

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

DEFENCE REFORM BILL

Fourth Sitting

Thursday 5 September 2013

(Afternoon)

CONTENTS

Examination of witnesses.

Adjourned till Tuesday 8 October at half-past Ten o'clock.

PUBLISHED BY AUTHORITY OF THE HOUSE OF COMMONS
LONDON – THE STATIONERY OFFICE LIMITED

£6.00

Members who wish to have copies of the Official Report of Proceedings in General Committees sent to them are requested to give notice to that effect at the Vote Office.

No proofs can be supplied. Corrigenda slips may be published with Bound Volume editions. Corrigenda that Members suggest should be clearly marked in a copy of the report—not telephoned—and must be received in the Editor's Room, House of Commons,

not later than

Monday 9 September 2013

STRICT ADHERENCE TO THIS ARRANGEMENT WILL GREATLY
FACILITATE THE PROMPT PUBLICATION OF
THE BOUND VOLUMES OF PROCEEDINGS
IN GENERAL COMMITTEES

© Parliamentary Copyright House of Commons 2013

*This publication may be reproduced under the terms of the Open Parliament licence,
which is published at www.parliament.uk/site-information/copyright/.*

The Committee consisted of the following Members:

Chairs: † MR GRAHAM BRADY, ALBERT OWEN

† Brazier, Mr Julian (<i>Canterbury</i>) (Con)	Jones, Mr Kevan (<i>North Durham</i>) (Lab)
† Brown, Mr Russell (<i>Dumfries and Galloway</i>) (Lab)	† Lancaster, Mark (<i>Lord Commissioner of Her Majesty's Treasury</i>)
Colvile, Oliver (<i>Plymouth, Sutton and Devonport</i>) (Con)	† Mordaunt, Penny (<i>Portsmouth North</i>) (Con)
† Docherty, Thomas (<i>Dunfermline and West Fife</i>) (Lab)	Pawsey, Mark (<i>Rugby</i>) (Con)
Donaldson, Mr Jeffrey M. (<i>Lagan Valley</i>) (DUP)	† Phillipson, Bridget (<i>Houghton and Sunderland South</i>) (Lab)
† Dunne, Mr Philip (<i>Parliamentary Under-Secretary of State for Defence</i>)	† Seabeck, Alison (<i>Plymouth, Moor View</i>) (Lab)
† Ellwood, Mr Tobias (<i>Bournemouth East</i>) (Con)	† Wheeler, Heather (<i>South Derbyshire</i>) (Con)
Gilbert, Stephen (<i>St Austell and Newquay</i>) (LD)	† Woodcock, John (<i>Barrow and Furness</i>) (Lab/Co-op)
† Hamilton, Mr David (<i>Midlothian</i>) (Lab)	Georgina Holmes-Skelton, <i>Committee Clerk</i>
Harvey, Sir Nick (<i>North Devon</i>) (LD)	
† Hinds, Damian (<i>East Hampshire</i>) (Con)	† attended the Committee

Witnesses

Chris Dando, PCS Ministry of Defence Group President, PCS

Garry Graham, Deputy General Secretary, Prospect

Bernard Gray, Chief of Defence Matériel, Ministry of Defence

Barry Burton, Director, Matériel Strategy, Ministry of Defence

Susanna Mason, Director General, Export and Commercial Strategy, Ministry of Defence

Philip Dunne MP, Parliamentary Under-Secretary of State for Defence, Equipment, Support and Technology, Ministry of Defence

Public Bill Committee

Thursday 5 September 2013

(Afternoon)

[MR GRAHAM BRADY *in the Chair*]

Defence Reform Bill

2 pm

The Committee deliberated in private.

Examination of Witnesses

Chris Dando and Garry Graham gave evidence.

2.11 pm

The Chair: Good afternoon. We are due to hear evidence from PCS and Prospect. As colleagues will have noticed, Mr Dando is not yet with us; he had some difficulties with his train getting here, but we are told he will be here soon. As soon as he arrives, he can just slot in and join us. We need to make progress because of the timetable. I once again remind members of the Committee that questions should be limited to matters within the scope of the Bill.

Q152 Mr Russell Brown (Dumfries and Galloway) (Lab): Good afternoon, Mr Graham. I am sure you will not be too lonely until Mr Dando arrives. How far have you been consulted on the proposals contained in the Bill?

Garry Graham: The consultation has been patchy in terms of the contents of the Bill. I can certainly say we have consulted widely with our membership. We believe that there are alternative solutions. One of the frustrations, particularly for Prospect—nobody is arguing that there are not challenges that need to be addressed—is that the proposals that we have sought to make over a number of years have fallen on deaf ears.

Q153 Mr Brown: What are your main concerns about the Bill and what, if any, changes do you believe should be made?

Garry Graham: Our major concerns relate to GoCo. We do not believe that a compelling case has been made in relation to the GoCo. I listened with interest to the evidence provided earlier this week by Lord West and others. There were areas of common ground in terms of both analysis and concern. If one looks at some of the drivers in terms of defence procurement and some of the problems that have been experienced historically, there has been overheating in the procurement programme. We are told that the books are balanced. That issue, to some extent, has been resolved. I know people still have questions with regard to that.

There has been an issue about fractured relationships. We heard earlier this week about the Levene reforms and efforts being made to reform the types of relationships and decision making within the Department and with stakeholders. The key driving force behind the issue of

the GoCo, as we see it, is about skills and competencies within the organisation to meet procurement needs. It has been a frustration on our side, but it cannot be beyond the wit of either man or woman that within the public sector we can have the skills and the competencies. What you need is an HR organisational framework that actually supports those competencies and skills within the organisation, because this function is different from a number of other civil service Departments that I have looked at. There is the issue of supporting specialisms, and the suggestion here is that what is needed is flexibilities—HR and reward flexibilities—to ensure that the appropriate skills and competencies are there. Surely we can achieve that in the public sector? That is what our members are seeking to achieve—[*Interruption.*]

Q154 Mr Brown: The cavalry has arrived—not that you needed rescuing. Obviously, we are moving here to nine-year contracts, and that is different. Are there concerns about that and about the potential for what might seem to be lack of competition, with only two bid teams?

Garry Graham: There is an underpinning concern here. When I look at large contracts, particularly if they are of significant duration, across the public and private sectors, one of the questions that I always ask myself is, “Where is the intelligent customer base?” Where is the ability to monitor, control, challenge and support that contract as it rolls forward?

The other concern that we have—I know others have expressed this as well—is that there does not appear to us to be a ready market in terms of a contract. There is not a large number of bidders out there. Certainly, Lord West and others have made the remark that this is not a direction that the US is going in—it is going in a completely different direction, in terms of contractorisation. France and Germany are not going in this direction. A concern about the duration of a contract of that length and size is, ultimately, whether you become a hostage to the contract. Do you have the intelligent customer base to challenge it? If things are not going right, where is the moral hazard for the people who are actually running the contract, in terms of their ability to execute it? So there are a range of complex issues and, if you then add on to that issues of intellectual property and concerns or perceptions about conflict of interest, then it takes you into really difficult territory.

Q155 Alison Seabeck (Plymouth, Moor View) (Lab): It is interesting to hear your comments. You have clearly picked up on comments made by witnesses on Tuesday, about the way in which the playing field has changed since Bernard Gray put his initial thoughts out there—some of the assumptions have changed. As part of your consultations with officials, have you been given any sense of the baseline from which MOD is working in terms of producing an assessment for both the GoCo and DE&S-plus on which it can ultimately judge which model might be the most suitable to take forward. Do you have any understanding of where the baseline is?

Garry Graham: One of the things that I can do is to write to the Committee once I have spoken to people who have been closer to the consultation taking place with the Department, but I do know that it has been a concern expressed by people—in terms of what we might call the optimistic assertions with regard to potential

savings from going down the GoCo route—and whether you are undertaking a comparison in relation to costs on a like-for-like basis.

Q156 Alison Seabeck: May I ask you both, looking at what might come out of a DE&S-plus or a GoCo, whether any discussion has been had about the potential changes to pay scales for the posts that are envisaged in a GoCo? Have you had discussions about where salary levels might go if the caps are lifted?

Chris Dando: I apologise for being late; I have had a nightmare journey. It is a very odd position. The Department has issued an invitation to negotiate; it has received bids, and I am sure Bernard Gray when he comes in shortly will update you on that. We have not had sight of them, because they are quoted as “commercial in confidence”. There is a real concern that for the majority of the members that Garry and I represent there will be little change in salary levels. Our members are concerned that if the GoCo does all the things that are promised and brings savings to the Department, salaries will go down, because the GoCo will have fixed costs and it needs to make a profit.

On your earlier question, we have tried to winkle out exactly how the comparison is going to be done. The Department is working with a very complex model. In an attempt to mitigate risk, it is doing the GoCo transfer in, effectively, a two or three-phase process, but it is asking the GoCo bidders to put together a bid as if they were doing a straightforward single transfer. On that basis, it has asked the DE&S-plus organisation to construct a model that looks like the GoCo model, so it has a comparison. We are asking all the time, at the centre of both the Department and DE&S, exactly how they will do the comparison and what factors they will use to assess risk, competency and conflict of interest. It is fair to say, answer came there none. Perhaps you will have more luck getting that information, but at the moment we do not have it. I do not think the Department has much of a clue about how to assess this, which is worrying.

Q157 Mr Brown: Can I just come in on the back of what you just said, Mr Dando? I expect that both of you have had experience of work forces transferring from the public sector to the private sector. Will you share with the Committee what you have experienced from that? You have talked about a reduction in salary and terms and conditions. What has been the impact on your members, and what was their experience? How was the business conducted beyond that?

Chris Dando: There is massive concern on the ground. People are very unsure; they still do not understand how the transfer will take place. There has been an announcement this morning about potential changes to the TUPE rules. They are concerned about the extent to which TUPE will really protect them in a privatised environment. They are concerned about the construct of the GoCo. If it is going to be predominantly American-led, what assurances are there that jobs will not be moved as a consequence of the GoCo coming in and saying, “We can do it cheaper overseas; we can do it cheaper in a different place”?

There is a big rush to the door, it is fair to say, because people are not confident, first, that it is going to work—people have a great deal of pride in what they

do in supporting the armed forces on the front line—and, secondly, that their futures are not going to be hampered or detrimentally affected by the GoCo. We have been pressing the Department, as much as it can, to give people as much reassurance now and on an ongoing basis. Until the bidders have put in their bids and the Department has assessed them and worked out exactly what the terms of transfer are, that uncertainty is only going to grow.

