



House of Commons  
Scottish Affairs Committee

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**The Referendum on  
Separation for  
Scotland: Separation  
shuts shipyards:  
Government Response  
to the Committee's  
Seventh Report of  
Session 2012–13**

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**3rd Special Report of Session 2012–  
13**

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## The Scottish Affairs Committee

The Scottish Affairs Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Scotland Office (including (i) relations with the Scottish Parliament and (ii) administration and expenditure of the offices of the Advocate General for Scotland (but excluding individual cases and advice given within government by the Advocate General)).

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### Powers

The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via [www.parliament.uk](http://www.parliament.uk).

### Publication

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/scotaffcom](http://www.parliament.uk/scotaffcom). A list of Reports of the Committee in the present parliament is at the back of this volume.

The Reports of the Committee, the formal minutes relating to that report, oral evidence taken and some or all written evidence are available in a printed volume. Additional written evidence may be published on the internet only.

### Committee staff

The current staff of the Committee are Eliot Wilson (Clerk), Duma Langton (Inquiry Manager), Gabrielle Hill (Senior Committee Assistant) and Ravi Abhayaratne (Committee Support Assistant).

### Contacts

All correspondence should be addressed to the Clerk of the Scottish Affairs Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 6123; the Committee's email address is [scotaffcom@parliament.uk](mailto:scotaffcom@parliament.uk)

## Third Special Report

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The Scottish Affairs Committee reported to the House on *The Referendum on Separation for Scotland: Separation shuts shipyards* in its Seventh Report of Session 2012–13, published on 20 January 2013. The Government response to the Report was received on 20 March 2013.

### Government response

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The UK Government is pleased to present its response to the House of Commons Scottish Affairs Committee's (SAC) Seventh Report of Session 2012-13 *The Referendum on Separation for Scotland – Separation shuts shipyards* (HC 892), which it welcomes as a valuable contribution to the referendum debate.

The UK Government sets a high priority on retaining, within our national boundaries, the ability to develop and support through-life those key military capabilities, which enable it to mount operations independently from the UK base. The fact that, other than during the World Wars, the UK has never built a complex warship outside the UK demonstrates clearly that the capability to build complex warships is critical to our national security. The UK Government therefore is committed to retaining in the UK the suite of capabilities required to design complex ships and submarines, from concept to point of build; and sustain those complementary skills to manage the build, integration, assurance, test, acceptance, support and upgrade of maritime platforms through life.

The Defence industry in Scotland, particularly shipbuilding, plays a key role in equipping and supporting the UK armed forces. Defence contracts sustain thousands of skilled jobs and generate billions of pounds for the economy of Scotland. The UK Government values greatly the highly skilled workforce in Scotland. The shipbuilding industry in Scotland forms a substantial part of the UK's shipbuilding industry and is a major beneficiary of Ministry of Defence (MOD) contracts. As recognised in the SAC's report, this includes the recent building of the Type 45 Destroyers and the ongoing build and assembly of the Queen Elizabeth (QE) Class Aircraft Carriers. Looking specifically at the impact of the QE Class programme, as at 30 November 2012, we had spent over £1.5 billion on work at Scottish yards on the QE Class – nearly one billion on the Clyde and about £560 million at Rosyth. More than 2,000 industry jobs at the shipyards on the Clyde and up to 2,000 in Rosyth are directly linked to this programme. In addition, over £300 million of sub-contracts have also been placed with Scottish-based companies by the Aircraft Carrier Alliance.

To ensure the UK retains a sustainable, high-performing maritime industrial sector, able to deliver and support an affordable complex warship building capability in the long-term, the MOD entered into a strategic partnership with BVT Surface Fleet Limited, now BAE Systems Maritime – Naval Ships (BAES MNS). In July 2009, a 15-year Terms of Business Agreement (TOBA) was signed with the company, which is an overarching agreement under which contracts are placed for complex warship building and support work. The

TOBA itself does not have any financial value attached and the value of the underlying contracts depends on the work awarded to BAES.

Under the TOBA, BAES MNS has been granted exclusivity for the design, manufacture and support of certain classes of naval vessels, subject to demonstrating value for money, in exchange for the delivery of guaranteed savings of around £350 million over the 15-year initial term of the contract. In addition, BAES MNS has an obligation to sustain a surface ship capability and contribute to the sustainment of sovereign capability through the provision and maintenance of key skills and facilities known as Key Industrial Capability (KIC). In return for maintaining this capability, BAES MNS will either receive sufficient work from the MOD or receive in lieu a KIC payment capped at £230 million per year.

As part of the TOBA, the company has also made a commitment to transform the sector into a sustainable entity for the future and one that delivers 'world class' performance. The agreement is already delivering benefit and is expected to continue do so throughout the duration of the agreement.

