamics (UK) Ltd’s preferred bidder status provisional. Their conversion to full preferred bidder status was dependent upon the agreement of acceptable commercial terms followed by the successful completion of a package of work on risk reduction.

As PUS said at the HCDC evidence session on 4 November 2008 we are still discussing exactly how to pursue the relationship with GDUK.
SPECIALIST VEHICLES

The Specialist Vehicle element of the FRES programme continues to make good progress.

In June 2008, Departmental approval was given for the Specialist Vehicle Assessment Phase. The aim of this phase is to refine the requirement, develop programme options for delivering the FRES Specialist Vehicle capability and to understand and mitigate technical risk. The Assessment Phase includes the placement of a range study of contracts with industry. We are also currently developing the Acquisition Strategy for future stages of the Specialist Vehicle programme.

MILITARY AFLOAT REACH AND SUSTAINABILITY (MARS)

<table>
<thead>
<tr>
<th></th>
<th>Original MG approval</th>
<th>Current Forecast</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost (£m)</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>ISD</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Key Events/Decisions since Initial Gate approval (July 2005)

— July 2005—entry into Assessment Phase announced via Written Ministerial Statement. The Procurement Strategy at the time was the formation of an Alliance, comprising the MOD, an Integrator, a Design, Outfit and Build Alliance Partner and a Through Life Support Partner.

— May 2007—Minister(DES) approved a decision to review the Procurement Strategy to take account of changing market conditions and the opportunities generated by the delivery of the Defence Industrial Strategy (DIS).

— December 2007—Following approval of open competition by Minister(DES), advertisement placed in the Official Journal of the European Union (OJEU) seeking expressions of interest from companies who wish to compete for the design and build elements of the MARS Fleet Tanker (FT) programme.

— May 2008—Minister(DES) approval to down select to four bidders (Fincantieri, Navantia, Hyundai and a consortium of BVT/BMT/DSME) to enter into Competitive Dialogue over the MARS FT programme.

Key Events/Decisions expected in the next six months

— 2009—The main investment decision for the MARS FT programme is currently expected to be made during 2009. A contract for the FT procurement will be placed with industry after that decision has been taken.

A400M

<table>
<thead>
<tr>
<th></th>
<th>Original MG Approval (90%)</th>
<th>Current Forecast (50%)</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost (£m)</td>
<td>2,744</td>
<td>2,632</td>
<td>−112</td>
</tr>
<tr>
<td>ISD</td>
<td>December 2009</td>
<td>December 2011</td>
<td>+24 (Months)</td>
</tr>
</tbody>
</table>

Progress Report

A400M remains a key element of the UK’s future defence capability, providing both tactical (intra-theatre) and strategic (inter-theatre) airlift capabilities. The programme remains on track to deliver against its performance targets and the UK is satisfied that the A400M will be an extremely capable platform.

Development delays announced by Airbus Military (AMSL) in 2007 led to a nine month slip in the ISD to December 2011. AMSL have recently announced further delays to first flight of the A400M prototype. We are pressing industry for further information so we can make a detailed assessment of the impact on production deliveries and also understand the scope of possible recovery actions.

The Design and Production Phase (DPP) contract for delivery of 180 A400M aircraft (including the UK’s order of 25) was placed in 2003 between AMSL and OCCAR, acting on behalf of seven Partner Nations (Germany, France, Spain, UK, Turkey, Belgium, Luxemburg).
Key Events/Decisions since March 2008

— Roll out of the first A400M Prototype in June 2008 in Seville.
— Draft issue to Airbus of our In-Service Support Request for Proposal.

Key Events/Decisions expected in the next six months (to April 2009)

— First Flight of the Engine Flying Test Bed.
— Initial In-Service Support Proposal from Airbus Military.

The A400M will replace the Hercules C-130K, the out of service date for which remains 2012. We are naturally concerned by delays to the A400M programme and will be monitoring the situation closely in the coming months. The Department regularly reviews its transport airlift requirements and is considering various contingency plans to mitigate any potential capability gaps. These include:

— Reallocating assets, dependent on changing operational requirements (eg Herrick drawdown).
— Extending the out-of-service dates of C130K. The potential costs and limitations of this option are recognised and critical investment decision points have been identified. We will remain adaptive to emerging information on the A400M programme.
— Leasing or procuring additional assets (C-17/C130).

NIMROD MRA4

<table>
<thead>
<tr>
<th>Cost (£m)</th>
<th>Original MG Approval</th>
<th>Current Forecast</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>ISD</td>
<td>April 2003</td>
<td>December 2010</td>
<td>+ 92 months</td>
</tr>
</tbody>
</table>

Key Events/Decisions since March 2008

— One of the trials aircraft (PA03) completed its contribution to the flight test programme in March 2008 and has since been utilised for Reliability, Maintainability and Testability work in aid of the Future Support programme.
— The first polar navigation by a Nimrod MRA4 was successfully completed by a trials aircraft (PA02) in June 2008. This involved a flight of more than 12 hours and 4,000 nautical miles.
— Trials aircraft deployed to Istres in Southern France in August 2008 to utilise the long runway and reliable weather conditions.
— Aircraft production remains on programme to meet an In Service Date of 2010.

Key Events/Decisions expected in the next six months

— A Main Gate submission proposing the strategy for the support of MRA4 is planned for Spring 2009.

A decision on the number of trials aircraft that can be converted to a full production standard is expected to be taken in Spring 2009.

FUTURE LYNX

<table>
<thead>
<tr>
<th>Cost (£m)</th>
<th>MG approval (70% confidence)</th>
<th>50% Forecast at MG</th>
<th>Current Forecast (50%)</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>ISD</td>
<td>1,966.4</td>
<td>1,901.0</td>
<td>1,911.2</td>
<td>+ 10.2</td>
</tr>
<tr>
<td></td>
<td>January 2014*</td>
<td>January 2014</td>
<td></td>
<td>0</td>
</tr>
</tbody>
</table>

* This is the ISD for the British Army’s Battlefield Reconnaissance Helicopter and is defined as 4 force elements at readiness to deploy on a small scale focussed intervention operation.

Key events decisions since approval

The programme is proceeding within current approvals.

— June 2006—FLynx Contract awarded to AgustaWestland, along with the signing of the Strategic Partnering Agreement and the Business Transformation Incentivisation Arrangement.
— October 2007—First metal cut for the FLynx Trials Installation aircraft.
— June 2008—Verification of the tail rotor concept complete.
— September 2008—Successful Production Readiness Review held.

(Note: There has been recent speculation about the MoD’s commitment to the Future Lynx programme. As a significant MoD project, Future Lynx is being reviewed as part of a wider examination of the Department’s financial planning process. No decisions have been taken).

Forthcoming key events/decisions

— November 2008—delivery of 1st Aircraft Structure from GKN Structures to Agusta Westland Build line.

HELIPTERS

6. A note setting out:

— the current UK military helicopter fleets (broken down by type/mark eg Sea King Mk 5), the number of helicopters currently in each fleet, and the forecast out-of-service date for each helicopter fleet; and
— the UK military helicopter fleets (broken down by type/mark) expected to be operating in 2020 and the number of helicopters expected to be operating in each fleet.

The table below provides a breakdown of the 594 aircraft currently in the military helicopter fleet (as at 1 October 2008), excluding helicopters that the Ministry of Defence operates but does not own, and sets out the respective out of service dates (OSDs).

71 of the 594 helicopters are categorised as non-effective. These aircraft are still on the Military Register but they are redundant, declared as surplus, awaiting disposal and consequently are not expected to be flown.

Without life extension work, the service life of the majority of the helicopters in our current fleets will cease before 2020. Where a life extension programme is planned to extend the out of service date of a helicopter, the resulting extended OSD is set out in brackets.

We also expect to complete a number of helicopter procurement programmes in advance of 2020. The capabilities currently provided by the Lynx fleet will be provided by the Future Lynx from the middle of the next decade, the Sea King Mark 3, 3A and 5s will be replaced under a PFI arrangement for Search and Rescue and the first tranche of our Future Medium Helicopter capability should have been introduced. In addition the eight Chinook helicopters reverted from Mark 3 standard to the 2/2A standard are also not included in the table but will have been introduced into service.