Garry Graham: If I may build on that, implied in the question is, can we think of examples of where it has not worked, and can we think of examples where it has worked and has alleviated people’s concerns? Certainly, I can think of an organisation that I worked for recently—NATS air traffic control, which was privatised by the previous Labour Government—where members had real concerns about the impact of privatisation. I think the journey since privatisation has been that people will have a variety of views. Some will see it as a positive move and some will be more negative. What assisted and underpinned that effective transition was, first, effectively a guarantee that trade union recognition would continue within the organisation when it changed its status and, secondly, there was no move from the new employing body to introduce two-tier or different terms and conditions for new entrants into the organisation. There was trade union recognition and we could engage positively with the employer on terms and conditions of employment and pensions. What we developed in the organisation was a coherent set of terms and conditions both for people who moved from the public sector and for those who were recruited when they entered and had a new status. What would help address members’ concerns on some of those issues is the commitment to continue trade union recognition—not only under TUPE for existing staff but for new entrants—and a positive dialogue with the employer on a coherent set of terms and conditions for staff within the organisation.

Q158 Heather Wheeler (South Derbyshire) (Con): I think you have almost answered the second part of my question which was to be about what contractual protections would need to be in place. I think that is an interesting list that you have given us. The first part of my question is this: how confident are you that the Government can maintain sufficient control over a private operator of defence procurement? You have other experiences of that.

Garry Graham: I think there is real concern with regard to that. That relates first to having that intelligent customer base that is able to challenge and monitor this type of organisation. Secondly, there is the issue I touched on earlier in relation to moral hazard of an organisation being almost too big to fail. What happens in seven, eight or nine years’ time if the organisation is not delivering as you would hope or expect it to deliver, given that this is not a marketplace where there are other competitors that you could go to? What type of controls do you have in that context?

Chris Dando: It is also going to be a very complex contractual relationship. I think we have concerns that there is very clear evidence that those contractual relationships lead to complacency, and after all MOD is not very good at letting, managing and co-ordinating contracts, if that is why the Government are proposing to do what they are doing. It seems odd to us that we are

going to have a super-contract to manage this. As Garry said earlier, there has been clear evidence of other countries trying this and abandoning it as too difficult, expensive and conflicted. We would like to see further evidence and further evaluation of that evidence to see how it is going to work here. Because it is not on day one, it is on day 1,001 where the impact of this is going to be felt.

Q159 Heather Wheeler: I hear what you say but I find it interesting that you are almost telling us that it is bad now and that this will not make it better.

Chris Dando: I think the evidence is that there are problems within the organisation. If we have time it would be useful to explore the points that are in the Bill that the proposal is trying to address. Most of them in our view are not caused within the DE&S organisation; most of them are external to it. Bringing a contractual relationship into that will, yes, cause a change to that relationship, but whether it is a beneficial one is quite interesting.

Q160 Mr Julian Brazier (Canterbury) (Con): Just a quick question. Could you just mention those countries?

Chris Dando: Our evidence so far has picked up on the American experience through what they called logistic systems integrators, where they tried for a couple of big contracts, both for the army and for the coastguard, to do a very similar overarching contractual arrangement with one consortium to manage the totality of the procurement and support function. There is some very good evidence in the Library of Congress of how that went wrong, to the extent that Congress recommended that the US Government did not do it again.

Q161 Mr Brazier: Could you send us a link to that?

Chris Dando: Yes, I certainly will.

Q162 John Woodcock (Barrow and Furness) (Lab/Co-op): Do you at all accept parts of the basic analysis of those pushing for a GoCo that what can be a very significant difference between DE&S and the private companies with which you negotiate creates a mismatch in skill sets?

Chris Dando: I think that there are two elements to that, if I can go first—we both represent different parts of that specialist equation. The problem is as much that because people work cheek by jowl with contractors, because it is that kind of organisation, they get to know what the salary and terms and conditions packages are for those contractors, and they decide that they would sooner go to work for those contractors and get more money and potentially more job security than if they stayed within DE&S. So we accept the analysis; what we do not accept is the diagnosis that the only way to change it is by being a GoCo. We believe that the DE&S-plus discussions with the Treasury to loosen the Treasury cap on salaries is the right way to do it, rather than to put it out to the private sector where, really, the Government are going to have no control over salaries whatever.

Garry Graham: If I could pick up on that, it is important to understand that the position we are taking is not an ideological one. We have in defence very good examples of employers in the public sector and some

very good employers out there in the private sector. Babcock, BAE Systems and Rolls-Royce are some very good examples. I have to say as an aside that the actions of QinetiQ in terms of de-recognition were regrettable and unhelpful. We are seeking to take that forward positively with them, and I think that QinetiQ's actions came as an unhelpful surprise to our members across the public and private sectors in defence, and also, informally, to a number of the private sector employers that we deal with in defence. However, there are good employers across the public and private sectors in defence.

In terms of the wage disparity issue, that is not limited to defence. I speak to chief execs in trading funds; I speak to senior people in some of the research councils. These are world-leading organisations, trading funds that are commercially successful, and one of the key restraints that they speak to us about at the moment is that they cannot recruit and retain some of the skilled people they need to take the business forward. In that context, and as part of civil service reform, where a compelling business case is made, you would think that you could develop the HR systems to underpin that. As an aside, the practical reality is that increasingly members will transfer around the public and private sectors in defence. Personally, I feel that that kind of cross-fertilisation of knowledge—the ability of people to build their skills and careers—is a good thing.

Q163 Penny Mordaunt (Portsmouth North) (Con): What, as you understand it, would be the comparator against which the GoCo is an option, and if it comes to fruition, what will be the comparator against which it will be judged?

Chris Dando: The DE&S-plus model is being established as what is known as the value-for-money benchmark, so it will be a straight comparison. The Department told us last week that it intends to down-select to a single bidder following the work that it is doing with the two bidders that it has at the moment. It will refine that down to reach preferred bidder status with one of the two bidders, and will then compare the final proposals from that bidder with the in-house option—DE&S-plus—which will stand as the value-for-money benchmark.

I suspect that the Department will also be looking to create a “should cost” model to test some of the GoCo proposals against. I have no doubt that it is using contractors at the moment to try to develop that model. As I have said, it is a little bit complex because of the risk mitigation approach that it is using, and it is placing it on a sequential basis, which makes it harder to judge exactly what the costs going forward would be for each option, to be fair.

The Chair: We have only got another 10 minutes of this session, so unless there is a particular reason why you both want to answer a particular question, it might be best to decide between you.

Q164 Penny Mordaunt: May I quickly ask what measurements you think should be being taken into account, both in assessing which is the best option and in how that new entity should be judged, whatever that new entity is?

Garry Graham: There are a couple of things in relation to that. There was a suggestion that we benchmark not only against GoCo-plus, but “as is”. In terms of some

of the points that I have heard made on the GoCo, it is a false dichotomy. People have been suggesting that it will provide additional accountability and transparency. There is a question in my mind on that. I can think of organisations in the public sector that are accountable and transparent, and I can think of organisations in the private sector that are accountable and transparent, but I can also think of poor examples in both sectors. My other concern is that one suggested benefit to customers of the GoCo is predictability on decision making. There is a level of naivety with the actual demands that come out of defence procurement. You cannot predict the unpredictable, and sometimes you have to react very quickly to that.

Chris Dando: May I ask you about two other things? There is flexibility, and that is the flipside to DE&S, because it is flexible. A GoCo will not be flexible, because it will be contractually bound. Risk is the other issue, and capturing risk will be difficult in both models.

Q165 Alison Seabeck: Clause 4 gives effect to schedule 1 to the Bill, which covers various exemptions that the contractor will be given, for example around health and safety, and because of the specific and often quite specialist and dangerous work that happens on MOD sites. Do you have any concerns about that? Do you see any potential for corners to be cut? From your reading of the Bill, do you think that it is tight enough and clear enough about what the contractors will or will not be able to do?

Garry Graham: I am concerned about how sweeping the power is. The schedule has a caveat that talks about “in the interests of the safety of the State.”

There is a question as to when that power will be exercised. Prospect represents many members in safety-critical environments, from nuclear new build in the civil sector to areas of defence. In a safety-critical environment, high-quality health and safety is not a cheap option for employers. We are developing a good track record in the UK. The national pride over what we delivered with the Olympics was palpable, in terms of health and safety. We are leading the world in health and safety with what we did on Terminal 5 at Heathrow and what we are doing on nuclear new build, but in my experience that demands unrelenting pressure from the client on their contractors to ensure that health and safety is of the utmost importance. My concern with the clause, as currently drafted, is that it sends quite a different message on the importance of health and safety.

The Chair: Russell Brown.

Mr Brown: I am minded to let my question go, because the Minister has the next question, and I would like to hear the answers to it.

Q166 The Parliamentary Under-Secretary of State for Defence (Mr Philip Dunne): You raised some concerns about whether the TUPE regulations would be sufficient for employees to transfer across in the event that a GoCo is successful. Do you have examples of other MOD transformations where that has not been adequate? Would you regard the establishment of the Atomic Weapons Establishment GoCo—it was many years ago, so I understand that it may predate your experience—as a suitable parallel here?

Chris Dando: The difficulty we have had, which we have raised with your officials, is that the information provided to the GoCo bidders about staff’s terms and conditions is quite lax. Bidders therefore have an easy way to interpret them. The Department is not good at defining our contractual terms and conditions, and we find in most transfers, post-event, that it is not long before someone goes through the list of terms and conditions and says, “Well, it doesn’t actually say this, so we’re going to do that.” We then spend an awful lot of time firefighting. We have not really started on the TUPE discussions yet, and we will be impressing it firmly on your officials that they need to do a better job. I think that they are aware of that problem, but my concern is whether there is the time in which to bring that about.

Mr Dunne: Thank you for raising that. I am duly advised and will ensure that our HR people take that on board. Do you want to add anything, Mr Graham?

Garry Graham: I think our ambition would go beyond TUPE. My experience of knowledge-based organisations of this type is that you need to develop a coherent set of terms and conditions that embraces all staff in the organisation. That is not to say that they all have to be the same, but the approach needs to be coherent. An approach that effectively allows for a two-tier work force within this type of knowledge-based organisation would be deeply damaging, in terms of flexibility and the ability to recruit and retain people. TUPE provides certain protections to people. It would be a helpful signal from Ministers and others about trade union recognition going forward—and not only for those people simply covered by TUPE—to allow for a proper dialogue to take place with the employer about future terms and conditions embracing all the staff in the organisation.

Q167 Mr Dunne: May I go back to my question about AWE? Does either of you represent members in AWE?

Garry Graham: We have a good relationship with the management in AWE.

Q168 Mr Dunne: Is there an example from when that became a GoCo of the problems that you are concerned about now not being addressed?

Chris Dando: It is so much smaller in scale. It is much easier to develop and maintain that relationship when you are talking about a reasonably small number of staff and a reasonably long-standing relationship. This is going to be a much bigger entity and will potentially be more problematic because of the different types of staff involved. We can certainly learn some lessons from that, but it was a while ago.

The Chair: We have time for one last question.

Q169 John Woodcock: You mentioned concerns about health and safety in the Bill as it is currently framed. Are there other areas where you estimate that the GoCo approach could have an impact on the many thousands of employees of British defence firms across the country?

