

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

DEFENCE REFORM BILL

Fifth Sitting

Tuesday 8 October 2013

(Morning)

CONTENTS

CLAUSE 1 under consideration when the Committee adjourned till this day at Four o'clock.

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

£6.00

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The Committee consisted of the following Members:

Chairs: †MR GRAHAM BRADY, ALBERT OWEN

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| † 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 |

Public Bill Committee

Tuesday 8 October 2013

(Morning)

[MR GRAHAM BRADY *in the Chair*]

Defence Reform Bill

10.30 am

The Chair: Before we begin our line-by-line consideration of the Bill, some brief explanation may be useful to those who are relatively new to Public Bill Committees. The selection list for today's sitting is available in the room; it shows how the amendments selected for debate have been grouped together. Amendments grouped together are generally on the same or a similar issue. The Member who has put their name to the lead amendment in the group is called first; other Members are then free to catch my eye to speak on the amendments in the group. A Member may speak more than once in a single debate.

At the end of a debate on a group of amendments, I will call the Member who moved the lead amendment again; before they sit down they will need to indicate whether they wish to seek to withdraw the amendment or to seek a decision. If any Member wishes to press any other amendment in a group to a vote, they need to let me know. I will work on the assumption that the Government wish the Committee to reach a decision on all Government amendments.

Decisions on amendments do not take place in the order the amendments are debated but in the order they appear on the amendment paper. I will use my discretion to decide whether to allow a separate stand part debate on individual clauses and schedules, following the debates on the relevant amendments.

I hope that explanation was helpful. I also remind Members that as today is the first day back after the recess, the Committee's sitting times are as if today were a Monday. Our first session today will therefore have to finish by 1 pm.

Clause 1

ARRANGEMENTS FOR PROVIDING DEFENCE PROCUREMENT SERVICES

Alison Seabeck (Plymouth, Moor View) (Lab): I beg to move amendment 1, in clause 1, page 1, leave out lines 9 to 10.

The Chair: With this it will be convenient to discuss the following:

Amendment 2, in clause 1, page 1, line 10, after 'DE&S', insert—

'subject to conditions on maintenance and upkeep set by the Secretary of State.'

Amendment 3, in clause 1, page 2, line 42, at end insert—

'(7A) Arrangements mentioned in this section must include provision for contractual obligations to be placed on the company operating the contract for defence procurement services under subsection (2), specifically including provision to—

- (a) require non-UK companies to establish special security arrangements for the operation of the contract;
- (b) disqualify from the directorship of the company any individual who holds a directorship over any other company whose main business is in the manufacturing or provision of equipment, works or services for defence purposes and;
- (c) disqualify from the directorship of the company any individual who holds financial securities in any other company whose main business is in the manufacturing or provision of equipment, works or services for defence purposes.'

Amendment 5, in clause 1, page 2, line 42, at end insert—

'(7A) Arrangements mentioned in this section may not be brought into force until the Secretary of State has published guidance on the operation of the contract, specifically including—

- (a) the system by which available defence contracts shall be advertised to potential bidders, and;
- (b) the responsibility of the company operating the contract under subsection (2) to produce and report annually against progress on an export strategy.'

Amendment 10, in clause 1, page 2, line 42, at end add—

'(7A) Arrangements mentioned in this section must include provision for contractual obligations to be placed on the company operating the contract for defence procurement services under subsection (2); specifically including provision to prohibit the sale of financial securities in any publicly-listed company appointed under subsection (2) where such sale would result in a change of majority ownership.'

Amendment 4, in clause 1, page 3, line 31, at end add—

“special security arrangements” means a proxy board or Special Security agreement set up to prevent foreign influence over British defence interests.'

Clause stand part.

Alison Seabeck: It is good to be here serving under your chairmanship, Mr Brady, bright and early on a Monday morning—[*Interruption.*] I am sorry, a Tuesday morning. We have survived reshuffles, at least for the time being.

There is a great deal of uncertainty about the proposals in the Bill, both within the Committee and among experts and the media. Concerns are bubbling up, and were evident during the evidence sessions. I am therefore going to press the Minister for clarification on a number of issues specific to the clause and to the amendments we have tabled. At present I will keep the option open as to whether the Opposition will press amendments to a vote; that will depend very largely on the Minister's response. We need him to convince us, not just to reassure us—the Minister can of course be very reassuring.