The need for restructuring of the maritime enterprise to reduce overcapacity in the UK warship build and support sector has long been recognised. The building of the Type 45 Destroyers and QE Class Aircraft Carriers has provided an unprecedented level of build work at yards across the UK. This high volume of work, however, cannot be sustained in the future and the shipbuilding industry has recognised that transformation is required. Against the agreed Defence Equipment Plan, the UK Government expects the BAES MNS' long-term future workload to be equivalent to one shipyard's worth of work, but has not stipulated how it should transform the industry to deliver that reduced workload more effectively and efficiently. Furthermore, the UK Government expects the TOBA to provide a strong foundation for the company to compete for non-MOD work, both in the UK and throughout the world. It will, therefore, be for the company to retain the skills and capacity it deems necessary in order to deliver its forward order book.

Looking ahead to the planned future warship build programme, the Type 26 Global Combat Ship (T26 GCS), it is anticipated that there will be a workload gap between the drawdown of the QE Class Aircraft Carrier Programme and the start of build work on the T26 GCS. Decisions taken in 2009 (principally the Equipment Examination and decisions to delay the Future Surface Combatant Programme (now the T26 GCS)) have added to the difficult decisions the Maritime enterprise now faces. How best to transition from the current to future warship build programmes is a challenge we recognise needs managing and one BAES MNS is actively addressing. We can confirm that we are continuing to explore a number of options with BAES MNS about how best to deliver the future shipbuilding programme at the lowest cost to the defence enterprise, and in a way that sustains key skills to complete the build of the QE Class and transition to the T26 GCS programme. However, no decisions on this issue have been taken.

The 2010 Strategic Defence and Security Review confirmed that the T26 GCS would begin replacing the Type 23 frigates as soon after 2020 as possible. Affordability, flexibility, interoperability and exportability are critical features of this programme in addition to it being adaptable to meet the future demands of the maritime environment.

In March 2010, the MOD launched an Assessment Phase (AP) to explore design options for the T26 GCS, which, on current plans, will result in the main investment decision being made by the middle of this decade. At this point we will confirm where the ships will be built and where they will be based when they enter service with the Royal Navy. The current planning assumption is for a class of 13 ships, and it is therefore estimated that shipbuilding work on the T26 GCS will be worth billions of pounds and support thousands of jobs.

Turning now to how the MOD will support the QE Class, the MOD is currently developing its plans for supporting the new aircraft carriers when the class enters service from 2016. An initial assessment of the support requirements has been completed during the Support Assessment Phase (SAP), which we are planning to develop further over the next two years during a Support Development Phase (SDP). The output from this work will be a fully costed in-service support proposal. Support will require collaboration with our leading industrial partners and is expected to be managed by a combined MOD and industry team.

A wide range of options for QE Class maintenance support arrangements will be thoroughly examined during the SDP, including potential location and associated commercial options for docking work. While locations outside the UK have not been ruled out, the security implications of commercial dockings outside the UK would need to be carefully considered.

European Union (EU) procurement law is designed to open up public procurement to competition amongst EU suppliers, effectively preventing EU Member States adopting "buy national" policies.

There is, however, a well established exception to this position. Article 346 of the Treaty on the Functioning of the European Union allows any member state to take measures it considers necessary to protect its national security. This exemption covers the production of trade in arms, munitions and war material and entitles any member state to ensure work under contracts to which the exemption applies is carried out within its national territory. It is for member states to define their essential security interests, which for the UK has consistently covered design and build of complex warships. The exemption is assessed on a case-by-case basis and when considering awarding contracts to build future complex warships, the UK Government would have to consider whether to retain its current position (i.e. that contracts for warships must be placed in the UK). As this exemption is currently applied, Scottish shipyards would not be eligible to bid for contracts to build complex warships for the Royal Navy if Scotland was to become independent.

If at any time the UK Government were to decide not to apply an Article 346 exemption to the procurement of a complex warship, it would be obliged to adhere to the rules governing open competition. In these circumstances, if an independent Scotland were a member of the EU, the MOD would be legally obliged not to discriminate on the grounds of nationality and would therefore treat all potential suppliers from EU member states on an equal basis. If an independent Scotland were not in the EU, suppliers established in an independent Scotland would have no right to participate in defence procurements under EU procurement law; the policy of open competition would mean that we would only do business with the wider defence manufacturing industries in Scotland where they

demonstrated that they offer best value for money. While we are sure that companies based in Scotland would continue to make strong bids for MOD contracts, it is important to note that they will be pitching for business in an international market.

In terms of the procurement of on-board systems, any application of Article 346 exemptions needs to be justified on grounds of national security. The question of whether companies in an independent Scotland would be able to bid would, of course, depend on how these exemptions were applied. It is highly likely that any justification for using Article 346 to retain national industrial capability for building complex warships at prime contract level would also require some retention of industrial capability for, for example, the ships' propulsion and other on-board systems. It would be for the UK Government to determine which system technologies needed to be retained for reasons of national security on a case-by-case basis.

The SAC raises a range of important questions, which are understandably a matter of concern not just for the Scottish shipbuilding industry, but the wider defence industry and supply chain based in Scotland. The UK Government is not in a position to give any guarantees that the current industrial structure and outlook would remain the same should Scotland become independent. As such, we urge the Scottish Government to consider carefully the issues raised in this report and clearly set out how they will guarantee jobs across the defence sector, as part of their future plans for an independent Scotland.