Broadly, we expect to sustain the levels of medium and heavy lift capability. We do expect to reduce the number of platforms used in lighter roles, such as currently provided by the Gazelle and Lynx. In the battlefield environment, the light helicopter fleet is in transition as a result of the introduction of the Apache which has reduced our reliance on Lynx in the attack role and improvements in communications and ISTAR coverage by other assets has reduced the numbers of Rotary Wing aircraft needed for battlefield reconnaissance. For such reasons we have already decided that we would not anticipate deploying Gazelle on operations overseas before it goes out of service.

As with all Defence programmes, it is not until Main Gate approval has been obtained that decisions such as the final aircraft numbers, the timescales for the upgrades and the revised out of service dates are confirmed. As such, the information provided in the table below is susceptible to change and we cannot be precise about the number and type of helicopters that will be in service in 2020. It is also important to recognise that our delivery of capability (which may include by contracting for availability) is the primary measure of success and so a focus on overall numbers alone can be misleading.
## HELICOPTER FLEET NUMBERS—BREAKDOWN AS AT 1 OCTOBER 2008

<table>
<thead>
<tr>
<th>Aircraft type/mark</th>
<th>MOD Departmental Fleet</th>
<th>Effective Fleet</th>
<th>Non-Effective Fleet</th>
<th>Current Planned OSDs</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Augusta 109</td>
<td>4</td>
<td>4</td>
<td>NIL</td>
<td>2009</td>
<td>It is expected these aircraft will be replaced during 2009 by 4 EC 365N3s.</td>
</tr>
<tr>
<td>Apache</td>
<td>67</td>
<td>67</td>
<td>NIL</td>
<td>2030</td>
<td>We expect to have to invest further in this aircraft (eg to address obsolescence and meet emerging requirements) during the next decade, in order to sustain its service life up to 2030.</td>
</tr>
<tr>
<td>Chinook Mk2</td>
<td>34</td>
<td>34</td>
<td>NIL</td>
<td>2015 (2040)</td>
<td>We expect to have to invest further in these aircraft (eg to address obsolescence, meet emerging requirements and extend the planned date of their retirement to 2040) during the next decade, although no investment decisions have yet been made.</td>
</tr>
<tr>
<td>Chinook Mk2a</td>
<td>6</td>
<td>6</td>
<td>NIL</td>
<td>2025 (2040)</td>
<td></td>
</tr>
<tr>
<td>Gazelle</td>
<td>99</td>
<td>64</td>
<td>35*</td>
<td>2012</td>
<td>Where there is an enduring requirement for the capability currently provided by Gazelle we are exploring arrangements based on leased aircraft.</td>
</tr>
<tr>
<td>Lynx Mk3</td>
<td>34</td>
<td>30</td>
<td>4</td>
<td>2013</td>
<td>It is expected that these aircraft will be replaced by the Surface Combatant Maritime Rotorcraft (SCMR) variant of Future Lynx from 2015.</td>
</tr>
<tr>
<td>Lynx Mk8</td>
<td>34</td>
<td>33</td>
<td>1</td>
<td>2015</td>
<td></td>
</tr>
<tr>
<td>Lynx Mk7</td>
<td>84</td>
<td>74</td>
<td>10</td>
<td>2013</td>
<td>It is expected that these aircraft will be replaced by the Battlefield Reconnaissance Helicopter (BRH) variant of Future Lynx from 2014.</td>
</tr>
<tr>
<td>Lynx Mk9</td>
<td>24</td>
<td>22</td>
<td>2</td>
<td>2013</td>
<td></td>
</tr>
<tr>
<td>Merlin Mk1</td>
<td>42</td>
<td>42**</td>
<td>NIL</td>
<td>2029</td>
<td>We are currently preparing to upgrade these aircraft through the Merlin Mk1 Capability Sustainment Programme.</td>
</tr>
<tr>
<td>Merlin Mk3</td>
<td>22</td>
<td>22</td>
<td>NIL</td>
<td>2030</td>
<td>We expect to have to invest further in this aircraft (eg to address obsolescence and meet emerging requirements) during the next decade, in order to sustain its service life up to 2030.</td>
</tr>
<tr>
<td>Merlin Mk3a</td>
<td>6</td>
<td>6</td>
<td>NIL</td>
<td>2030</td>
<td></td>
</tr>
<tr>
<td>Puma</td>
<td>43</td>
<td>34</td>
<td>9***</td>
<td>2012 (2022)</td>
<td>We expect to have to invest further in this aircraft to extend the planned date of its retirement to 2022, when it is expected that the capability provided by these aircraft will be replaced by the Future Medium Helicopter programme.</td>
</tr>
<tr>
<td>Sea King Mk3/3a</td>
<td>25</td>
<td>25</td>
<td>NIL</td>
<td>2017</td>
<td>It is expected that the capability provided by these aircraft will be replaced by a joint PFI service with the Maritime and Coastguard Agency.</td>
</tr>
<tr>
<td>Aircraft type/mark</td>
<td>MOD Effective Fleet</td>
<td>Non-Effective Fleet</td>
<td>Current Planned OSDs</td>
<td>Comments</td>
<td></td>
</tr>
<tr>
<td>-------------------</td>
<td>---------------------</td>
<td>---------------------</td>
<td>----------------------</td>
<td>----------</td>
<td></td>
</tr>
<tr>
<td>Sea King Mk4</td>
<td>37</td>
<td>37</td>
<td>NIL</td>
<td>2012 (2018)</td>
<td></td>
</tr>
<tr>
<td>Sea King Mk6c</td>
<td>5</td>
<td>5</td>
<td>NIL</td>
<td>2010</td>
<td></td>
</tr>
<tr>
<td>Sea King Mk5</td>
<td>15</td>
<td>15</td>
<td>NIL</td>
<td>2017</td>
<td></td>
</tr>
<tr>
<td>Sea King Mk7</td>
<td>13</td>
<td>13</td>
<td>NIL</td>
<td>2018 (2022)</td>
<td></td>
</tr>
</tbody>
</table>

We expect to have to invest further in this aircraft to extend the planned date of their retirement to 2018, whereupon it is expected that the capability provided by these aircraft will be replaced by the Future Medium Helicopter programme.

It is expected that the capability provided by these aircraft will be replaced by a joint PFI service with the Maritime and Coastguard Agency.

We expect to have to invest further in this aircraft to extend the planned date of their retirement to 2022.

This table excludes the eight Chinook Mk3s undergoing Reversion Programme.

MoD Departmental Fleet:

All MoD-owned aircraft currently on the Military Register. This is all “effective” and “non-effective” aircraft.

Effective Fleet:

Those aircraft expected to be flown by the MoD. This is all aircraft in Forward and Depth. Depth to include depth maintenance and repair, those undergoing modification, trials aircraft (other than manufacturers'), storage (including attrition/reserves) and surplus aircraft awaiting classification as “non-effective”.

Non-effective Fleet:

Aircraft no longer expected to be flown by the MoD. Aircraft still on the Military Register that have been declared surplus and are awaiting disposal, plus Ground Instructional Aircraft.

Explanatory notes:

* Gazelle—8 “attrition” aircraft were mistakenly included in the non-effective figures. These have now been correctly accounted for in the effective figures, Non-effective. The Non-effective fleet currently includes 30 a/c for disposal and 5 ground training a/c.

** Merlin—4 of these aircraft are in storage and have been cannibalised heavily; 1 has been extensively modified as part of a joint MOD/Industry technology demonstrator programme. Recovery to a fully serviceable condition would take significant time and investment. These aircraft are, under today's definitions, classified as effective until such time that a decision is taken to dispose of them.