Your guidance in the selection of amendments suggests, Mr Brady, that because of the wide-ranging nature of the clause there is no need for a separate stand part debate. I therefore hope that the Committee will bear with me as I have quite a long speech, some of which is also fairly technical.

I will start with the general concerns about the model for the Government-owned contractor-operated organisation. At the outset, we need to seek confirmation from the Minister on the exact shape of the GoCo and to press him on the issues relating to it that gave the most cause for concern during our previous sittings. He

needs to justify to the Committee the need for a GoCo. A number of questions were posed during the evidence sessions—most notably by the Royal United Services Institute, ADS and Lord West—that are pertinent to the clause and to the questions raised by hon. Members themselves during those sessions. In order to ensure a debate on the issue, we took the somewhat drastic step of tabling an amendment—amendment 1, which would delete lines nine to 10—that would remove a chunk of the clause.

During the witness sessions, Dr Louth of RUSI said clearly that some of the assumptions made in 2009, when the previous Labour Government started the process that led ultimately to the proposal for a GoCo, are no longer relevant. Many in the industry also seem to have reached that view. As we are repeatedly told, the defence budget is no longer overheated, and the Levene reforms are addressing some of the dysfunctional relationships that existed within DE&S. The main driver for the measure would therefore appear to be the lack of skills available to drive procurement and project management.

During meetings in the conference season, I heard time and again that defence procurement in the UK is actually among the best in the world, so people asked what it is we are trying to improve and whether the Bill enables that improvement. We appear to need to improve and enhance three key elements within DE&S: negotiating skills, because there is a weakness that can be—and probably has been, at times—exploited by business; project management skills, some of which is about the constant churn of individuals; and risk assessment and the associated IT skills, as we need to drill down into individual programmes, but that is not quite happening as it should. I also heard that the approach taken through the assessment phase could be flawed, because it does not consider an “as is” option. It would be interesting to have on the record the rationale behind the exclusion of that option, because that is relevant.

The clause allows for detailed examination of the proposals, and I hope that some of the issues I outlined will be discussed. Let us start at the beginning: the clause gives scope for the arrangement for the GoCo to be put in place, which consists of one or two company options. In Mr Gray’s evidence, he tried to explain how the model might work. He stated:

“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.”—[*Official Report, Defence Reform Public Bill Committee*, 5 September 2013; c. 82-3, Q172.]

I will return to the decapitation issue, and the possible reasons for removing the head, later.

As Mr Gray made clear in that quote, the clause allows for premises, property and employees to be provided to the contractor, and it allows for the contract to be

terminated and passed on to another contractor or to be brought in-house as the Secretary of State sees fit. It also sets out the scope for the changes to be introduced in phases, with the maritime sector, I believe, going first. The Minister’s parliamentary answer to me suggested that, but it has not been easy to track down precise details on the new Government website. Perhaps he could touch on the logic behind the decision, while staying within your parameters, Mr Brady. Why maritime: did the Minister think that was the easiest service to change first, or did he perhaps opt for the most complex? We would be interested to hear about that.

I turn to international partnerships, an area that is equally uncertain. Despite the reassuring noises made in the witness sessions, the future of our relationships with key international partners and allies gives cause for concern. A number of hon. Members, on both sides, sought answers to questions about the positions of our allies, particularly the USA. Of course, the Americans, as was discussed in the witness sessions, looked at their own versions of the GoCos and backtracked. The recent RUSI paper, “What the Government must do in Defence Procurement”, dated September 2013, sets out the US definition of what should be carried out within government, which varies from the position the Government have taken with the GoCo. Moving to a GoCo sends out a message that equipping our armed forces personnel is not

“a function that is so intimately related to the public interest as to mandate performance by public employees.”

Any decision, therefore, to progress with the GoCo will be of interest to our key ally, because we appear to be taking a view quite different from the way they intend to operate.