Chris Dando: I think the biggest concerns are about conflicts of interest, and the extent to which it is possible to protect the knowledge that the DE&S organisation

and its various constituent parts will have from spilling out into other activities. We have yet to be convinced that the Chinese walls that may need to continue through this organisation will be sufficient to protect that. I can understand that there will be some nervousness from people who already have a contractual relationship with DE&S about the details of their bids and their cost bases being known to a third party. I am not convinced that there is sufficient rigour or protection in the Bill to avoid that, because I am not sure how you would.

Garry Graham: Concerns have been raised about the protection of intellectual property and the Bill's provisions, and about conflicts of interest, particularly if contracts are already let to certain organisations that are bidding to be part of this. My experience of the regulatory environment elsewhere is that it is not just about people's concerns; perceptions have a validity in and of themselves. They may not be able to prove them in a court of law or undertake litigation, but the very fact that there are perceptions or concerns about that is, I think, telling of itself.

The Chair: I think we are just about at 45 minutes past 2. On behalf of the Committee, may I thank Mr Graham for holding the fort and Mr Dando for doing his best to get here after a broken-down train?

Examination of Witnesses

Bernard Gray, Barry Burton and Susanna Mason gave evidence.

2.46 pm

Q170 The Chair: Good afternoon. Thank you for coming to give evidence to the Committee. May I ask you all to introduce yourselves for the record, please?

Bernard Gray: Good afternoon. My name is Bernard Gray. I am the Chief of Defence Matériel. That means that I run the approximately half of the Ministry of Defence responsible for acquiring, supporting and providing logistics to the armed forces, so all the equipment expenditure is under me.

Susanna Mason: My name is Susanna Mason. I am director general, exports and commercial strategy. My role involves doing any of the work to do with exports in the MOD. The commercial strategy part of my job means that I run the commercial scrutineers for investment decisions. I run the current "Yellow Book" regime.

Barry Burton: Good afternoon. I am Barry Burton. I am the matériel strategies director in the Ministry of Defence responsible for the programme.

Q171 Damian Hinds (East Hampshire) (Con): May we start with a broad question of principle? Is it appropriate for a private company to run public sector procurement, and what reason is there to believe that such an entity would do that more effectively and provide better value for money to the taxpayer?

Bernard Gray: Perhaps I might have the first go at that question. It is a rather broad question; it depends on what you mean by "private sector" and "run", for example. I need to be absolutely clear: this is not a privatisation. What we are doing is creating a Government-owned entity, which we will direct to act as an agent on

our behalf to conduct procurement activities for us. It will effectively provide the technical services that we need to get the job done.

Although we will put the entity into a company, for a variety of reasons that we could go on to discuss, effectively we have the right to pull that company back into Government control at any time, depending on its performance, for example. Therefore, in that sense, we are not putting it beyond Government reach; what we are doing is creating an entity that will allow us to act with greater freedom than we can with the civil service today, which has a number of advantages, and that allows us to import significant skills from outside.

The second point I would make is that we do this all the time in a variety of different ways, including in GoCos: the Atomic Weapons Establishment has been running for 20 years in exactly this format, building, maintaining and developing our nuclear weapons programme very successfully in a structure exactly like this. Similar structures were used for delivering the Olympics last year, which everybody seems to think was a reasonable success, not only as far as medals were concerned, but as regards the building of the facilities.

We are also fundamentally dependent on the private sector for delivering all our military equipment; it is the private sector that builds all this. What we are talking about is the management of that programme, but fundamentally, beyond that, the companies deliver it for us. There is a lot of evidence that we already do this in a variety of similar ways—it is not precisely the same, and not in precisely the same area, but quite similar—and it has been successful. What evidence is there that suggests that it would be a superior model? The operation of the AWE, the operation of the Olympics. We have looked overseas at similar models, including the operation of the Los Alamos nuclear labs in the United States, and they have all achieved better results, by which I mean better delivery of their products, on time and to cost, than prior to their injection into a GoCo kind of structure.

Q172 Damian Hinds: Do we have any exemplars on this scale?

Bernard Gray: On this scale in this sector, no, we do not, but my point is that we have things that are roughly a third of the size of this, on a variety of different scales, and if you think about it, the Olympics were about half this scale in a different marketplace. I do not think that there is any difference of kind here, and I am not sure that the difference of scale makes a substantial difference to the risk profile.

Q173 Damian Hinds: On a definitional point—I do not know to which of you I should direct this—we are talking about GoCos. In other industries, such as petrol, you have CoDos—company-owned, dealer-operated—and it is obvious who owns which bit of it: the petrol company owns the site, and a dealer operates it. In this GoCo, what is it that is Government-owned, as opposed to licensed?

Bernard Gray: What we will be doing is splitting it up into several layers. There is a top management company that, if we proceeded with it, is owned by whichever consortium won a competition and we appointed. The parent companies of that would own the shares in the

management company, which would have just a handful of employees. Underneath that, there is an operating company that they have the right to operate. They own it for as long as we allow them to, but we have a golden share that allows us to take it back into Government control, or indeed to transfer it to a different operator at our choosing. We have a stable operating company platform, inside which the employees, all the structures and contracts, and everything else remain undisturbed, and we have what you might call a decapitation layer that we can change, not at will, but according to how it performs and who wins a subsequent contract and so on.

Q174 Alison Seabeck: Thank you all for coming. You talked about pulling back in-house if Government decided things were not working too well. If you look at the US experience with the lead system integrator model that was undertaken for the future combat system, it was subsequently rescinded. Congress then banned it. The estimated cost of doing all that was \$1.5 billion. Clearly we do not want our Government to have to find additional money if we want to put it all back in-house under similar circumstances. What lessons have you learned when framing this legislation from the US example? Can you point us to exactly where in the legislation the protections are to ensure that the British Government and the British taxpayer will not get caught out in the same way?

Bernard Gray: To be very clear, we are not proposing to establish lead systems integrators in the way that the US did.

Q175 Alison Seabeck: No, I accept that, but there is a model in the US where there was a similar sort of set-up. It was very similar; all the evidence is saying that this is not dissimilar.

Bernard Gray: No, I am sorry, I do not agree. I have had a number of conversations with my US opposite number on this point. When we first started to talk to the US, they said, “You don’t want to do that. That is what we did, with lead systems integrators; it didn’t work.” We said, “No, you’re not listening to us. This is what we are proposing to do.” Over the course of a number of conversations, they realised that there are significant differences between what we are proposing to do and what they did with lead systems integrators, and they said “Oh!” There was literally a “Eureka!” moment in the conversations, when they turned round and said “Oh, you mean you are not proposing to do this; you are proposing to do that.” We said “Yes,” and they said “Oh, okay; I understand.”

Q176 Alison Seabeck: Right, so there are no additional costs expected if the Government have to bring it back in-house?

Bernard Gray: I am just addressing the first point that you make. If you wish, and if we have the time, we can get into why this is significantly different from a lead systems integrator approach.

Alison Seabeck: That would be helpful, thank you.

Bernard Gray: I do not know whether you want to do that now or later.

Alison Seabeck: It would be helpful now, because it is relevant.

The Chair: As briefly as you can, please.

Bernard Gray: Sure, but I think this is a false assertion. The lead systems integrator model put a company—there is the example of Boeing and, I think, the ground systems vehicles—in as a super-prime contractor over the top of a series of other prime contractors, with Boeing, in the example I mentioned, bearing the risk of managing a specific programme and integrating that specific programme to deliver a family of vehicles. Effectively, Boeing was taking the risk on that. That was the lead systems integrator model. Boeing was acting as a prime contractor over a series of projects for that purpose.

What we are proposing is much more akin to the role of an architect; a company would act as our agent managing a whole set of prime contractors over a portfolio of projects. We are talking not about a single project, where it is responsible for making sure that this, that or the other contractor pulls in something inside what is effectively a single programme with very strong links between contractors, but about a portfolio of separate projects, where we want it to bring in project management skills to ensure that we manage all our different prime contractor-led projects in and out of the station to the appropriate time and cost. That is a very different model.

Alison Seabeck: Thank you.

Bernard Gray: What safeguards do we have on performance? A lot of this is not in the legislation because the legislation is, in structure, enabling, but it is contained in the draft contract that we have for delivery of the project. The key issue there is to consider a whole bunch of things. The first is the way that the incentives are set up, so the company effectively will only make money if it saves us money. For Committee members who are not particularly well versed in our business—it is not everybody’s mainstream day job—about 8% of our costs are associated with running my organisation. The overheads of all the staff, buildings and everything else that we have is about 8% of our expenditure, and 92% of our expenditure goes out to private industry. About half of that goes on buying new equipment and about half on supporting existing equipment. Our objective is principally to ensure, first of all, that we avoid the problems of the past where we have seen significant growth in the cost of that 92%, and then to drive down the cost of delivering that 92%, both in new equipment acquisition and in the cost of supporting our equipment. That is where the majority of the value is.

The principal objective of a company operating this model would be to seek to ensure that we deliver our programmes to time and cost much better than we do today, which is the principal source of savings. The first thing is the incentives inside the contract, which ensure that a company in that position does not make any money unless we save money. We have a set of protections inside that that say: “We have step-in rights if we are unhappy about the company’s performance across the piece over various periods of time.” All that contract performance is being controlled by an organisation that we call the governor organisation at the centre of the Ministry of Defence.

Q177 Thomas Docherty (Dunfermline and West Fife) (Lab): Mr Gray, would it be fair to say that your conclusion from 2009 has been that a succession of Ministers of both political persuasions have failed to be robust enough with the defence contractors and the service chiefs, and that what is really driving your confidence and belief that this is the way forward is that you think it is the only way to inject robust rigour when a defence contractor such as BAE Systems says, “I can deliver the Type 45 for £500 million,” and that is not true?

Bernard Gray: With the best will in the world, Ministers cannot do all the work surrounding £15 billion-worth of expenditure and 2,000 contracts. I have known most of the defence procurement Ministers over the last 20 years, and they are all diligent, capable people. There are just not enough hours in the day for a Minister to be able to control all those things to prevent things from happening in the first place. About 17,000 people work in my organisation; one Minister cannot effectively do the job of those 17,000 people. What we need is all those people who are involved in that detailed, day-to-day activity to be focused on delivering the outcomes that the Government need. At the moment, they are effectively in a position where they can be pushed around by vested interests in a whole variety of ways, with very little protection. If any individual in that structure tried to say to the Minister, “I am being shoved around by this vested interest”, they would be putting themselves at enormous hazard. I do not think the answer is credible that says, “Herculean, heroic Ministers can sort all this out.” We need a structure that fundamentally is capable—at the 17,000 people level—of speaking truth to power.

Q178 Thomas Docherty: The problem with that—although I understand why you have travelled down that path—is that there will still be a relationship, if GoCo is a contractor to the MOD customer, whether that be you or your successors. It struck me, in listening to you yesterday at the Defence Committee, that you have a very optimistic view about how robust the GoCo is going to be, back to its customer. I am not sure why you have the confidence that a contractor in a GoCo will be that robust. Can you explain?