*** Puma—2 aircraft at the contractor for repair were previously wrongly classified as part of the Non-effective Fleet these have now been correctly accounted for as Effective. The Non-effective fleet include 5 x Cat 5s plus 4 x Cat 4s not expected to fly as Puma HC1 a/c.
DE&S PERFORMANCE/PERSO

The MoD Annual Performance Report for 2007–08 states that “procurement performance declined, failing to meet our in-year Public Service Agreement sub-targets for cost and time, and only partly meeting the overall target”. What were the key factors behind the decline in procurement performance in 2007–08? How did the need to support current operations affect DE&S’s procurement performance in 2007–08?

The key factors for cost and time variation in Financial Year 2007–08 can broadly be grouped into three categories:

- decisions taken by the Department in the broader context of the defence needs (this would largely include elements of changed requirement; changed budgetary priorities; procurement strategy);
- factors outside the Department’s direct control (this would largely include international contracting process and procurement strategy issues, accounting adjustments and re-definitions; inflation and exchange rates); and
- factors reflecting the realisation of unplanned or low level/high impact risk for the Department and/or Industry (technical factors).

On this basis much of the in-year cost variation falls to factors either outside the Department’s direct control, with international factors being the single most significant element, or the realisation of unplanned low level/high impact risk. We have sought to mitigate the impact of these risks by taking decisions that can be managed within the broader context of defence.

The impact of international collaboration on performance, cost and time is something that it is currently hidden amongst the factors normally ascribed to change. UK Defence benefits enormously from international collaboration. Not only does collaboration increase military inter-operability for coalition operations but provides a means of sharing development expenditure and production economies of scale. Indeed, capabilities such as Typhoon, Joint Combat Aircraft, A400M and the Guided Multiple Launch Rocket System would probably be unaffordable on a UK-only basis. However, within international collaboration, we are only one customer amongst several and our influence is inevitably diluted; we are subject to the influence of the intricacies of programming decisions in each of the member nation’s defence programmes; and we are often obliged to pursue more traditional means of procurement compared with our generally more innovative and progressive approaches.

Five projects—Naval EHF/SHF Satellite Communication Terminals (19 months), Soothsayer (16 months) and Terrier (27 months) Replacement General Service Respirator (22 months) and Precision Guided Bomb (18 months)—account for a high proportion of the total in year slippage. Taking the broader approach to reasons for variation outlined above, nearly all of the change appears to result from factors ascribed to international programmes with the remainder relating to the realisation of unplanned risks. This latter factor still obscures the fact that, where such risks emerge, the Department does have a choice over a lower standard of capability or performance, to cancel the project, or to trade time to ensure delivery of capability. Because of the demonstrable need for the capability the latter option is likely to offer the lowest risk solution.

The extent to which the Department makes deliberate trades in performance, cost and time is not adequately reflected at present. An example this year is the Beyond Visual Range Air to Air Missile where we have revised the definition of In-Service Date to preserve delivery of the missile as a key project milestone but slipped the point of integration on Typhoon to avoid additional costs. We did this in the knowledge that we would not create a capability gap—recent analysis shows existing systems can meet the requirement during such a pause.

Supporting operations, not least through the procurement of equipment to meet Urgent Operational Requirements, has been the Department’s highest priority. Resources within DE&S have been prioritised accordingly. It is not, however, possible to assess to what extent, if any, this effort has impacted on our performance against the procurement targets.

How is DE&S performing in 2008–09 against the three sub-objectives under “PI 3.1 Procuring and Supporting military equipment capability through life”?

The current DE&S position has highlighted a number of risks to Time and Cost, and options to recover these are being investigated.

How many DE&S personnel were in post at 30 September 2008 and how many are expected to be in post at the end of March 2009? Is it still the target to reduce the number of DE&S personnel to around 20,000 by 2012? Has this target been re-examined to take account of the need to continue to support current operations?

On 30 September 2008, there were approx 23,400 personnel of full time equivalent (FTE) employed within DE&S (17,800 civilian and 5,600 military). It is anticipated that the FTE strength at 31 March 2009 will be approx 23,300 FTEs (17,700 civilian and 5,600 military).

DE&S is currently reviewing its manpower requirements as part of the PR09 process. Based on current PACE (Performance, Agility, Confidence, Efficiency) manpower requirements, it is planned to reduce to a figure of around 20,000 by 31 March 2012 with resources re-prioritised where necessary to enable the effective delivery of our outputs.
10. What progress has DE&S made to upskill its staff? How did DE&S perform against its target of staff completing a minimum of six training days in 2007–08 and against the “further target of four days for Continuing Professional Development in the key acquisition disciplines of Commercial, Finance, Programme and Project Management, Engineering and Logistics”?

DE&S must continue to develop and acquire skills needed for the future. The funded Upskilling programme has been expanded to embrace the wider functional community as well as broader acquisition, leadership, management and core competence skills. In year some £10 million has been allocated to fund a range of skills interventions. The Skills Directors appointed for each discipline have drawn up skills plans to improve the skills capability in each of the functions and are on track to meet Professional Posts targets to ensure key designated posts are filled by suitably qualified individuals.

Over 70% of the DE&S workforce met the 6 + 4 training days target last year (2007–08). The current levels of achievement against the 6 + 4 target are twice as high this year than for the same period last year.

Achievements in the programme include:

**Project and Programme Management**—Project Management Level 3 Licence development commenced with a pilot of the Certificated Project Manager (CPM) qualification; 25 Professional Post holders are undertaking the pilot which will complete in March 2009. A total of 484 Project Management Licences (which are linked to the Association of Project Management) have been issued, including 80 at Level 2.

**Finance**—Over 55% of staff in DE&S finance professional posts are qualified accountants. To improve the future position, the Training Accountant Development Scheme (TADS) has been increased and 22 new graduates commenced the development programme in September 2008. Existing TADS achieved 100% pass rate in the May 2008 CIMA exams, with two TADS achieving a mark that brought them into the “top 10 worldwide”. A further 39 have been accepted for Association of Accounting Technician training.

**Commercial**—Over 70% of DE&S commercial professional posts are filled by individuals with the relevant Chartered Institute of Purchasing and Supply (CIPS) qualification. The target of 100% of Commercial Directors with MCIPS or on the Professional Development Programme is currently at 75%. The target of 100% is expected to be reached by 31 March 2009. The B2 conversion 2007–08 intake graduated in September 2008.

**Logistics**—New Defence Academy learning courses have gone live. Inventory Management Licences have been launched with 500 passes to date. Ten Supply Chain Management courses are being delivered.

**Engineering**—Twenty one DESG Graduates commenced the development programme and a further 51 have been given an offer of contract. Delivery of places achieved on Land Systems Post Graduate Certificate. Delivery of modular Aerospace Engineering Technology & Systems Engineering awareness courses. Increase to apprentice recruitment, September 2008 intake expected to be in excess of 40.

11. What progress has DE&S made in “producing a Workforce Strategy during 2008,... and introducing Workforce Plans in support of Business Plans to identify opportunities for recruitment, interchange and partnering with industry in order to develop a strong and sustainable skills capability”?

DE&S has been engaged with other MOD Top Level Budget areas on the development of a pan-Departmental approach to Workforce Planning during 2007–08. This resulted in the adoption by the MOD’s Director General Civilian Personnel (DGCP) of the MOD Guide to Workforce Planning. The DE&S Workforce Plan seeks to identify critical skills that will be required to deliver DE&S outputs over two, four and 10 year horizons and the risks associated with recruiting and retaining those resources. Since January 2008, DE&S DG Human Resources has been engaged with the DE&S 2-star Clusters through their HR Business Partners to undertake Workforce Planning within business areas. The Workforce Planning process was trialled with DG Information Systems and Services, and DG Safety and Engineering from February—June 2008 to test the methodology. The lessons learned from these trials were incorporated into the roll out of Workforce Planning across DE&S during June 2008. The Workforce Plan is focussing on the identification of critical roles and skills to the business, whether these will grow, shrink or remain constant and the gaps or surpluses that will arise in these role/skill areas. The DE&S Workforce Plan will seek to aggregate together role/skill issues from across the TLB. Once TLB critical roles/skills have been identified, the Workforce Strategy will be produced to identify interventions to meet the critical shortfalls. In some business areas (eg Naval Bases), measures enabling staff to work alongside partners to develop knowledge and skills are in hand. Work is currently in train to identify “near-term” recruitment requirements to meet critical resource shortfalls within the business over the next 6 –18 months. It is planned that co-ordinated recruitment activity to meet identified resource requirements will be launched in November 2008.