The Minister and the Chief of Defence Matériel confirmed that, although a taskforce had been set up by the United States, they were confident that the interfaces could be made to work. Some of the companies involved in the bidding process also believe that, based on their experience of working on joint US-UK projects, there should not be an issue. Other companies, though, have voiced concerns owing to their experience of working with the US on projects at the highest security level.

Mr Kevan Jones (North Durham) (Lab): What is my hon. Friend’s view on how the GoCo will work not for new contracts, but existing contracts such as the F-35, which is a joint contract with the United States and other partners? Does she think that the United States, or other partners, will have a view on a GoCo somehow taking control of that contract?

Alison Seabek: There are serious concerns about existing contracts and some of the retrospectivity issues in the Bill, some of which I will come on to later. My hon. Friend has rightly raised a pertinent issue that I hope the Minister will be able to address in due course.

Companies from the UK think they can manage the level of involvement. However, as my hon. Friend has just made clear, there are potential issues for the US with existing big projects and future projects, and perhaps for our joint projects with other countries such as France, Italy and Spain. I would welcome the Minister’s view on those relationships and how they will work in the future.

Mr Tobias Ellwood (Bournemouth East) (Con): The hon. Lady has made an important point, which has been highlighted by the hon. Member for North Durham. Will she explain in what way there would be a conflict of interest if the GoCo were an international consortium, and how that would affect an existing contract such as that for the F-35? That contract is complicated, but no doubt there are firewalls in place to ensure that intellectual property rights are protected. Without such an explanation, the hon. Lady could be adding confusion rather than providing clarity.

Alison Seabeck: There certainly are firewalls in place and as I said, at the moment companies feel that, by and large, they work. There are definitely concerns about conflicts of interest that need to be thrashed out, and I will come on to them in more detail later.

The Minister is in a far better position than I am to explain how he will respond to the question asked by my hon. Friend the Member for North Durham about the position of existing contracts. I await with interest the Minister's detailed response.

Mr Jones: The proposal before us does not have any structures that guarantee that the intellectual property of entities such as the United States is protected. At the moment, European companies that conduct business in the United States have to have US-only boards. There is no such firewall at all in the proposal.

Alison Seabeck: As my hon. Friend knows, we have tabled an amendment that proposes separate boards. I will come on to all those issues further down the line.

The hon. Member for Bournemouth East asked a perfectly reasonable question. When we met with members of the French equivalent of the Select Committee on Defence, many eyebrows were raised about the GoCo and how they would fit into a future process; there are issues.

The Americans themselves are looking at issues such as international intellectual property agreements and programmes, export controls, special programmes, technology transfer, foreign disclosure, third-party transfers, export licences, industrial control and nuclear programmes. Generally, the feedback from the United States is that the UK Government have been responsive in trying to answer some of the questions the Americans have about the "showstoppers", as they might be described. However, we still do not know whether we have fully satisfied our US counterparts. Will the Minister tell us which concerns are still current and are still being raised by other Governments? Does he know whether the Americans intend to test case studies against our GoCo modelling in due course? Rumour has it that they are likely to want to. What is the fall-back position? What contingency is there if they find they cannot make it work to their satisfaction?

If that is the likely route plan, when does the Minister expect to be able to put on record that he has firm confirmation from the Americans, and other nations that might be looking to undertake similar reviews on their joint working, that they are entirely happy with the GoCo model? Are we looking at 2013, 2014 or 2015? Otherwise, we will be asked to vote through a measure about which there are still significant reservations, both nationally and internationally.

I turn to conflicts of interest and amendment 3. A number of companies and trade organisations have voiced scepticism—in the witness sessions, in the media and directly to me—about the potential for conflicts of interest. There are, however, differing views. Babcock's chief executive, Peter Rogers, openly said that he believes there will be conflicts of interest. I quote his words as reported in *The Independent*:

"It's inconceivable that you could be responsible for the GoCo and win contracts. I'm not sure it's dawned on Serco yet."

Peter is a shrewd operator and always quick to see an opportunity, as his company's results show. He has clearly decided not to put Babcock forward for tenders because he believes it could damage his business.