Bernard Gray: First, we have to bear in mind that we are making relative judgments. It does not have to be perfect. The question is, can we make something that is better than exists today? That is the challenge. I have only looked back 50 years, but we have at least 50 years’ evidence of chronic failure of the current system. My riposte to that would be, “What is it that makes anybody believe that the current system will work better if we all man up?”

Q179 Thomas Docherty: Or woman up.

Bernard Gray: It is a term of art. I do not believe that that is true. Why would a separate entity be different? Because it has an incentive to be different. An entity would make money if it delivered projects for what it said it would deliver them for. If it says it will deliver a Type 45 for £500 million a copy and it turns out to cost £1 billion a copy, it will not make any money. It has no incentive to agree with a First Sea Lord who wants to believe that the Type 45s are only going to cost £500 million each. It will be wanting to say in the first place,

“Well, no, actually I think it’s going to cost £1 billion or more,” because it will want to give itself, effectively, a shot at making a decent amount of money. It will invest significantly in predicting accurately what a programme is going to cost in the first place, because if that is wrong it will not get paid.

Q180 Thomas Docherty: Who in the world has done this right so far?

Bernard Gray: In terms of which countries?

Q181 Thomas Docherty: On procuring, who is your benchmark?

Bernard Gray: As I said to you yesterday, I think, we find evidence of good performance pretty well nowhere. You will find the odd programme that is run well, but on a systematic basis, that is a problem for almost everybody.

Thomas Docherty: Is the problem not—

The Chair: Sorry—can we move on?

Q182 John Woodcock: Let me dig a bit further on the incentives question. You are talking about the baseline to save money. What gives you confidence in the new model that Government will have sufficient skills to make sure that that is priced correctly, so that you are not taken for a ride by the GoCo, which says, “Minister, actually it is going to cost £2 billion”, with a sucking of teeth—then, lo and behold, it manages to come in a bit below that and make shed-loads of money?

Bernard Gray: The first statement to make about this is that the baseline for the current programme is already set. The Secretary of State set down what we believe the current programme is going to cost and what contingency we have against that programme in balancing the programme 18 months ago. That is the starting position, which, effectively, we are requiring the GoCo contractors to accept as part of our structure. You then turn to new programmes that we would add to that. If a new project comes along, how do we ensure that that is robustly costed? I have the answer in two parts. The first is that there is a natural tension which exists between, as it were, buyer and seller; we want to believe it is going to be as cheap as possible, and they want to believe it is going to be as expensive as possible. We then have to haggle down to what we think a reasonable common position is. Fundamentally, that is a much more robust position than something where everybody is leaning out of the same side of the boat wishing to believe it is an optimistic outcome, which is what happened about the cats and traps.

Everybody wants to believe that it is going to cost nothing. My point is that you have a natural tension and a negotiation. That negotiation is informed by a whole lot of work, including work by the cost assurance service which benchmarks, against historical outturns and what other countries are doing, what something should cost. I think that that is fundamentally a much more robust way of assessing something that is, to a degree, inherently unknown—to say what a future system is going to cost—but it is much more resilient than our current structure where there is no counterweight to the optimism.

Q183 Mr Brown: Good afternoon. My colleague has made mention of some of the changes since 2009—the reforms, the balancing of the defence budget and greater delegation to the procurement authority. May I ask you what further improvement is still needed? How can a GoCo offer this improvement with a degree of certainty?

Bernard Gray: The first point to make about this is to draw a distinction between an acute and a chronic problem. It is true that we have balanced the programme today, but this is a bit like me going on a crash-diet and getting down to 11 stone and then starting to eat doughnuts again. The question is not whether we managed to balance the programme at a point in time, but how we keep it balanced over time.

Our experience over the last 50 years is—this is one of my small theories—that the large reason for the existence of defence reviews is that they were the only mechanism that people have ever had for cutting the programme back down to size. You have a process where, fundamentally, defence acquisition is a bit like buying on a credit card. The day that you announce something is not the day that you have to pay for it. Normally, the day when you have to pay for it in substantial size is five years down the road. There is a natural tendency on behalf of service chiefs, politicians, industry and everybody who wants to be able to have a rah-rah good story to announce something, and it is especially helpful that you do not have to pay for it for five years. That incentive causes people to over-order over time if there is no corset put on that.

What you see over a period of time is that the size of the defence programme rises relative to the likely available resources. Even when it was very strongly out of kilter, as it was in 2009, and I produced evidence in the report that I showed to the Department that said, “You are substantially in excess of any likely level of resources that you are ever going to get” but people do not want to believe it. The way that it finally catches up with you is, of course, that the credit card bill arrives and you cannot pay it. The demands of the programme in cash flow exceed the cash flow that the Department has got. Traditionally, we then have a defence review that then hacks it back to some kind of stability and then we start growing again.

What we are trying to do here is effectively put in place a mechanism which will cause it to be balanced over time, not at a moment in time. One of the reasons for putting this mechanism in place would effectively be to cause that to happen. The second reason for putting it in place is that we do not have the skills in my organisation today that we need to be able to negotiate with industry effectively. Depending on the particular job and skill-level and so on, we are something between a quarter and three quarters underpaid relative to industry. That means that I am losing my most talented people to industry, particularly at a level in their 30s when they start to have family responsibilities and bills. We all know that public sector pay restraint is very strong, but unlike the rest of the civil service which is operating in a policy arena, the people I employ are engineers, programme managers, finance professionals—people who are strongly bid in the private sector. I am losing significant numbers of people to that sector so I am trying to negotiate on behalf of the Government with people who are paid substantially less than the people on the other side of

the table and industry is coming along and cherry-picking the best of my team. That is not the best way to drive value for the public purse.

Q184 Mr Tobias Ellwood (Bournemouth East) (Con): Just pursuing that for a second and the approach of trying to have a rolling control over the budgets, how does that fit in with some of the bigger projects that we see where there are enormous cost overruns, not because they could have been predicted, but simply because you are building kit that has never been built before: the F-35B, the Astute class, Vanguard and so on? There are often unforeseen developments. How does the new GoCo approach ensure that these are tied in or recognised upstream?

Bernard Gray: These are definitely complicated systems which operate over many years—

Q185 Mr Ellwood: Sorry, could I also add that often either the Ministers or the MOD somehow then add bells and whistles to whatever they are building?

Bernard Gray: That definitely has been a problem. They are complicated systems but I would contest the idea that they have never been done before. The Astute submarine is only the latest class of SSN hunter-killer submarines that we have built. From memory, I think we have built four or possibly five different classes. This is just the most recent. Some of the problems occurred because there was a gap in production when effectively Barrow—I will not go so far as to say they forgot completely, but they certainly forgot some of the components of how to build it. I do not agree that it is entirely novel. Nor do I believe it is unpredictable.

In the case of the A400M transport aeroplane that EADS is building, my cost assurance and analysis service did some parametric data analysis which basically goes back and calculates the cost of making such an aeroplane at any time over the last 60 years. They have data sets going back for a long time. It was a logarithmic scale, unfortunately, which means that the cost is accelerating and it had a line on it and the cost of the A400M came about half way up towards that line. So effectively the parametric data that we had at the time we signed the contract said that it should cost twice what the contract says it was going to cost. We chose to believe what the contract said it was going to cost. Then it caused a disaster for EADS and Airbus and it cost them about \$5 billion and cost the nations some more money. Guess what? The cost of the airplanes is up at the line.

It is not that we cannot know a lot about this. We also know that the unexpected happens. In development programmes that I have been involved in before in areas like IT, you will always have an unallocated provision against that which says, “I have used all my best analysis to say what this is going to cost and I am going to put some money in here on top of that because something is going to happen and I don’t know what it is.” It would be possible for us to do that. We do not do that today.

Q186 Mr Ellwood: On the e-mail system on the QE class, for example. That was a profound change in direction which caused huge cost overruns. There is no way that anyone could have predicted that.

Bernard Gray: No, but on the specification changes, you are absolutely right. The two things that destroy value most are changing our minds in terms of specification

and changing our minds in terms of delivery dates. The carrier has been subject to both of those where we slow it down. That causes it to be in yards with all the overheads associated with that for longer. So that costs more for the same amount of ship. Then if we change our minds about it, it costs more. Why might a GoCo mechanism constrain this? I do not know what I would have done if I had been in post on that day but when my organisation gets phoned up and asked how much it will cost to put an e-mail system in the right answer is, "I don't know. We will do some serious work and find out because it is a serious question." However, people come under pressure, with people saying, "Everybody wants to know, we have to have an answer today. If you were any kind of a person you would be out there and would be able to tell us what this costs," and so on and so forth; people have their arms put up behind their backs, and so they put in a number. That is a fundamental mistake and a weakness of the current system: it allows people to offer an opinion about something when they cannot about something like that.

We should have done the appropriate work: we should have said, "We cannot make a decision about that, however much you want us to. We cannot offer you a price on that at this moment in time," then done six months' work, and come back and said, "It will cost £2 billion to do that." It is up to Ministers to decide what they want to do, but if they want to spend £2 billion on it, because they think that is a good use of public money, they can; my point is that they should make the decision based on what the real number is, and not what the back of a cigarette packet said it should be. Similarly, when people choose to slow things down we should say, "Look, the real cost of slowing this down is x. If you want to make the decision to slow it down, you can, but it is going to cost you a lot of money."

Q187 Mr Ellwood: Are you referring to the dockyards being kept open?

Bernard Gray: No, I am referring to the 2008 decision to postpone the carriers by two years.

The Chair: I think we need to move on.

Q188 Alison Seabek: We have heard witnesses, both on Tuesday and today, express concerns about the MOD's capacity to negotiate the GoCo, full stop, partly because of the issue you yourself have pointed out, that there is a risk that good staff get cherry-picked away and you are unable to attract them to your teams because of pay constraints. How confident are you that you have the strongest team around you at the moment to do that negotiation? Have you had to employ any consultants in order to do it?

Bernard Gray: I do not know about having had to; we have certainly chosen to. I would like to talk about that both in the current frame and going forward, as well, as both are important. It is hard for me to say, since I am leading it—this is a slightly awkward moment—but I think we have a strong team: we have the best team that we have on it. It has a very significant amount of my time; the commercial director of the MOD, Mr Les Mosco, is leading the negotiations on our part—he is our most senior commercial officer—and we have a very strong team, led by Barry, doing the detailed work.

We have employed financial advisers, legal advisers and strategy advisers. We have also retained the services of one of the major engineering firms: there are about half a dozen firms in the world that might be credible to do the work on our behalf; we went out and hired one of them before we started to make sure, on a sort of poacher-turned-gamekeeper basis, that we had advice on our side of the table about how to handle those firms. Those relationships can endure for as long as the Department wants.

We are confident that we have a high-quality team to go out there and negotiate this in the first place. Although I do not want to get into numbers because it is in the middle of a procurement, we should be clear that in terms of scale and dollar value—the actual money flowing through this contract—this is a medium-scale contract for us. We are appointing it, like an architect, as our agent: this is the money to pay our agent. All the contracts that go out to BAE Systems or other contractors effectively flow from the Ministry of Defence into them; what we are paying this consortium to do is manage that process for us.