Additionally, DE&S has been engaged, through DGCP, in the Defence Sector strategic workforce and skills planning programme. The aim of this is to enable the Defence Sector to identify common “skills demand signals”, exert more influence on the national training and education system and establish joint methods of reducing common skill gaps.

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DEFENCE INDUSTRIAL STRATEGY

12. In December 2006, the MoD provided the Committee with a “Summary Progress Report on significant DIS Milestones” which was published in the Committee’s Report “The Defence Industrial Strategy: update” (Sixth Report of Session 2006–07, HC 177). The Committee would be grateful for an updated version of the Summary Progress Report.

An updated Summary Progress Report on significant DIS Milestones is at Annex B to this Memorandum.

13. **Where does responsibility for promulgating and implementing the DIS fall within the MoD?**

The Defence Commercial Director (DCD) is the Senior Responsible Owner for the DIS, charged with overseeing its implementation and execution, and for seeing that it is refreshed, current and relevant to the business needs of MOD and industry. The Defence Acquisition Change Programme (DACP) is responsible for implementing the majority of internal change programmes that resulted from the DIS. It is the responsibility of DE&S, and its sector clusters, to implement the sector strategies of the DIS.

UPDATED VERSION OF THE DEFENCE INDUSTRIAL STRATEGY

14. **What is the latest position regarding the publication of the updated version of the Defence Industrial Strategy? What assessment has the MoD made of how the delay in publishing the updated version has affected industry?**

The Department remains firmly committed to the Defence Industrial Strategy and has engaged closely with industry to develop it further. Work continues on developing the policy framework and examining the medium and long term equipment programme issues that will inform the industrial sector strategies. We are discussing the revision of the Strategy with the National Defence Industries Council; and through bilateral meetings with individual companies at all levels.

We do not believe that the lack of an updated version is having a significant impact on the achievement of the original DIS objectives, where we continue to make good progress. The principles set out in the original DIS still underpin all MOD’s acquisition activity and are driving transformation that will deliver equipment to the front line at value for money for the taxpayer.

UK/US DEFENCE TRADE COOPERATION TREATY

15. **What progress has been made with the UK/US Defence Trade Cooperation treaty and when does the MoD expect the Treaty to be ratified?**

HMG has been working closely with the US Administration to achieve ratification of the Defence Trade Cooperation Treaty. Unfortunately, the US Senate Foreign Relations Committee was unable to consider the Treaty during the closing sessions of the 110th Congress due to a number of other high priority issues also being dealt with by the Senate staff. The Committee chair, Senator Biden, has made it clear that the Treaty will be dealt with as a priority in the early part of the 111th Congress, due to start in late January 2009. While this is clearly disappointing news, we understand that the SFRC continues to fully support the aims of the Treaty and that they are content with the way it will be implemented and enforced. The MOD will continue to work with the US Government to ensure the Treaty remains a priority issue and can be brought into force as quickly as possible upon ratification.

DISPUTE RESOLUTION

16. **How does the MoD usually seek to resolve disputes with defence equipment contractors? What assessment has the MoD made of other approaches to dispute resolution, such as the sorts of approach offered by bodies such as the Winchester Group?**

The MOD seeks, where possible, to resolve disputes by negotiation as early as possible. It is our preferred approach as it is the most efficient in terms of time management, costs, and control of process. Where negotiation fails to produce a settlement that is acceptable to the parties, the MOD will seek the agreement of the contractor to use alternative methods to settle the dispute. These alternative methods might include a contract pause period coupled with Alternative Dispute Resolution (ADR) which comprises, amongst other techniques, mediation, neutral evaluation and expert determination. Should these fail the parties are then able to resort to arbitration, or litigation. Where ADR is used, an ADR organisation will be selected under whose auspices the dispute resolution will be conducted. A wide range of these alternative methods is now available and the MOD considers along with the contractor in dispute which is most suitable for each dispute as it arises and when it is most suitable to deploy the chosen method. A number of different approaches have been used to solve real life disputes with contractors such as Early Neutral Evaluation.
For example, on the Survey Vessels project, at the MOD’s suggestion, the Winchester Group were engaged to assist in resolving a dispute between the MOD’s contractor and one of its sub-contractors which was preventing one of the vessels from being delivered.

Annex A

DEFENCE EQUIPMENT CAPABILITIES (SERIAL 3)

There are 12 Director of Equipment Capability (DEC) areas. Each DEC has responsibility for specific Capability Management Groups.

The key current and future equipment projects which deliver or are planned to deliver these capabilities are listed in the table below. “Current” can be difficult to be precise about, but has generally been taken as those projects underway which are close to reaching the In Service Date. The term “key equipment projects” has generally been interpreted as the Category A projects i.e those with an expected total procurement cost in excess of £400 million (or which are subject to the same level of scrutiny due to risk, complexity, precedence or similar reasons), with the exception being DEC Chemical, Biological, Radiological and Nuclear whose largest project is Category B.

<table>
<thead>
<tr>
<th>DEC—Capability Management Groups</th>
<th>Current and Future Capability Projects for Planning Round 09</th>
</tr>
</thead>
<tbody>
<tr>
<td>DEC Above Water Effects</td>
<td>Current Projects</td>
</tr>
<tr>
<td>The ability to provide Control</td>
<td>None</td>
</tr>
<tr>
<td>and Denial of the Above Water</td>
<td>Future Projects</td>
</tr>
<tr>
<td>Battlespace to allow Joint</td>
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<tr>
<td>Commanders to utilise the</td>
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<tr>
<td>seaward flank in military</td>
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<tr>
<td>operations.</td>
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<tr>
<td>DEC Deep Target Attack</td>
<td>Current Projects</td>
</tr>
<tr>
<td>The ability to deliver effects</td>
<td></td>
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<tr>
<td>against land based targets from</td>
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<tr>
<td>all environments supported by</td>
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<tr>
<td>their embedded enablers.</td>
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<tr>
<td>DEC Deep Target Attack</td>
<td>Current Projects</td>
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<tr>
<td>Joint Land Forces Engagement</td>
<td>Munitions Acquisition, the Supply Solution</td>
</tr>
<tr>
<td>Complex Weapons</td>
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<tr>
<td>Future Projects</td>
<td></td>
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<tr>
<td>Joint Land Forces Engagement</td>
<td>Future Indirect Fire System (FIFS)</td>
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<tr>
<td>Indirect Fire Precision Attack</td>
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<tr>
<td>(IFPA)</td>
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<tr>
<td>Joint Strike—Joint Combat Aircraft (JCA)</td>
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<tr>
<td>SUAV(E)—Deep &amp; Persistent Offensive Capability (DPOC)</td>
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</tr>
<tr>
<td>Surface Attack Heavy—Future Long Range Direct Fires Capability (FLRDFC)</td>
<td></td>
</tr>
<tr>
<td>Surface Attack—Medium—Selective Precision Effects at Range (SPEAR)</td>
<td></td>
</tr>
</tbody>
</table>
DEC—Capability Management Groups

### DEC Under Water Effects

The ability to deliver coherent and cost effective decisive military effects from and within the under water environment both to deny the enemy’s and to allow own forces’ freedom of manoeuvre above and below the water to deliver capability requirements set by other capability areas which achieve their goals through exploitation of the under water environment’s unique qualities.

### Directorate of Strategic Requirements

The ability to deliver a UK operationally independent, continuous and invulnerable strategic nuclear deterrent capability that is capable of launching nuclear strikes worldwide when ordered.

### DEC Command Control and Information Infrastructure

The ability to Command, Inform and Manage the Battle and Business space collaboratively from the strategic functions of the Department of State to individual military platforms over a defence-wide network.