10.45 am

The other big worry for business—the other side of the coin—is the potential for companies involved in running the GoCo to gain advantage from the knowledge they gain from being in control of project management and IP. Will they be able to use that knowledge when bidding for contracts outside the UK—say in South Korea or Australia—against companies to whose data and strategies they have had access through their role in the UK GoCo? How will those companies know that the companies in the GoCo have not used insider knowledge to unfair advantage? Should Babcock worry that it is not on a level playing field with companies involved in the GoCo, rather than the disadvantage that it felt would exist from being involved with it? Which is it? We will return to this topic later in the debate, so I will not labour the point, but it begs further questions about whether a GoCo is the right vehicle for the change in DE&S.

One of the bidders is anonymously quoted in the media as saying:

"Conflicts will be top of our list; it's going to be a nightmare. It's not possible to be part of a conglomerate bid of this size without conflicts of interest."

That is a slightly ambiguous statement, because it might imply that there will be conflicts and tensions within the consortia, but either way, it is a concern.

Many people involved in the GoCo will have directorships and posts with other defence-related interests. The chief executive of C2HM HILL has said that he will step down from his role at BAe if it is given the contract, but what guarantee is there that that will apply across the piece? Will the Minister ensure that there is no cross-pollination of directors or employees at any level, which would give cause for concern? Amendment 3 would disqualify directors of companies in the GoCo from sitting on other defence companies' boards. The CEO of C2HM HILL has already made his position clear, but the Bill should contain a clear provision to ensure that directors' positions cannot be abused. For example, directors involved in the consortia should be restricted from owning shares in defence companies that are the beneficiaries of defence contracts.

The amendment mentions the special security arrangement used by a number of UK companies when dealing with the US, which my hon. Friend the Member for North Durham touched on. The SSA enables the board of a company to be composed of US citizens and nationals from the parent company's country. For Rolls-Royce, GKN or BAe—companies that operate in the States—when matters of national security are discussed,

only the US managers can participate, and we propose to mirror that arrangement in the UK. That would allow financial issues to be visible, but not technology, and offers some insurance and integrity in the system. Has the Minister considered that set-up and the protection from undue foreign interference it offers?

Mr Jones: My hon. Friend referred to directors of the GoCo not having conflicts of interest while they are directors, but does she agree that there are concerns about former directors of the GoCo leaving the GoCo to join defence companies or other contractors that have contracts with the MOD? They might have undue influence in getting those contracts.

Alison Seabeck: There is a question about whether rules similar to those that govern Ministers' movement into defence companies should apply to directors, but it is difficult to be over-restrictive if somebody has experience and they want to use it some reasonable time later. We have some concerns, and we are likely to press amendment 3.

On premises, property and transfers, subsection (1)(b)(i) allows a company "to acquire from the Secretary of State rights in or over premises and property".

Will the Minister give the Committee an idea of the likely total valuation of the sites to be transferred and the level of dilapidation? How will the transfer be delivered? Will it be on a PFI-type contract or will it be a straight transfer, as the wording of the Bill suggests; and if so, what guarantee is there that the company will adequately maintain the premises? Clearly, we do not want to be faced with a massive repair bill if the premises are later brought back in house. How will the upkeep of the premises be overseen? Will it include renegotiation of any rental or leasing of goods, equipment or property transferred under the clause? Will the company be liable for the maintenance of the property and premises acquired? Will it fall within the governor's role to oversee the use of such premises and to ensure that they are maintained to a proper standard?

Are there any sensibilities over their use? Subsection (1)(a) and (b) mentions employees, property and premises "being made available for providing the defence procurement services."

Can the Minister confirm that such resources cannot be used for any other related or non-related purpose by the GoCo, such as working for any of the companies that make up the GoCo, which may have private defence procurement interests? Is the wording of the clause tight enough to prevent that abuse?

What are the wider implications of the transfer for the economy of the south-west? Do the bidders intend to retain Abbey Wood and to continue to run the company from those premises? What discussions have the Minister or his officials had about a continuing presence in Bristol following any potential transfer? In the worst case scenario, is there anything to prevent the new company from deciding to move the DE&S function lock, stock and barrel to another part of the country, or to break it up? The Treasury green book and the MOD guide to investment appraisals contain guidance that dictates that officials involved in defence procurement should consider the wider socio-economic impact on the nation: will that apply to the GoCo when it is making decisions about what it does with both people

and buildings? If the company acquires rights over premises currently in use by the MOD for defence purposes, could it sub-let portions of the buildings, perhaps to a foreign company carrying out defence procurement work for someone else? It could argue that that counted as "defence purposes". I am not clear where the Bill specifies that such action is restricted, so if the Minister points me in the right direction, I will be grateful. Subsection (8) sets out the definition of "defence purposes" as

"the purposes of defence (whether or not of the United Kingdom)".