On an enduring basis, we need to make sure that we retain an intelligent customer function capable of recognising what good value looks like. That will be done in a variety of ways, which include using part of the cost analysis service that I mentioned earlier; using a large part of Ms Mason's organisation, which sits at the centre of the Ministry of Defence and effectively offers a strategic, independent view of commercial activities; and the retention of some external advisers such as the engineering firm I mentioned earlier. Their job will be to oversee the performance of that contract. My contention is that it is easier in those circumstances to have a credible intelligent customer community that we can recruit, retain and make effective when we are talking about a few hundred people than it is at the level of thousands of people when we are trying to do it inside DE&S.

Q189 Alison Seabek: Have you had any conversations with Her Majesty's Treasury about the budget for that team where you clearly need to keep people and for the DE&S-plus model? Have you had any discussions at all about flexibility and pay scales?

Bernard Gray: Yes, we have.

Alison Seabek: And terms and conditions?

Bernard Gray: "HR freedoms" is the way we characterise it, because it is a wider question. We have a whole variety of levels. I will pass on to Barry in a second, because I am conscious of talking a lot.

At my level, I have already had conversations with Nick Macpherson, the permanent secretary at the Treasury, and said, "This is part of our problem." One example he cited was the Debt Management Office, which is the office that issues gilts to raise Government borrowing. That operates much closer to City terms and conditions, even though the people working for it are central Government employees. That is a few hundred people rather than many thousands, but he said, "We offer flexibility in some areas."

Of course, we have the core civil service, but we have many other public sector workers who work on different terms and conditions from the core civil service—teachers,

doctors and other specialist work, in different ways. So it might be possible under the DE&S-plus model or under the governor model to change that. That is a discussion that Barry and the team are having.

Barry Burton: We have discussed at some length with both the Treasury and the Cabinet Office how we would take forward freedoms in the way we handle our people, in terms of both the GoCo and DE&S-plus. It is fair to say that we have had to scrub that in greater detail for the GoCo model to get to the position in terms of approaching the market that we are in at the moment. However, in both sides of the options for the material strategy—both the DE&S-plus and the GoCo—we have been very clear with Treasury and Cabinet Office colleagues that part of the deal here is to explore how far we can push the employment models to give us the freedom to be able to run what Mr Gray describes as a rather different sort of business, moving away from policy generation into programme management, engineering and things like that, in a rather different way. So the short answer to your question, at almost every level, is yes we have.

Mr Brown: I was about to give you a rest, Mr Gray, and ask one of your colleagues to speak.

Bernard Gray: Don't let me hold you back.

Q190 Mr Brown: The explanatory notes to the Bill suggest that if the clause 1 arrangements are pursued, they will deliver a net benefit of £934 million over 10 years. Can someone explain how that sum has been arrived at? How confident are you of making those savings? Are there targets that you want to hit as you move through that period?

Bernard Gray: The precise envelope of what we end up doing will of course be determined partly by a negotiation that we have in the competition we are having at the moment—"Make us proposals," we are saying to industry—and partly, of course, by what actually outturns. I have made the point before that they will make money only if we make money.

How did we arrive at our initial analysis? We have done three sets of work. The first was done by a company called L.E.K. for my 2009 report, where they did a substantial amount of work. All the results of that are in the public domain. The relevant part is associated with what we have described as the frictional costs component—how much is it costing us? When we see that this, that or the other project has escalated in cost by 10%, 15% or 20%, how much is all that costing us on an annual basis? They did a lot of work, which, broadly speaking, said that—we were quite conservative and broad at the time, because it was the first time anyone had tried to do that—somewhere between £1 billion and £2 billion of our new equipment expenditure was wasted every year in the way that we have discussed, in terms of the aircraft carrier. That project sat in industry and absorbed the costs of industry for longer than it needed to, and we ended up with the same amount of product at the end.

There were also other areas. We needed something in the meantime. As it had not arrived, we went out and bought something else cheap and cheerful to keep us going in the meantime, or it costs us more to maintain the existing equipment. There is a variety of sources of

additional cost. One of the things that I want to underline is that it costs us of the order of 25% of all new equipment expenditure in wasted money. It is not legitimate profit to industry; it is just waste each year. Why do I think that it is important for us to do something substantial about it? Because effectively we are only getting 75% of our cash to work right now. They produced their estimate based off that. When I came to work for the Department, we subsequently appointed Booz Allen to do some separate work for us. I said that I wanted them to assess independently the costs of the same kind of thing, but that I did not want them to look at the way in which they did it, but to figure out for themselves as an independent body what they were doing.

It is interesting whether or not there is competition between firms, and they came up with an estimate of £1.2 billion to £1.9 billion, quite close to the line, but inside the other people's—to prove that they could be more accurate. We did a third piece of work with Corporate Value Associates, looking at it in a different way, which ended up with a similar gross potential saving. We then had to look into what we thought the cost of delivering those savings was going to be, which obviously to a certain extent would take away from the total net possible saving. We have to recognise that not all of the saving could be got out of the system. There will always be some problem somewhere that you cannot eliminate. There is a set of ranges, but the central point of the range is the £900 million figure that you mention.

Q191 John Woodcock: Notwithstanding those strands of work, do you not feel that, given that you are at an early stage of the negotiating bidding process—I was captured by your analogy with the e-mails—effectively, this is a Minister coming up to you and saying, "Look, Mr Gray, if you were any kind of man, you would be able to come up with a figure for this for the next 10 years"? Do you not feel that your arm has been put behind your back in coming up with a figure of £934 million? Should we not treat that with a severe degree of caution at this stage?

Bernard Gray: Of course, I do not know what we will deliver yet. I am saying that I am reasonably confident that that is the size of the prize. I am absolutely confident that the central case is that we are wasting a billion and a half of £6 billion of new spend every year, just by doing it the way that we do it. The question is: how much progress can we make on that?

If I turned round and made £500 million worth of improvement, and you said, "Well, that is not £900 million worth of improvement, is it?", I might say, "Don't you want it then? If it is embarrassing you, I will take it home." As a practical manager, under the circumstances, it is my job to drive the best deal that I can for the taxpayer, and that is what I am trying to do. We were not specifically asked by Ministers what we could do. It comes out of our seeking to understand the size of the problem and how much of the problem we might be able to get at.

Q192 John Woodcock: Can you give us an update in as much detail as you can of where you are with the process of scoping out and selecting consortia for this?

Barry Burton: We are currently under way in the opening salvos of negotiation and discussion with two consortia. The make-up of those consortia is in the

public domain and, since the invitation to negotiate was issued in July, we have been engaging in the first round of discussions with them, having shared an ITN that set out broadly what we were trying to achieve. Our approach is to do it on an iterative basis, because of the complexity of our business and the nature of what we are trying to achieve. We want to be able to engage with those two consortia through a process that leads us to a final proposition from them around March next year, and we will meet a number of milestones as we go through that.

Q193 John Woodcock: Are you content, Mr Gray, with the two consortia? Does that not raise some competition concerns at the outset?

Bernard Gray: I have three. In the way that I think about the proposition and, as I said at the Defence Committee yesterday, I quite like the formulation, we are running a competition in the private sector, but we are also running a competition with the public sector, so the DE&S-plus model is very real and I invest a lot of time in trying to strengthen that proposition and to force it ahead to be as good as it possibly can be. I like the proposition that I can go to the private sector potential providers and say, "You need to try harder, because the public sector's pushing really hard here." I don't know why I like this, but I quite like being able to go to the Treasury and the Cabinet Office and say, "You've got to be able to do better in terms of what we can do with the public sector work force here in order for the public sector to be competitive against the bid." We have that double tension there, which I think is very helpful.

Would I like more bidders? Yes, we would always like those, but there are constraints in this competition in that we are looking for a highly skilled organisation. You cannot just have anybody walking in. There are potentially four, five or six worldwide companies that are of a scale to do this, and we have hired one of them on our side of the bid.

I am happy that the two consortia both really want to win this. Although nobody in the world has quite done this at this scale yet, a lot of other countries are very interested in what we are doing. Were we to execute on this, I would not be at all surprised to see some countries that we know well following this with their own variant of it quite soon. I think all the companies are interested in that business opportunity as well. We are a huge calling card for anybody who wants to go out there and compete somewhere else in the world for this work. I am sure that they will vie with one another very extensively to win this. As I said, I am also pushing DE&S-plus very hard.

Q194 John Woodcock: If the GoCo is in place, is there a plan B that will be genuinely effective for the taxpayer if it failed to deliver on a requirement? I have particularly in mind the fact that BAE in Barrow shipyard has been described as effectively a GoCo. I am not sure whether you accept that. There have been significant cost overruns, and ultimately it is the taxpayers who pick up the cost.

Bernard Gray: That is a slightly different issue. In that case, what is the performance of Barrow? What should the status of Barrow be? In my mind, that is much more about the performance of BAE submarines than it is about anybody else. I have regular conversations with

John about the operation of the business. The fact that that has been mooted from time to time is a confusing coincidence. It is not directly applicable. A wider question would address whether the GoCo failed to perform either on a specific programme or across the piece. As I have said, we have set it up in a way that allows us to be effectively able to take it back in-house very cleanly.

We have looked at other examples and we have already engaged, as it were, an alternative provider to sit on the Government's side of the fence. If we chose to take it back in-house and run it through the governor team and the engineering firm we have hired to assist the governor team, we could do that, and we could then decide whether we wished to run a subsequent competition to replace the GoCo contractor in the long term or to reintegrate it in the Ministry of Defence.

Q195 John Woodcock: It is unlikely their skills base would remain in place once a GoCo was established.

Bernard Gray: Whose?

John Woodcock: The team: the engineers and consultants who are in place now.

Bernard Gray: My point is that we have hired Jacobs Engineering, a major US international firm with a very large footprint in the UK, which could bring to bear the resources that we would need to step in in an emergency. So we would be reaching back into Jacobs in order to bring forward the sets of skills that we needed in the short to medium term while we decided whether we wished to integrate it in the Ministry of Defence.

One reason why this is more complicated than other things might be is precisely because it allows us a degree of control over this entity. We want management skills and freedom to deliver a better job, and we put a relatively complicated structure in place to allow the Government to be able to effectively control it.

The Chair: I think we need to move on.

Q196 Damian Hinds: Mr Burton, you mentioned that the make-up of the two consortia is in the public domain. Nevertheless, for convenience, could you remind us?

Barry Burton: We have one consortium led by Bechtel, and one led by CH2M HILL. CH2M HILL has Serco and Atkins working for it, and Bechtel has—

Bernard Gray: PwC and PA Consulting.

Barry Burton: A team effort.

The Chair: Alison Seabeck.

Alison Seabeck: To be fair, Mr Brady, a lot of the question has been answered by Mr Gray already.