---

**Current and Future Capability Projects for Planning Round 09**

**Current Projects**

None.

**Future Projects**

- **Nimrod—MRA4**
- **Initial ASTUTE Support Solution**
- **Submarine Production—ASTUTE**
- **Director Surface Combatants—Future Mine Countermeasures Capability (FMCMC)**
- **Merlin IPT—MERLIN Capability Sustainment Programme (CSP)**
- **FSM IPT—Maritime Underwater Future Capability (MUFC)**

**Current Projects**

None.

**Future Projects**

- **Nuclear Propulsion—Core Production Capability**
  - Next Generation Nuclear Propulsion Plant (NGNPP)
- **Strategic Weapon System—Missile Compartment**
- **Nuclear Warhead—Nuclear Weapon Capability Sustainment Programme (NWCS)**
  - Successor SSBN Platform
- **Trident D5 Life Extension Programme**

**Current Projects**

- **Skynet 5—military satellite communications system**
- **Bowman Combat, Infrastructure and Platform—tactical radio communications system**

**Future Projects**

- **Defence Information Infrastructure—Future Deployed**
  - Falcon—Formation level land communications system to support headquarters from Corps to Brigade and RAF deployed operating bases.
- **Joint Command and Control Support Programme (JC2SP)**
- **Joint Military Air Traffic System**
- **Future Logistics Information System (FLIS)**
- **Future Core Network**
**DEC—Capability Management Groups**  

**Current and Future Capability Projects for Planning Round 09**

**Current Projects**

**DEC ISTAR**

The ability to provide accurate, timely and appropriate information and intelligence capabilities, and deliver influence and information effects through information.

**Future Projects**

**PICASSO**—a classified programme that provides a national capability to exploit imagery.

**ASTOR**—The Airborne Stand Off Radar (ASTOR) system

**HELIX**—to sustain the UK’s airborne electronic surveillance capability

**WATCHKEEPER** Tactical UAV system

**SKASaC** (Sea King Airborne Surveillance and Control) Capability Sustainment Programme (formerly Maritime Airborne Surveillance and Control)—delivery of maritime ISTAR force protection for the Carrier Strike capability

**DABINETT**—to address the UK’s future ISTAR requirements

**DEC Special Projects**

Project Information not included due to classification.

**DEC Expeditionary Logistics and Support**

The ability to deploy and redeploy a Force to a theatre operations and to support and sustain it for the duration of operations in accordance with Defence Strategic Guidance and other Departmental Policy.

**Current Projects**

**Strategic Manoeuvre**—C130 (ongoing work taking place)

**Future Projects**

**Maritime Sustainment**—MARS Fleet Tanker

MARS Fleet Solid Support Ships

MARS Joint Sea Based Logistics Ships

**Strategic Manoeuvre**—A400M

Future Tanker/Transport Aircraft

Future Comms Fleet

**Theatre Ground Sustainment**—

Support Vehicles

Operational Utility Vehicles
### DEC—Capability Management Groups

#### DEC Theatre Airspace

Theatre Airspace's vision is Joint Forces protected from all air threats; fully prepared and protected air power. To provide the Front Line of today and tomorrow with affordable, agile, interoperable and battle-winning capabilities which enable effective and secure air operations and give a joint force the freedom to operate without interference from threats to and from the air environment.

#### DEC Air and Littoral Manoeuvre

The ability to deliver the landing force from the sea; and attack, lift and find elements by air, to contribute to campaign success as part of a joint and/or coalition force.

#### DEC CBRN (Chemical, Biological, Radiological and Nuclear)

The ability to enhance survivability and reduce degradation of individuals and equipment in order to maintain operational tempo.

#### DEC Ground Manoeuvre

The ability to deliver decisive close combat effects in the Land Close Battlespace for the Army, Royal Marines and RAF Regiment.

### Current and Future Capability Projects for Planning Round 09

#### Current Projects

- Typhoon
- Beyond Visual Range Air to Air Missile
- UK Military Flying Training System
- Advanced Jet Trainer

#### Future Projects

- Network Enabled Air Defence and Surveillance
- Mission Training Through Distributed Simulation

### DEC Theatre Airspace Current Projects

- **Air Manoeuvre**—FRC (Future Medium/Heavy/SAR H lift Rotorcraft Capability)
- Battlefield Reconnaissance Helicopter/Surface Combatant maritime Rotorcraft.
- Attack Helicopter Future Support Arrangements.
- **Littoral Manoeuvre**—Landing Craft Rationalisation and Transition to Over The Horizon Operations (Cat tbd)

### DEC Air and Littoral Manoeuvre Future Projects

- **Littoral Manoeuvre**—Future Amphibious Assault Ships

### DEC CBRN (Chemical, Biological, Radiological and Nuclear) Current Projects

- Medical Countermeasures

### DEC CBRN (Chemical, Biological, Radiological and Nuclear) Future Projects

- CBRN Protection (Cat B)

### DEC Ground Manoeuvre Future Projects

- **TERRIER**

### DEC Ground Manoeuvre Future Projects

- Challenger 2 Capability Sustainment Programme
- Warrior Capability Sustainment Programme
- Future Rapid Effect System
- Future Integrated Soldier Technology
- Hard Kill Defensive Aid System
- Next generation Light Anti-armour Weapon
### Annex B

**SUMMARY PROGRESS REPORT ON SIGNIFICANT DIS MILESTONES (SERIAL 12)**

<table>
<thead>
<tr>
<th>Sector</th>
<th>DIS Commitment</th>
<th>Original Milestones and Public Milestones for 2007</th>
<th>Updated Position</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maritime (1)</td>
<td><strong>We will immediately start negotiations . . . to achieve a programme level partnering agreement with a single industrial entity for the full lifecycle of the submarine flotilla.</strong></td>
<td>For the award of the contract for the fourth and subsequent Astute class submarines. (2007)</td>
<td><strong>Ongoing</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td>A range of options is being considered, however a Joint Venture (JV) is likely to be the most beneficial, subject to satisfactory arrangements and a commitment to continuous efficiency improvements.</td>
<td>A collaborative arrangement is in place for the Successor submarine concept phase. Construction on Astute Boat 4, AUDACIOUS, started in May 2007 under a contractual limit of liability. <strong>Achieved</strong> Since April 2006 submarine programme management within MOD has been unified, and sits within DE&amp;S under the Director General Submarines. <strong>Achieved</strong> Agree a route map to a Long Term Collaboration Agreement between MOD and key Industrial Partners covering full submarine life-cycle by Summer 2007.</td>
</tr>
<tr>
<td>Sector</td>
<td>DIS Commitment</td>
<td>Original Milestones and Public Sector DIS Commitment Milestones for 2007</td>
<td>Updated Position</td>
</tr>
<tr>
<td>----------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------</td>
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<tr>
<td>Maritime (2)</td>
<td><em>For surface ship design and build, we aim within the next six months to arrive at a common understanding of the core load required to sustain the high-end design, systems engineering and combat systems integration skills.</em> . . .</td>
<td><em>Within six months from publication June 2006</em></td>
<td><em>Achieved</em> MOD and BVT have agreed a coherent view or “common understanding” of the loading on industry and the skill base that underpins it based on analysis by the RAND Corporation that identified what skills are key to preserving the UK’s ability to design and build complex warships. Progress was made possible by establishment of the BAE Systems/VT Joint Venture (BVT Surface Fleet Limited) on 1 July 2008.</td>
</tr>
<tr>
<td></td>
<td><em>Agree the core load required to sustain the high-end design, systems engineering and combat systems integration skills by Summer 2007.</em></td>
<td></td>
<td><em>Ongoing</em> The agreed coherent view of the core work load required to sustain high-end design, systems engineering and combat systems integration skills is part of work to agree a new MOD/BVT Terms of Business Agreement (TOBA) which will transform the UK naval shipbuilding sector and establish MOD’s commitments to sustainment of key design and build capabilities and future activity (the core workload). We hope to conclude the TOBA in Spring 2009.</td>
</tr>
<tr>
<td></td>
<td><em>Achieve an affordable programme following robust industry commitments to consolidation and performance improvement by Summer 2007.</em></td>
<td></td>
<td><em>Achieved</em> The establishment of BVT Surface Fleet Limited on 1 July 2008 meant that MOD was able to announce placement of the CVF manufacturing contracts with BVT on 3 July 2008 and offers the opportunity, outlined in the TOBA Heads of Terms, for industrial rationalisation, representing a significant efficiency for CVF and the future warship building programme.</td>
</tr>
<tr>
<td></td>
<td><em>Industrial restructuring for Surface Ships which delivers potential cost improvements across the maritime programme Summer 2007.</em></td>
<td></td>
<td><em>Achieved</em> Significant industrial restructuring has taken place in the UK maritime sector. Babcock’s acquisition of DML at Devonport in June 2007 and formation of BVT on 1 July 08 offers significant opportunities for industrial rationalisation and transformation and cost reduction of warship build and support.</td>
</tr>
</tbody>
</table>
The TOBAs with BVT (expected in Spring 2009) and Babcock Marine (expected in Summer 2009) will see incentivised delivery of efficiencies; encouraging the two companies and MOD to co-operate and work together more closely; sharing in the risks and rewards.