I am sure that the Minister received watertight legal advice, but it is important that we are assured that there is no scope for the sort of abuse I describe.

Are safeguards in place regarding what people are used for when transferred? What safeguards has the Minister put in place, or what safeguards does he intend to put in place, to ensure that corners are not cut by the new company when it comes to employing the appropriate skill sets? Is there a risk that the company could decide to cut back on skilled personnel, and in so doing cut its wage costs and increase profits? We can discuss the matter in more detail when we reach clause 9, but it is a concern.

We also want to see a duty to issue guidance to potential bidders for defence contracts to be managed by the GoCo to ensure that small and medium-sized contractors receive information at a level that works for them and enables a bidding process that is not too onerous or repetitive. We are keen to ensure transparency in the export achievement and strategy of the contractor, and amendment 5, which may be rather heavy handed, was designed to flag up the concerns raised by many SMEs, including those I visited in the north of England during the summer. The Minister and his Department have been working with BIS and are seeking to enable such companies to bid, but it is definitely still an issue. Amendment 5 is probing, so I will wait to hear the Minister's response, but we may return to and vote on it later. Export strategy is another matter of particular interest to industry and is relevant when looking at the MOD and the impact of its procurement decisions on the wider economy.

The impact assessment, which specifically relates to the second part of the Bill—I assure you that I am not straying off-piste, Mr Brady—states that there will be a "simplified single source procurement process for smaller contracts and suppliers".

That is welcome, but will the Minister confirm what is meant by "simplified"? Will similar rules apply to people seeking contracts from the GoCo?

The question of private and foreign ownership has caused widespread anxiety and controversy, in part because of private sector involvement. Is there a risk of another G4S Olympics debacle or a Serco scandal? There have been allegations of overcharging for electronic tags. What are the risks to the GoCo of foreign ownership? There are two separate issues, and I will start with foreign ownership

Much of our defence sector is foreign-owned, and we have defence equipment built for us out of country. However, take a scenario where the GoCo tender is won and the companies in it have, as part of the bidding process, satisfied the MOD and the Secretary of State, but a couple of years down the line, shares are traded

[Alison Seabeck]

and they end up in the hands of a Russian oligarch or another interesting party; the company may even be subject to a takeover. How would the Government react to that scenario? Would they simply take the whole thing back in house if there were serious concerns about ownership and access to UK defence interests? Would they decapitate it, as the CDM suggested? What would the legal position be for the other parties to the consortium? Can the Minister reassure the Committee by citing any UK precedents? What criteria would he use to decide whether there was a serious risk?

In the evidence sessions, the CDM pointed out that many companies have been barred from the bid process, but he went on to say:

“The conflict of interest of the people who are here is pretty small.” —[*Official Report, Defence Reform Public Bill Committee*, 5 September 2013; c. 95, Q198.]

When he said “here”, did he mean the UK, or did he mean that part of the process? Those are basic questions, perhaps, but I would welcome an answer. If the CDM meant here in the UK, where does that leave those overseas companies that are part of the bidding process? Do they have conflicts of interest that we cannot touch? Do we need to consider our amendments, which would ensure that the UK part of the business is rigidly firewalled and go beyond simply ensuring that there is a British CEO or chairman? That moves into the realms of the point made by my hon. Friend the Member for North Durham. Those are perfectly reasonable questions, and I am sure the Minister will be happy to answer them.

We also have questions about the transfer of the contract, which is dealt with in subsection (2)(a). Does the Minister envisage more than one contract being run at the same time under this part of the clause, perhaps for one or more of the service pillars, with one contractor running in parallel with another? Does the paragraph simply allow the Secretary of State to end one contract, start another and have continuity and overlap to allow staff to be transferred; if so, how will that transfer of staff work? We will come back to that when we discuss clause 9.