Q197 Mr Brazier: Mr Gray, we had a long exchange yesterday in the Select Committee, and I do not want to cover the same ground. I have a couple of quick questions. Are you really satisfied that two companies are enough to have a decent competition?

Bernard Gray: I think I have answered that question. The short answer is yes. I have three bidders. I have two vectors, and, within one of them, two companies. I am

smiling slightly because the idea that one of them would cede to the other without a fight to the death is mildly entertaining. They are two very large international rivals, who would definitely see it a major victory for one to win over the other.

Q198 Mr Brazier: We discussed conflict of interest at length yesterday. For the benefit of this Committee, how will you avoid the problem that a company that is related to a company within one of the consortia that is running the project may be bidding for one of the contracts?

Bernard Gray: One of the things that constrains the pool of companies able to do this for us is that we have already ruled out a lot of potential companies for conflict of interest reasons. It has been a very active process, and it has taken about four months to go through it in great detail with all those people. Prime defence contractors—the BAE Systems and Lockheeds of this world—unlike for the lead system integrator role, are barred from doing this. The conflict of interest of the people who are here is pretty small. It is related to a few extant contracts that were let some time ago. They have all accepted that they will not be able to come in and bid for any work that is being managed by the GoCo.

Q199 Mr Brazier: Last question. We spent a lot of time on this yesterday, but I must ask it for this Committee. As someone who is agnostic about this, I am open to the idea, but I have real concerns about overseas contractors. How will we cope with the problem of a foreigner working for a foreign company—I am talking about people, and principally about soft intellectual property and commercial in confidence, rather than state secrets—simply going to a job with a defence contractor bidding for a contract the next week? We could pursue them through the courts if they were in this country. How would we do that with a foreigner working for a foreign company?

Bernard Gray: Forgive me, Mr Brazier, but I think you are compressing a number of issues in that question, and I need to tease them out. For the national security concerns—

Q200 Mr Brazier: No, let us deal with commercial in confidence.

Bernard Gray: Okay. For the commercial in confidence, I am struggling with your question; I am trying to imagine the hypothetical you are posing, and I want to make sure I get it right. Are you asking what would happen if a foreign national who was working for the GoCo leaves the GoCo and joins some other foreign company? For argument's sake, let us say it is an American—an American working for the GoCo leaves the GoCo and joins a foreign firm bidding for a British contract.

Q201 Mr Brazier: Bidding for one of the contracts that has perhaps been on his desk already. There are straightforward ways of dealing with it in the British system.

Bernard Gray: Right, but there are straightforward ways of dealing with it wherever you are. If you commit a crime in somebody else's country—

Q202 Mr Brazier: Well, we are not really dealing with a criminal offence here, are we?

Bernard Gray: It depends what you are talking about. I am not an expert in criminal law, but that sounds pretty close to fraudulent activity. There was a case three or four years ago in relation to helicopters, where somebody left us and joined the bidder's company. One of the first things that we would do under those circumstances is to rule out that bidder, which is what happened in that case: a search and rescue competition was stopped. I was trying to tease this out because it is fairly straightforward. If somebody, against all our business employment rules and all the rest of it, joined some firm that was bidding for our work and was clearly taking commercially sensitive material to them, we would probably terminate the competition at that point because it had been fundamentally prejudiced. If we did not, I am sure that, as night follows day, 24 hours later one of the other bidders would raise an objection to us continuing with the competition.

The Chair: Time is short, so we need to move on.

Q203 John Woodcock: Eyebrows have been raised about the length of the contracts—nine years—when these big, lucrative or burdensome contracts run for much longer than that. How can we be sure that that can be effectively performance-managed when the final outcome is beyond the renewal of the GoCo contract?

Bernard Gray: Effectively, we have split the programme into two halves. For the new equipment acquisition part, of which, as you say, a large proportion is long-term contracts, we would use the fairly standard measurement mechanisms from the programme management industry of earned value analysis or earned value management—EVA or EVM, depending on your taste—to track the progress against those major projects in order to check whether they are delivering, even though they will not have finally out-turned. That is widely used in the industry and, indeed, in some parts of our organisation today for measuring long-term contracts. However, half the programme is effectively in-year spend—it is all the servicing we do in-year. In the order of £7 billion a year is spent on that, and you get much quicker results on whether that ship was refitted or those tanks were serviced, and so on. It is a mixture of the two mechanisms, but EVM is the short answer for the long one.

Q204 Penny Mordaunt: A quick clarification, to ensure that I have understood your response to Thomas and John. There is effectively no “as is” option to choose from because—I am paraphrasing—the status quo is not good, but there is an “as is” option for accountancy purposes, against which you will benchmark.

Bernard Gray: Yes, there is an “as is” baseline—we have a business plan that stretches out over the rest of the decade but has the detail for the next three years. I did not mention this yesterday at the Defence Committee, but we set out a number of options and this is option A, which currently runs through to 2015 in detail. I am now doing another review that will stretch out for two to three years beyond that in detail, which has a whole work force wiring diagram, work force plan and laid down activity, as well as the equipment plan, which incorporates the new equipment and the support plan.

All that exists in detail and will be the benchmark against which either DE&S-plus or a potential GoCo contractor is required to be assessed.

The Chair: For what I am afraid must be the last question, Alison Seabeck.

Q205 Alison Seabeck: Can I ask about the bid documents themselves—the selection and marking criteria? I know that this issue was raised yesterday in the Select Committee, and there was concern that there was a reluctance to allow that Committee to see how you were going through the process. Are you able to give us any time scale as to whether that information will be published? It would add value if we could have it.

Bernard Gray: Reflecting on yesterday, I think that we are the victims of our own perspective. We have not done a good enough job of explaining clearly the proposition in our minds—how it works, what the exclusions are and how the contract will work. I am happy to try to create such a document to give a much clearer picture. We know what we think, but we have not done a good enough job of explaining it to others. I put my hands up to that as it is absolutely fair.

On the slightly more ticklish question, I do not think that there was a reluctance on our part. In the middle of a competition it is very difficult to start publishing widely a lot of the documentation around that competition. I simply do not know what is allowed to happen from a Ministry of Defence rules point of view, so I said, “I do not know the answer. I will go away and look and be as helpful as I can.” At the level of trying to scratch the itch to help people to understand what this would look like and how it would work, we could certainly produce significantly more documentation.

The Chair: That brings us neatly to the end of the time available for this session. I thank the witnesses for their assistance to the Committee. We will give the Minister time to move from one end of the room to the other for the next session.

Examination of Witness

Mr Philip Dunne gave evidence.

3.45 pm

The Chair: If the Minister has caught his breath, I think we can go straight on.

Q206 Mr Brown: Minister, we have a series of questions here and some will be duplicates of what you have already heard and taken part in this afternoon. May I ask you the first question I asked Mr Gray? What has happened since 2009? What further improvement is still needed in this entire system? Regarding the balancing of the defence budget and the whole procurement issue, what more really needs to be done?

Mr Dunne: Thank you for inviting me to give oral evidence to the Committee that I am sitting on. That is a unique experience for me thus far, but I know it is not unusual in Bill Committees.

Much of the response to those questions was given by Bernard Gray earlier. I would add that through the defence transformation work—much of it following on

from Lord Levene’s report which he undertook for this Government when we came to office—we have sought to do two structural things outwith DE&S to try to get a grip on the procurement spending.

The first was to balance the budget, which Bernard Gray referred to. We succeeded in doing that about 15 months ago. The second was to publish for the first time an equipment plan, which lays out our intentions annually for 10 years by domain, by capital equipment in the equipment plan, and spending on support, in the equipment support plan. That is a degree of granularity that has not happened before in the MOD.

That provides the services within the MOD with a much clearer understanding of how much money they can expect to be available over a 10-year period. It also gives industry contractors much greater clarity over where they might look to invest their research and development effort over those years, so that they are more clearly aligned for the future.

We think that in itself will have quite a big impact in overcoming one of the major shortfalls identified by Bernard Gray in his report in 2009, which much of the discussion was about: Ministers and service chiefs changing specification requirement and political considerations impacting on annual budgets and spend in the equipment plan. We think those are fundamental building blocks.

What then needs to be done is look at the way we go about the procurement itself, that is the matériel strategy, which the previous speakers all focused on. How do we do the mechanics of procurement better than we do at the moment? That is why the focus is on three main areas: processes, skills and the tools of the trade, with all of which, it would be fair to say, the present DE&S has handicaps in being able to take advantage of current best business practice that is available in the private sector. That is where we think the private sector contractors can add real value through a GoCo, much of which would be less readily available in a DE&S-plus, although we would like to try to introduce as much as possible into a DE&S-plus.

Q207 Alison Seabeck: Minister, you will have heard Mr Gray’s response to questions about whether it is appropriate for a private company to run public sector procurement and the specific concerns raised about the ability to respond when we have operational requirements. Are you absolutely confident that you would never be in a situation where the GoCo would say, “Oh, sorry. No, we actually can’t produce that to the time scale that you want” when you have troops in the field desperately in need of that particular piece of kit? I understand that there are penalties: you can pull it back in-house if it does not meet its contractual terms, but do you have any worries at all that you could find yourself in that sort of scenario?

Mr Dunne: Not really. The requirement setting for each of the services will be undertaken much more by the service themselves than has happened in the past. That was another impact of the defence transformation. We delegated, as from April this year, primary responsibility for equipment capability setting to each service, so if there is an urgent operational requirement in the field to supply—Foxhound is the example that is often used—protected mobility vehicles, that requirement will come from the Army and it will then be fed into the GoCo with a specific requirement that the GoCo will be

responsible to procure. What was evident in the procurement of Foxhound, as it happened, was that the private sector leapt into the breach to come up with the proposal and it took, I think, 40 months from initial requirement setting to production of the vehicle to field in service, which is one of the fastest procurements for a platform that we have ever achieved—admittedly, it is not the biggest platform—and that was done by the private sector. Therefore, I have no doubt that it would react in the same way and I do not think that a GoCo would interfere with that; it might help.

Q208 Alison Seabeck: Within the contract, which we have not seen, I assume that there will be some caveats to ensure that operational requirements are protected and guaranteed, with penalties if they cannot be fulfilled.

Mr Dunne: I do not see any distinction between a regular procurement and an urgent operational requirement procurement when it comes to capability setting and demanding the GoCo to go out and meet that procurement.

Q209 Alison Seabeck: That is encouraging. In terms of the GoCo's role and its relationship with the MOD, yesterday, to the Defence Committee, Mr Gray—I think he has gone, unfortunately—said that the head of the GoCo would be an additional accounting officer. How will that work?

Mr Dunne: I think the Secretary of State was asked about that when the White Paper was debated, or it may have been on Second Reading—I forget which—and he made it clear that accountability to Parliament will be much the same as it is now: reporting through Ministers to Parliament in the way that we do at the moment. As is the case with many other branches of government, each Government-owned entity has an accountable officer. A GoCo would be a Government-owned entity and the chief executive of the GoCo would be an accountable officer and could be summoned to appear before the Select Committee.