Validate the core load requirement against the surface build programme and rationalisation proposals for build capability by Autumn 2007.

**Overview**

- **Ongoing**
  - Managed rationalisation of the UK’s surface ship build capacity is needed to balance supply and demand in the longer term post-CVF. The MOD/BVT Heads of Terms identified the long term build capability needed to support the MOD forward programme. The process of finalising the TOBA refines those assumptions in terms of skill levels but does not change the underlying principles.

- **Achieved**
  - The MOD/BVT TOBA will seek to transform the business, incentivising improved performance, cost and timeliness.

### Maritime (3)

- **For surface ship support, we will start immediate negotiations with industry with the aim of exploring alternative contracting arrangements and the way ahead for contracting the next upkeep periods, which start in the autumn of next year. Key maritime equipment industrial capabilities will be supported by the production of a sustainability strategy for these key equipments by June 2006.**
### Original Milestones and Public DIS Commitment Milestones for 2007

<table>
<thead>
<tr>
<th>Sector</th>
<th>Original Milestones</th>
<th>Updated Position</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Throughout 2007 and early 2008, complete individual contract negotiations for the refits and docking periods (known locally as the “Gloucester X” upkeeps) due to commence between Spring 2007 and Spring 2008.</td>
<td>Achieved The Contracts for the first five upkeeps to be managed by MoD and the dockyard companies, known as the “Liverpool 5”, were awarded in Autumn 2006. Contracts for the second group of upkeeps, known as the “Gloucester Batch”, have also been awarded (Spring 2007 through Summer 2008). The work share has been agreed between MoD and industry on the third batch of upkeeps (the “Ark Royal Batch”).</td>
</tr>
<tr>
<td></td>
<td>By Spring 2008, subject to both approvals and consultation, establish the Surface Ship Support Alliance (SSSA).</td>
<td>Achieved MOD confirmed than an “alliance based” option was the preferred strategic end-state for the delivery of future surface ships in Summer 2008. A formal Trades Union consultation process was completed in September 2008.</td>
</tr>
</tbody>
</table>

The Surface Ship Support Programme will drive forward a four year incremental change programme to deliver complex warship support through an alliancing arrangement with industry.

### Ongoing

- **Key maritime equipment industrial capabilities** will be supported by the production of a sustainability strategy by June 2006.
- **Arrive at a sustainability strategy for key Maritime equipment industrial capabilities by Summer 2007.**

**NOTE:** There was an error in the original publication of DIS milestones which ran together equipment sustainability and SSS milestones.

Key industrial capabilities have been defined for platform (tier 1 supplier) design and build. Both BVT and Babcock Marine recognise the need to maintain healthy supply chains (for innovation and value for money) and increased MOD visibility of make/buy strategies. This will be part of the respective TOBAs.
### Fixed Wing (1)

<table>
<thead>
<tr>
<th>DIS Commitment</th>
<th>Original Milestones and Public Sector DIS Commitment Milestones for 2007</th>
<th>Updated Position</th>
</tr>
</thead>
<tbody>
<tr>
<td>... we will work with BAE Systems and the other companies in the defence aerospace sector so that it can reach the appropriate size and shape for demand ... we aim during 2006 to agree the way ahead—which will be challenging given the scope of the scale of the transformation that is required—and to implement it from 2007.</td>
<td>Agreement of LTPA in 2006. Implementation from 2007 onwards</td>
<td>Ongoing MOD and BAE Systems agreed the aims and objectives of a possible future LTPA in 2006 and entered into a Foundation Contract in 2007. At the end of the Foundation Contract both parties agreed that more time was required to de-risk a full LTPA and to work together to build on the good progress made.</td>
</tr>
</tbody>
</table>
## Original Milestones and Public Sector DIS Commitment Milestones for 2007

<table>
<thead>
<tr>
<th>Sector</th>
<th>DIS Commitment</th>
<th>Updated Position</th>
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<tbody>
<tr>
<td><strong>AFVs</strong></td>
<td>We will be working hard with BAE Systems . . . to give effect to the long term partnering arrangement . . . We intend to establish a joint partnering team within the early part of 2006 and to establish a business transformation plan underpinned by a robust milestone and performance regime.</td>
<td>capable of flight in non-segregated airspace. MOD will initially fund £9 million of the first phase of the programme, intended to prove concept development through to flight demonstration.</td>
</tr>
<tr>
<td></td>
<td>Early part of 2006</td>
<td>Discussions are underway to identify capability through potential future spirals.</td>
</tr>
<tr>
<td></td>
<td>Agree a strategy for sustaining the current and future Armoured Fighting Vehicle (AFV) fleet by <strong>Spring 2007</strong>.</td>
<td>Achieved</td>
</tr>
<tr>
<td></td>
<td>Implement the strategy for procurement of the FRES system by <strong>Spring 2007</strong> including initiation of a competition to provide the FRES Utility Variant</td>
<td>An AFV Partnering Agreement between MOD and with BAE Systems Land Systems was signed on 15 December 2005. Two Joint Business Plans and Industrial Sector Strategies have now been developed that identify the issues facing the Sustainment of industrial capability in the AFV Sector and propose a strategy for addressing them.</td>
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<td></td>
<td></td>
<td>Achieved</td>
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<tr>
<td></td>
<td></td>
<td>The DIS Sustained Armoured Vehicle Coherence Pathfinder defined a strategy for sustained coherence of the AFV Fleet in March 2007. The BAE Partnering Agreement published a sustainment strategy as part of the Joint Business Plan (JBP).</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Achieved</td>
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<tr>
<td></td>
<td></td>
<td>Industrial Sector Strategies have now been published for two successive years working through an effective AFV Industrial Associate Group.</td>
</tr>
</tbody>
</table>
Helicopters

**Original Milestones and Public Sector DIS Commitment Milestones for 2007**

**Updated Position**

- **Achieved**
  - A Strategic Partnering Arrangement (SPA) and contractually-binding Business Transformation Incentivisation Agreement (BTIA) were signed with AgustaWestland (AW) on 22 June 2006.

  These agreements enshrine the demanding partnered relationship envisaged by the DIS and include challenging measures and targets to maintain effective business transformation both within AW and the MOD.

- **Ongoing**
  - The SPA, signed in June 2006, is underpinned by a contractual Business Transformation Incentivisation Agreement (BTIA) which encourages both partners to work together on improving aircraft availability, schedule adherence and responsiveness, while bearing down on cost and ensuring AW sustains core Design Authority skills onshore to support MoD helicopter fleets.

  Performance against the BTIA has been good during its first two years. Work continues, including through the launch of the MOD/AW Joint Modification Service in March 2007, to improve delivery to the front line.

  - Reach decision on preferred bidder and transfer of responsibility for operation of DARA (RW and Components Business Units) and initiate action to place appropriate contracts and agreements by Summer 2007.

  - Vector Aerospace were selected as the preferred bidder for the purchase of the DARA Rotary Wing and Components businesses at Fleetlands in Hampshire and Almondbank in Perthshire on the 25 July 2007.

  Vector Aerospace subsequently assumed ownership of the businesses on 1 April 2008.
**Ev 102  Defence Committee: Evidence**

### Original Milestones and Public Sector DIS Commitment Milestones for 2007

<table>
<thead>
<tr>
<th>Sector</th>
<th>Original Milestones</th>
<th>Updated Position</th>
</tr>
</thead>
</table>
| **Complex Weapons**     | We will establish a multi-disciplinary team charged with working with all elements of the onshore industry to establish how we might together seek both to meet our ongoing requirements and sustain in an industrially viable manner the critical guided weapons technologies and through life support capabilities that we judge to be so important to our operational sovereignty... Our intention is that we should have a clearer way ahead by mid-2006. | Achieved  
Team CW, consisting of MBDA UK, Thales Air Defence Ltd, Thales Missile Electronics, Roxel and QinetiQ, were formed in July 2006.  
The formal Assessment Phase (AP) for Team CW commenced in July 2008 with the aim of delivering military capability, while sustaining indigenous industrial capabilities, achieving VFM, and delivering industrial transformation in the sector. Work in examining strategic options for the delivery and support of underwater weapons with BAES Insyte is also underway. |

Achieved  
The Complex Weapons Sector strategy was publicised in July 2006 through a statement by the then Minister (Defence Procurement). The commencement of the Team CW AP represents the first step in the implementation of this strategy.  
Changed  
This milestone has been overtaken by events. MOD and the industrial Team CW members jointly signed a Teaming Agreement for the AP, and two enabling contracts with the two Team CW prime contractors (MBDA UK and Thales UK) in July 2008.  

Achieve Signature of a Complex Weapons Strategic Partnering Arrangement (SPA) by end 2007.  
Achieved  
This milestone has been overtaken by events. MOD and the industrial Team CW members jointly signed a Teaming Agreement for the AP, and two enabling contracts with the two Team CW prime contractors (MBDA UK and Thales UK) in July 2008.  

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<table>
<thead>
<tr>
<th>Sector</th>
<th>DIS Commitment</th>
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<th>Updated Position</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Munitions</td>
<td>We will be taking forward Project MASS, with a view to making decisions on how best to sustain our required access to general munitions in the summer of next year . . . We are also actively pursuing partnering arrangements with other suppliers.</td>
<td>Summer 2006</td>
<td>Achieved A long term MASS (Munitions Acquisition the Supply Solution) partnering contract worth potentially over £3 billion was signed with BAES LSM in the Summer of 2008. This followed work with BAES LSM to improve efficiency and create a viable future for general munitions production in the UK.</td>
</tr>
<tr>
<td>CBRN</td>
<td>Achieved Confirm the preferred commercial strategy for meeting this requirement in Summer 2007. Achieve contractual commitments in support of this before Spring 2008.</td>
<td>Complete the CBRN Industry Capability Matrix and share the findings with the Home Office in Early 2007.</td>
<td>Achieved Industry Capability Matrix shared with the Home Office in February 2007</td>
</tr>
<tr>
<td></td>
<td>Achieved Continue to build on the concept of Team CBRN by creating a Joint Focus Group which delivers an Initial Gate Business Case for CBRN sector transformation by Mid 2007.</td>
<td></td>
<td>Achieved A joint MoD-Industry Steering Group (Team CBRN) has been formed leading to increased co-operation and transparency with industry. The project has entered a pilot phase to assess the strategy. Working with industry, the MOD will trial the future business processes. MOD hosted a sector transformation Industry Day in October 2008 with over 100 companies attending.</td>
</tr>
</tbody>
</table>

14 November 2008

Supplementary memorandum from the Ministry of Defence

TLCM

(i) At the evidence session on 18 November 2008, industry witnesses emphasised the importance of the Through Life Capability Management (TLCM) approach. Is the MoD content with the progress made to date in implementing the TLM approach? When does the MoD expect this approach to be fully embedded within the department? To what extent is funding limiting the progress in implementing the TLM approach?

1. Good progress has been made in implementing Through Life Capability Management (TLCM). Since the publication of the Enabling Acquisition Change report in 2006, the Department has introduced new capability planning structures and procedures, which were initially tested in Planning Round 08 and are currently being used across the MOD for Planning Round 09. The new approach is designed to ensure that
all aspects of new and existing military capability (equipment, training, people, infrastructure, support, etc.) are planned and managed coherently from cradle to grave, with better knowledge of all relevant factors including up-front acquisition costs and through-life support.

2. TLCM will take time to implement as it requires different ways of thinking and working rather than just process change. The basic elements are already embedded across defence, principally to support the way we approach our capability planning. As part of the next phase, we are focusing on how we deliver military capability more effectively. In line with the Office of Government Commerce’s guidance on Managing Successful Programmes, we will introduce a programme approach; aggregating many individual delivery projects, both new and in service, into broader through life capability based programmes. This next phase commenced in early November 2008 and is expected to be embedded by March 2010, although experience from similar changes in other public and private sector organisations suggests a need for continuous improvement over time.

3. Spending Review 2007 provided the Department with annual growth of 1.5%, raising the Defence Budget to £36.9 billion by 2010–11. The introduction of TLCM will help to ensure that the Department delivers value for money to the tax payer and the best solution for Defence within the resources available. The through life impact of both short and long term measures is taken account of in the Department’s decision making process.

PROGRAMME SLIPPAGE

(ii) The MoD’s Annual Report and Accounts 2007–08 states that slippage on several programmes “reflected low probability but high impact risks emerging during the test and trial phases towards the end of the programmes”. What lessons has DE&S learned from these programmes? Is there scope to improve how future programme risks are identified and managed given the experience on these programmes?

4. Low probability but high impact risks are more likely to occur during the testing and evaluation phase of a project. Of the major contributors to the reported forecast slippage in 2007–08, three projects—Terrier (Combat Engineer Tractor) (27 months), General Service Respirator (22 months) and Precision Guided Bomb (18 months)—were at this stage. Delays to the Naval Satellite Communication Equipment (19 months) have occurred in a second increment to the project where delivery of the capability is dependent upon the associated US programme. For SOOTHSAYER (16 months) the delay reflects technical issues (classified) relating to Sensor development and platform integration.

5. To reduce both schedule and cost risk, greater emphasis is being placed on investment prior to Main Gate decisions, the aim being to ensure greater technical, financial and commercial maturity of solutions. Evidence of this comes from the Future Carrier programme where the assessment phase was extended to further mature the design and carry out additional risk reduction work aimed at reducing both schedule and cost risk. Other examples are the Search and Rescue Helicopter (SAR H) project and Maritime Airborne Surveillance and Control (MASC) project.

ARMoured VEHICLES/FRES

(iii) What will happen to the 400 vehicles that will be removed from current operations when the new vehicles, which were announced on 29 October 2008, come into service? If they are to be retained, will the storage and/or recuperation costs be funded from the MoD budget or from the Reserve?

6. A decision has yet to be made on this issue. The Department is considering the options to ensure it maintains the best capability for Defence at the best value for money.

(iv) Has a contract for the package of risk reduction work relating to the FRES Utility Vehicle programme been let and, if not, when is it expected to be let? When is the risk reduction work expected to be completed by?

7. As the Secretary of State announced on 11 December, it has become clear to both parties that it would not be possible to reach agreement on the commercial conditions required to enable further progress on the basis of the current procurement strategy. The Department has, therefore, withdrawn General Dynamics (UK)’s provisional preferred bidder status for the FRES Utility Vehicle design. As commercial agreement was the first stage of the package of work, the remainder of the risk reduction process had not begun.