The Chair: We have a lot of material to get through with the Minister. I propose to stick fairly rigidly to the lines of questioning that we agreed in advance. If we have any time at the end, I will take other colleagues who have indicated that they want to put questions.

Mr Dunne: Without wanting in any way to cut across your role in terms of questioning, I am conscious that in the previous session the focus was almost exclusively on GoCo and if there is an opportunity to talk about some of the single-source issues that the Committee has, I will be happy to cover those.

The Chair: That is precisely why I am keen to ensure that we get through the entirety of the lines of questioning we have discussed.

Q210 Heather Wheeler: I will be brief. I have two quick questions. Are you confident that the MOD will be able to get the best deal from the contract setting up the GoCo itself? Also, will the MOD be able to retain sufficient skilled staff to retain oversight of the contract to ensure that that is being operated as it should? Do you have a feel of how many employees from the DE&S would be likely to go in the transfer to the GoCo? That is the difference between who is left and who goes.

Mr Dunne: If I may, I will answer the second part of your question first. I am glad that you asked that question, because there has been a certain amount of confusion about what numbers of personnel will be in scope and out of scope. I would just like to add to the comment that Mr Gray made earlier. We intend, before the Committee meets again, to provide some clarifying guidance on the overall concept of the GoCo, to try to lay it out more simply than we perhaps have hitherto. That may include some numbers that I can give in summary today. As Mr Gray mentioned, some 17,000 people report to Bernard Gray within DE&S. It is our intention that by 2015 that number will have reduced to about 14,500, and a large part of that reduction will come from the outsourcing of the logistics, commodities and services activity.

We also anticipate that by the time a decision is taken, if we do go down a GoCo route, the 1,400 people who are presently within DE&S managing navy bases will be devolved to the Royal Navy. We are also anticipating that the just under 2,000 people who are in the information systems and services activities—the IT management activity—will be transferred out of DE&S. Approximately one third of the roughly 3,000 people involved in what we call functional directorates, which are the common resources, finance and legal-type commercial teams, will be retained within the MOD and will not go into a GoCo to form part of the intelligent customer. That leaves approximately 9,000 people out of today's 17,500 people who would be expected to be within the scope of a GoCo. Of those, we expect that approximately 2,000, although that number is not yet finalised, would be military personnel on secondment to the GoCo. I hope that that is helpful.

You also asked me what confidence I have that we will be able to effect a contract. As was said earlier, we have got some of the very best legal, financial, delivery and consulting advice on our side, and the fact that we, as was repeatedly mentioned by Mr Gray, have got one of the potential bidders choosing not to bid in order to act as the MOD's friend and consultant is very reassuring. We should be less inclined to miss any commercial tricks in this contract negotiation.

Q211 Mr Brown: Minister, obviously I posed the question to Bernard Gray about the £934 million net benefit. He explained in detail how that figure was reached. Rather than simply ask you how confident you are about those savings, because I suspect that you agree with him, I want to ask you whether any further work was done beyond the work that Bernard Gray did.

Mr Dunne: I think the only thing I would add to what Mr Gray said about these estimated benefits is that they are an estimate. Until we receive commercial bids with clarity about the costs and the anticipated savings we can assume from each proposal, it is just an estimate. It is a well-informed estimate. He has explained that we have had three separate reports to try to validate that number, but to give you a bit more clarity on how it is arrived at, the figure of £934 million assumes that there will be approximately £250 million of annual cashable benefits, once we get up to a steady state. That does not happen on day one, and that is why you cannot multiply £250 million by 10 and get to the savings. They will ramp up over time. We have also estimated that there will be some £318 million of non-cashable benefits,

which is some of the waste that Mr Gray was talking about when he talked about the inefficiency in the system. That underpins the £934 million.

Q212 Heather Wheeler: I am going to come back to something we touched on a little bit before, which is the international concerns. If we go ahead with the GoCo, how confident are you that we can allay the fears of our allies? That is my first question. My second question follows on from that and may indeed be part of your answer. How can we deal with sensitive information belonging to the Government in effect being protected with our new contractors?

Mr Dunne: We have had considerable engagement with our principal allies and partners and concerns are often raised regarding the US reaction. We are clear that our relationship with the United States will not be disturbed by this transaction. We have gone out of our way to ensure that we are informing the US at every step of the process. I am pleased that the Department of Defence has established a taskforce of dedicated people within the DOD to interact with Barry Burton and his team. They have regular interaction. They are explaining where we are in the process and any issues that are unearthed are being addressed. For example, they have taken a contract where they have an interest and they have gone through every stage to see, were there to be a new procurement with US involvement, how a GoCo would impact and whether different personnel might have to be engaged, such as someone who has the Government's pen when Government to Government authority is required. If that is not happening at the moment, we are ensuring that we will be able to do that in future. We are doing this in a rigorous and careful way. There are no issues that have not been surmounted thus far, and I have had direct conversations with my counterpart and Bernard Gray's counterpart in the Department of Defence.

We have had discussions with many of our other European allies. Both Bernard Gray and I have discussed the matter with our counterparts in France. I have spoken to my counterparts in Germany, Italy and Spain. I believe that the Australians were in the office yesterday and were being taken through the process. We are rigorously consulting with allies.

The point about confidential information was addressed quite well by Bernard Gray earlier. I know that it was raised by Mr Brazier in the Defence Committee yesterday. All that I would add is that we have many of these issues today in DE&S in that we are dealing with highly confidential information. It is handled in a very considered and careful way. We are very practised in dealing with such things and ensuring that conflicts of interest, if they appear to arise, are handled properly. For example, many private companies advise teams within DE&S on a consultancy basis on some highly sensitive contracts. If it is a contract that is sufficiently sensitive that we require it to be UK eyes only, it is UK eyes only. If the issue is highly secret, the work is compartmented and only people who have been read into that compartment, which is the expression that we use, are able to access the information. All those things happen today and we do not see any difference if that happens with individuals in the GoCo. As was said earlier, there are very isolated examples of security breaches and leaks and we deal

with them appropriately at the time. We honestly do not see this as the spectre that it has perhaps become in this Committee.

John Woodcock: I have one quick supplementary question that will elicit a one-word answer.

The Chair: Then straight on to the next thing.

Q213 John Woodcock: How much do you anticipate paying this world-leading engineering firm that is on the side of the Government in this contracting process?

Mr Dunne: We have made it public that we are authorised to spend up to £30 million on external advice across the whole range of advisers for the duration of the procurement if we go down a GoCo or indeed a DE&S-plus route.

Q214 John Woodcock: You were here when concerns were expressed by industry about the single-sourcing changes. How do you respond to that? How will the new system incentivise industry and not destabilise the process?

Mr Dunne: The single-source elements of the Bill are extremely important in rebalancing the relationship between the MOD and its principal contractors. The relationship has been in a time warp—in the narrow context of the contractual relationship—since 1968. I use that word because it is exceptionally difficult, within the yellow book framework, for the MOD to assess what it is being charged for contracts that are procured on the single-source basis. We have to wait until the end of a contract, and we have two years after the end of a contract to look back and challenge whether any of the costs that have been charged into the project are, in our view, unfair, unreasonable or inappropriate. If I tell you that we have a dedicated team of, I think, 30-odd people on the case of reviewing these single-source contracts, and that each year they find between £60 million and £120 million of inappropriate expenditure that is challenged and won for the MOD—there are others that are challenged and not won—that gives you some idea of the scale of the regular, recurrent problem that we are trying to address.

We anticipate that the single-source arrangements, by introducing much greater transparency into the information flow, will change behaviour in these companies so that they do not try to charge as routinely things into the MOD that they quite properly should not be charging. The combination of that and the fact that, as I have said, of the order of £60 million to £120 million is being found anyway means that we should get about £200 million a year of savings out of changing to this regime. We think it is entirely appropriate.

To get directly to your question, we do not think that there should be any reason for the contractors to feel destabilised by this relationship. What we will be asking them to do, in essence, is to provide, on a routine basis—probably quarterly—information about the costs that they seek to charge. We are not, through this process, looking to change the profit arrangements. There is a clear profit formula that the industry has signed up to, and that is not subject to change as we are currently proposing it. I do not think that anybody who is charging in costs on a fair and reasonable basis has anything to worry about.

Q215 Alison Seabeck: Lord Currie, in helping to inform this part of the Bill, did a very interesting and thorough piece of work. It is a shame he was unable to come to the Committee. However, ADS came to the Committee and spoke at some length about the industry's concerns about independence, particularly in clause 13. Have you given any consideration to bringing in an independent element, or having a business representative on the board?

Mr Dunne: Yes, indeed, and I am glad that you raised Lord Currie. I would like to pay tribute to his work, which absolutely informed the conclusions that we are seeking to bring into legislation. I agree that it is a great shame—we tried hard to encourage him to give oral evidence, and I am sure he will be in a position to contribute as the Bill goes through the House of Lords.

Yes, is the short answer. The intention here is that the members of the single-source regulatory board will be publicly advertised. There will be no nomination process as such; it will be up to anyone to apply if they wish to. There will be a panel that will select those who are recommended to the Secretary of State, and that panel will follow the guidance of the Office of the Commissioner for Public Appointments. OCPA will appoint a public appointments assessor, and secondly they will select an independent. Thirdly, the CBI will nominate an industry representative on to the panel, and there will be one MOD representative on the panel, who presently will be the director general for exports and commercial strategy, or her successor. So, there will be a panel of four, three of whom have nothing to do with the MOD. Those individuals will nominate to the Secretary of State, who will then have the opportunity to decide between however many people they nominate to go on the board.

The board itself, once it is constituted, will then have autonomy as to how it decides to hire people to work in the organisation. There will be a chairman, a chief executive and I think five non-execs on the board. The non-execs will deliver independence on to the board itself.

Q216 Mr Brown: I recognise, Minister, that it is Government policy, rightly, to protect SMEs. How will this be achieved under the single-source contract regime? How can we ensure that that policy is carried through?

Mr Dunne: As you know, Mr Brown, the Government are keen to increase the role for SMEs regarding procurement across Government, and particularly in the MOD where I have some responsibility for this issue. We have had concerns that for single-source contracts, the burden of information-gathering on small companies might be a challenge. Therefore, we are introducing in the regulations a de minimis threshold so that these regulations would not apply to contracts under £5 million, and they would not apply through the supply chain where subcontracts are less than £25 million. You might ask why we have a larger figure for the subcontractors than for the primes. The reason is that the prime contractors, almost by definition, are in the single-source regime anyway, and are of a scale and substance whereby clients with information requests will not be overly burdensome because they will be doing it anyway. That is why we have that distinction.

This gives me an opportunity to say that we are intending to include those rules as part of the regulations, and we expect to write to you with the regulations

before we sit in October. Given that these regulations relate to part 2, and as we will not be covering part 2 for the first week, at least, in October, I imagine that should give colleagues plenty of time to review the regulations before we get on to part 2.