8. Separately, as the Secretary of State also announced, in the context of current operations and bearing in mind the considerable recent investment in protected mobility, we have concluded that the highest priority should now be accorded to delivering the Warrior Capability Sustainment Programme and the FRES Scout vehicle as quickly as possible. Whilst this will mean a delay to the FRES Utility Vehicle programme, we recognise the importance of the Utility Vehicle and are now looking at the best way to take this procurement forward.
Nimrod MRA4

(v) In 2007–08, the Nimrod MRA4 programme experienced an additional cost increase of £100 million and an additional three months time delay. Has the programme experienced any further cost increases or delays in the current financial year? If so, of what order? If there are further delays on the programme, are there other aircraft which might meet the required capability and, if so, are they being considered?

9. In Spring 2008 further potential cost increases were identified by BAE Systems on the procurement aspects of the Nimrod MRA4 programme. Work is underway to scope the extent of these increases and identify potential mitigation measures. The programme has not experienced any additional time delays.

15 December 2008

Supplementary memorandum from the Defence Industries Council

1. At the hearing on 18 November I agreed to provide you with some further thoughts on the issue of defence inflation. As others have acknowledged there is a lack of firm statistical information on which to base any analysis and we would therefore welcome an opportunity to study this issue in greater depth with the MOD.

2. Although we cannot be precise about the rate of defence inflation it is generally accepted in those countries with significant defence programmes that the rate of inflation applied for the sector is higher than the rate applicable more generally in the economy. There are many factors which can contribute to this additional rate and their individual impact will depend upon the balance of the individual yearly programmes ie a period of significant overseas operations would make the budget particularly vulnerable to fuel cost variations, while an equipment programme which largely included production runs of proven equipment might be more stable than a programme with a greater emphasis on the development of new systems.

3. MOD is best placed to explain the inflation rates which are applied across the totality of their expenditure. It should be recognised that the procurement of goods and services from industry is only one element that may contribute to defence inflation and it is not necessarily the most significant. Additionally different factors may contribute to different inflation rates being applicable for the provision of equipment, services, construction, hardware, software as well as where different procurement approaches are applied. Nevertheless there are some factors applicable to the provision of equipment, support and services which may contribute to “defence inflation”. These include:

— Firstly, defence equipments and systems are becoming increasingly sophisticated and integrated with other systems on the battlefield. Therefore cost comparisons between generations of individual assets need to reflect the increasing capabilities that are being provided ie the difference in cost and capabilities between a broom, carpet sweeper and vacuum cleaner illustrate this trend.

— Defence tends to seek capabilities that are at the leading edge of technology and therefore bears the brunt of the research and development costs. In consumer terms it is the classic early adopter situation where you pay a higher price for new technology before the technology is established and before economies of scale for mass production reduce the subsequent cost.

— Additionally defence systems are generally produced in relatively small numbers with little opportunity to benefit from the economies of mass production and are often upgraded frequently through a long service life. It is therefore misleading to make comparisons with the reducing cost of consumer electronics where that sector enjoys a fast turnover, generally uses proven technology and benefits from large production runs. It is also significant that the cost of securely linking and integrating multiple advanced technologies and assets together on the battlefield is a challenge, and cost, which is rarely replicated in other sectors.

— The approach to contracting may also contribute to defence inflation. As we discussed at the hearing, the old policy of fixed price design and development contracts resulted in occasions where neither the supplier nor the customer fully understood the risks associated with a programme. As those risks materialised programme costs rose. Where adequate investment is made at the development stage of a programme it should significantly reduce the risk of costs growth in the future (although fluctuations in other costs could still be a factor).

— Moreover, continued delays in the MOD decision making process mean that industry project teams are retained longer and consequently the overall cost of projects themselves increase. Historically you can look at the impact of Germany’s wish to slow the Typhoon programme which contributed to a significant increase in the cost of the overall programme. Companies will bear some of these additional costs as increased overhead, which reduces their profitability, but some costs will be passed on to MOD. Although this is not a new problem given the delays in MOD's
decision making process over recent years this may be an increasing factor. Similarly, reductions in the numbers of units purchased means that the fixed (and often irreducible) overheads for each programme are recovered across a smaller number of units and therefore the price of each unit increases accordingly.

— At the hearing we also discussed wage inflation within the sector and its potential impact on defence inflation overall. We have reviewed some data on wage settlements provide by the Confederation of Shipbuilding and Engineering Unions (CSEU) but have been unable to identify statistics which could provide a reliable basis for analysis across the sector. The evidence we have seen suggests some major companies have had pay awards at or below the RPI while others have been above that rate but these have generally have been linked to productivity improvements. Overall the pay awards increases within the defence sector appear consistent with those in other manufacturing sectors. It is also the case that the defence sector generally employs a greater proportion of highly qualified, and sought after, scientists and engineers than in other manufacturing sectors and needs to pay competitive salaries to attract and retain such personnel. Despite these pressures productivity within the sector has been increasing steadily—in aerospace and defence it increased by 6.85% in 2007. While employee costs are a significant element of industry costs the proportionate impact on defence inflation will depend, in part, on the maturity of individual programmes—proportionately the spend on employees would be higher at the early research and development stage of a programme than it would be during the production stage.

4. Finally, some 50% of MOD contracts by value made use of the Government Profit formula for non-competitive contracts which provides for the MOD to have full visibility of costs and to examine and challenge any variations in specific costs which may occur. This allows MOD to assess whether any specific increases in costs are fair and reasonable.

5. I hope this letter helps to explain some of the issues we believe contribute to defence inflation. We would be delighted to work with the Government to establish a better understanding of how these factors contribute to defence inflation and to understand whether the GDP deflator, which is currently being applied, is in fact underestimating the impact of defence inflation.

16 December 2008

Further supplementary memorandum from the Ministry of Defence

**Maritime Industrial Strategy**

(i) In June 2008 the MOD announced that it would not be taking the option to order the seventh and eighth Type 45 destroyers. On 11 December 2008 the MOD announced that the in-service date for the new carriers is likely to be delayed and that the fleet tanker element of the MARS programme is likely to be deferred. What do all these announcements mean for the Maritime Industrial Strategy? Does the MOD plan to revise the Maritime Industrial Strategy in the light of these announcements and, if so, by when?

While the announcements in June and December 2008 may alter some programmes, such as the in-service dates for Future Carrier, the Maritime Industrial Strategy principles remain current and we remain committed to them; the Secretary of State for Defence reaffirmed this to industry at the most recent meeting of the National Defence Industries Council.

**The Military Afloat Reach and Sustainability (MARS) Programme**

(ii) The Written Ministerial Statement on 11 December 2008 says that, following a review of the MARS fleet auxiliary programme, the MOD has concluded that there is scope for considering alternative approaches to procurement for this programme. What alternative approaches are being considered? Does a change in the procurement approach mean a delay to the MARS programme?

As the Committee has rightly noted, we recently concluded that there is scope for considering alternative approaches to the procurement of the MARS Programme to assist in addressing overall affordability within the Defence Programme.

For the Fleet Tanker element of the MARS Programme, we are reviewing the overall requirement and procurement options, and any resultant implications for the current international competition. We expect to determine a way forward later this year. This review may involve a deferral of the Fleet Tankers.
HELICOPTERS

Q. What involvement will AgustaWestland have in the work to upgrade to the 12 Lynx Mark 9 helicopters set out in the written Ministerial Statement of 11 December 2008? Will the work on the Future Lynx and some of the other helicopter programmes set out in the Written ministerial Statement secure the required industrial capability relating to military helicopters in the UK?

Agusta Westland will act as Prime Contractor for the Mk 9 upgrade and the authority for the design and embodiment of the modification.

The continuation of Future Lynx is a positive outcome for all those involved in the Future Lynx programme, including AgustaWestland. It safeguards jobs and helps ensure the sustainment of an on-shore helicopter capability to underwrite our helicopters as set out in the Defence Industrial Strategy. In addition, work on those other programmes featured in the written Ministerial Statement, which includes modification and upgrade projects on our existing fleet together with export orders, such as the VH-71 US presidential aircraft, will also contribute.

The business transformation resulting from the Strategic Partnering Arrangement agreed with AgustaWestland in 2006 is also focused on sustaining skills onshore to support our helicopter fleets.

19 January 2009