Q217 Alison Seabeck: I am glad you made that statement about regulations, because the next question is about exemptions that are possible under the new regulations. As we have not seen the new regulations, it is a bit difficult to ask questions, particularly intelligently. However, in the circumstances, can you explain to the Committee a circumstance in which an exemption might be used?

Mr Dunne: The starting point is that we put these exemptions in, but not in the expectation of using them. They are a reserve power but there may be examples where it is appropriate, and we think it is right to give the Secretary of State the opportunity to exercise that if the circumstances are appropriate. The sorts of circumstances we can envisage are, if there is a procurement matter which is critical to national security, or one involving equipment that is not normally talked about—we do not normally talk about special forces equipment in the public domain. It is possible that some Government-to-Government contract might not be appropriate to include within the single-source regime. Those are the kinds of things. It is not going to be used routinely; it is going to be used exceptionally.

The single-source arrangements themselves do not apply to foreign military sales such as the US Government procurement system, and do not apply to international collaborations—the often “big-platform” collaborations in which we are jointly procuring with other nations; those would be exempted. But they do otherwise apply to a conventional procurement from a foreign supplier.

Q218 Alison Seabeck: Okay, but there is no way in which a foreign company could be treated more favourably than a UK company? That was certainly one of the issues raised in one of the briefings we had.

Mr Dunne: We do not see it working that way.

Q219 Mr Brown: When will the regulations and single-source contracts be published in detail, and how much consultation has there been around all of that?

Mr Dunne: There was considerable consultation around the time of Lord Currie's report, which was the result of consultation that he undertook at that time. There has been general awareness for a couple of years among industry that we were looking at this. Since the Currie report was published, which I think was in 2011—I forget which month—we have engaged with various bodies. We have various engagement structures within the MOD and the one that springs to mind is the Defence Suppliers Forum. It is chaired by the Secretary of State and attended by the chief executives of the largest dozen contractors, all of which are single-source companies, and representatives of the trade associations, both ADS and the smaller companies. We have used that forum as a means of disseminating our plans to industry at a senior level.

We then had engagement with the Defence Industries Council, with the CBI, with RUSI's defence acquisition team and I have been involved in meetings with all of

them, discussing this among other things. We think we have had a pretty extensive engagement with industry. We published the White Paper in June. I have had two meetings with ADS's defence acquisition team: one shortly after I took up my post and one around the time of the publication of the White Paper. They have made representations. Some of those representations we have taken into account. It would be fair to say that they are concerned that we are going to introduce something that might have an impact on their ability to charge us in the way they have been doing. They have not been overwhelmingly enthusiastic about these measures, but there is a recognition that it is time there was a change. You would need to ask them, but I think they would say that they understand there should be a change and they are more concerned about some of the detail, rather than the principle.

Q220 Mr Brown: So there is nothing out there, Minister, that you are aware of that came forward through the consultation that has not been considered? It has all been dealt with.

Mr Dunne: I think we have been very transparent about this.

Q221 Alison Seabeck: It would be really remiss not to mention the security of IP under schedule 5. Are you satisfied, and can you explain why you are satisfied, that it protects against failure to protect rather than wilful disclosure?

Mr Dunne: Yes, is the short answer. There are two types of information where there might be a concern. Within the single-source arrangements we are asking for details of costs at a granularity that is much greater than applies for a competitive tender. We have introduced a criminal offence for disclosure of that information because it is so much more sensitive. It also includes things like forward business plans, for example, and forward information, not just historic information. That would never be required of a competitive process. So we think that it is appropriate that that has a level of protection that does not apply elsewhere.

Just to be clear about this, because it was raised on Tuesday, we are following the model used by other regulators such as Ofwat, Ofgem and so on. They have a specific criminal sanction for disclosure of information that is provided to them inappropriately, because it goes down to a level of detail which gets under the skin of the businesses that they are regulating. That is the parallel we have been using. As for intellectual property itself, we are used to dealing with this all the time in DE&S at the moment. We really do not see that a GoCo environment introduces extra risk that cannot be properly managed with the right contractual controls.

Q222 Damian Hinds: I want to turn to the subject of Reserves. I open with a general question: the impact assessment for the Bill states that the Government intend to ensure that

“The reserves will complement the regulars within an integrated Whole Force, providing military capability in a different way from the past to deliver the range and scale of military forces and skills required.”

Are you confident that the Bill does enough to provide that?

Mr Dunne: That is a really good question. The Bill has relatively few clauses that relate to Reserves, largely because we think that most of what needs to be done to the Reserves does not require legislation. My answer to you therefore would be that we think that we have covered the things that require legislation, which is why we have put them in the Bill. We also recognise that there is an opportunity, in two years' time, for the quinquennial defence Bill to make further changes if we have missed anything out, or if we think something needs to be adopted. That gives an adequate belt and braces.

Q223 Penny Mordaunt: What are the challenges in achieving the desired number of Reservists?

Mr Dunne: That question was put earlier by the Committee, appropriately, to those among the service chiefs who are responsible for Reserves. We think that we are doing a lot to bring about our plans for increasing the recruitment of Reserves in the Army, which is where the main challenge lies. I would point you to the £1.8 billion that has been committed from the defence budget to provide training and equipment, and improvements to terms and conditions, for Reservists; that is the most tangible thing we are doing to make it an even more attractive activity for people.

We are also making things a bit easier for small and medium-sized enterprises. We have responded to one of the consultation issues regarding SMEs and the impact the plan might have on them by bringing in the additional payment. Those on the Committee who are Reservists will already be aware of this, but those who are not might like to be reminded that the £500-a-month payment to SMEs that we are talking about in the proposals is in addition to the payment they get in lieu of salary for the lost individual. People may have the impression that the £500 is to pay for the salary, but it is not: it is to pay for the administrative costs of hiring somebody else and looking after them for a short period. That was a direct response to a consultation that was undertaken, which Mr Brazier's commission also had a big input into.

Q224 Penny Mordaunt: I will raise just two further points. Obviously there has, quite understandably, been lots of discussion around business and small business in particular. Some professions, such as the teaching profession, are affected. In my unit, 20% of my young officers are teachers, and they really struggle to get time off, even though you would think that it is a profession that is well set up, through the supply system, to accommodate that. How will the Bill help in those instances with those professions?

Mr Dunne: I cannot honestly say that the Bill will help any individual group of potential Reservists. We are acutely aware of the challenges for teachers that you are raising. You are right that, with teachers generally being able to take school holiday periods off work, that should provide time for them to undertake the enduring training commitment. You would have thought that, as schools tend to finish earlier in the day than other occupations, teachers ought to be able to get to evening training sessions. It should not be a particular problem for teachers.

The challenge for the MOD in engaging with teachers is that this is a very devolved activity. We can try to encourage teaching unions and the Department for

Education to make information available, but there is no single big school; I do not know what the number of employees is in the largest school, but it will not be very many, so it is unlike dealing with big industry and big corporates, where you can disseminate a message to thousands of people. You cannot really do that in the education world quite so readily, and I am afraid that the Bill does not directly address that.

Q225 Mr Brown: Clause 45 makes provision to exempt Reservists from the statutory two-year qualifying period for claiming unfair dismissal from their civilian employment where the reason is connected to their membership of the Reserve forces. What kind of feedback have you had from those currently serving, and potential Reservists, about the extent of that problem? Will this measure resolve it? Is there a risk that this could discourage businesses from employing Reservists?

Mr Dunne: The evidence that we had from Mike Cherry of the Federation of Small Businesses was extremely helpful in that regard. He undertook a survey of his membership, specifically asking whether they either do, or would be willing to, employ Reservists. From memory, the figures were that 7% do and 40% would be willing to do so. When I asked him directly whether he thinks that the provision we have in the Bill would deter employers from encouraging the employment of Reservists, he thought not; he advised caution in introducing a specific discrimination ban until we can see how it works and whether it is something that we can look at later. As I mentioned earlier, if there is evidence of discrimination, we could consider it at the time of the next quinquennial armed forces Bill. We do not think, therefore, that that is a significant issue. I am sure that there will be individual cases. Members of Parliament may have had cases drawn to their attention, but we do not think that there is a systemic problem.

Q226 Mr Brown: As you indicated earlier, the Department has outlined its intention to gather evidence of that sort of thing—of whether there is discrimination against Reservists. I believe that the aim is to consider further measures in the next armed forces Bill. Would that create any delay or hindrance to the work towards Future Reserves 2020?

Mr Dunne: No, I do not think so.

Q227 Mr Brown: Can that work run in parallel?

Mr Dunne: Yes. We will be working very hard. Clearly, it is a big challenge to increase recruitment to our Reserves so that we get to the strength that we need by 2020. The good news is that both the RAF and the Royal Navy Reservists are not far off target. The problem is focused in the Army. As you heard earlier today, a major recruitment campaign will be starting on Monday. We are encouraging serving units to devote effort to supporting that campaign this autumn, and we will be monitoring it very closely.

On your point about the impact of discrimination, our consideration of whether that deters people can

absolutely run in parallel. That is something that should be properly addressed in 2015, when we see how we got on.

The Chair: There is time for one more question.

Q228 Mr David Hamilton (Midlothian) (Lab): Thank you, Mr Brady. I was hoping to get it in.

On SMEs, I welcome the fact that protection has been put in. When major contractors take contracts and sub-contract to the SMEs, can we consider affording them protection? A small contractor will never complain about the person from whom it has got the contract, but in many cases, the major contractor runs across on to the small one when it makes the bid. That is one of the areas on which the Select Committee on Defence reported some time ago, but it still needs to be addressed.

Earlier, the Minister indicated that changes will take place, with personnel being moved to different places; it sounded like deckchairs being moved. Could you write to indicate the actual numbers and say what protection will be afforded to those workers when they transfer?

Mr Dunne: Yes, to the last question: I will give written evidence to the Committee. In relation to SMEs through the supply chain, in the regulations on the single source regulations office, there will be a requirement on single-source companies to declare their spend through the supply chain with SMEs. We are introducing that; they will be obliged to make that clear to us, annually I think, although it may be more frequent than that. Aside from that, we have a defence security industrial engagement policy for overseas primes looking to use the UK supply chain network. The policy is for them to report to us on a regular basis on their use of the SME defence supply chain in the UK. There are presently four overseas primes signed up to that.

We also are doing a separate exercise, which is running through the Cabinet Office because it applies across Government, with all the major suppliers to the MOD and to other Government Departments to establish their use of SMEs through the supply chain. To date, there are 67 UK-based defence suppliers providing information on that on a quarterly basis. We are gradually building our database on the use of SMEs. You will be pleased to know that, as I mentioned on Tuesday, 40% of contracts placed last year were placed with SMEs.

The Chair: That brings us to the end of our allotted time for questions to the Minister. I thank the Minister for giving evidence to the Committee and look forward to him rejoining the Committee when we consider of the Bill.

Ordered, That further consideration be now adjourned.—(Mark Lancaster.)

4.30 pm

Adjourned till Tuesday 8 October at half-past Ten o'clock.