John Woodcock (Barrow and Furness) (Lab/Co-op): Does my hon. Friend share my concern about the potential transfer of risk, particularly in relation to nuclear safety in Barrow shipyard? Real questions remain about the assessment framework and whether we can reasonably expect sufficient expertise in such a critical matter to reside properly in whichever contractor takes over the GoCo.

Alison Seabeck: My hon. Friend, with his experience of Barrow, asks a good question. I am sure the Minister has noted it and will respond. Risks at all sorts of levels run through the Bill, and my hon. Friend has highlighted a risk specific to Barrow and a few other sites.

In the transfer of functions under the clause, will the cost assurance and analysis service be transferred to the GoCo? The CAAS is currently based within DE&S and that organisation is its primary customer, along with MOD head office and the Defence Infrastructure Organisation. The CAAS verifies figures and offers cost management support to the front-line commands, given their increasingly important role in procurement. Since

2010, the Government appear to have been making serious efforts to improve the role and function of CAAS and to have recognised that cost assurance and analysis plays a major role in ensuring best value for money.

11 am

Strengthening the service and expanding its use were particularly noted in Lord Levene’s report on defence reform in 2011. One of his original recommendations was to mandate the use of the service more broadly across defence to support all investment decisions and planning, not just those directly related to DE&S. In fact, in his first annual report in December 2012, Lord Levene noted:

“The use of CAAS has been mandated across DE&S and capability areas of Head Office. In addition Smart Approvals states that the Approving Authorities would expect to see that all figures contained in cases have been verified by CAAS. CAAS has also initiated cost management support to the Front Line Commands, recognising their increased responsibilities through Defence Reform.”

What will be the impact on CAAS of the proposals in the Bill?

I notice that a contract notice was posted earlier this year, and the intention was to award the contract for a three-year period. The contract is similar to one awarded to KMPG in 2010 to strengthen the cost assurance role in the MOD. On that basis, it would appear that the MOD intends to continue to develop the service and envisages a future role for it, but nothing is stated explicitly in the Bill or explanatory notes.

The majority of the work that CAAS does is for DE&S. Transferring it and its personnel to a GoCo, as referenced in the clause, probably as part of the common resource platform that will cover commercial, financial, technical and HR functions, would therefore seem a likely outcome, but CAAS also does cost assurance work for MOD head office and, increasingly, for the front-line commands—the “requestors” who will continue to drive the overall equipment plan. Under the proposals for GoCos, the governor who will oversee the GoCo contracting entity will also have cost assurance obligations to meet in relation to the GoCo contract itself. The question is, therefore, can we transfer the CAAS to a GoCo and allow it still to fulfil those functions—particularly the latter—independently, or does there need to be some element of CAAS that is separated off and stays within head office? It has also been suggested that CAAS should be developed into a cross-departmental centre of excellence, thereby providing cost assurance services to other Government Departments, not just the MOD. How would that aspiration work if it became part of a GoCo?

The explanatory notes to the Bill state:

“The provisions in Part 1 of the Bill will not apply to any services which the contractor provides to anyone other than the Secretary of State.”

Does that mean that the contractor will be able to offer services elsewhere, both inside and outside Government, or indeed inside or outside the UK? Some clarification on that technical point would be helpful.

Clause 1(7) touches on giving the contractor free rein in the name of the Secretary of State. Will the Minister give a few examples of the circumstances in which the contractor may find himself able to use powers previously reserved for the Secretary of State? Does the contractor

have to go to the Secretary of State when he wants to make use of such freedom, or can he go ahead without getting any clearance? Is the governor the person who will oversee the use of such freedoms on behalf of the Secretary of State?

The CDM, who is likely to become the governor, said during our oral evidence session:

“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”.—[*Official Report, Defence Reform Public Bill Committee*, 5 September 2013; c. 97, Q205.]

He promised the Committee sight of a document giving a clearer picture, which might have helped us to understand better the powers that the governor will take on behalf of the Secretary of State, as well as the layout and workings of a GoCo, but we do not appear to have received it. Perhaps I could ask through you, Mr Brady, for the document to be provided to the Committee before we complete our scrutiny of part 1 of the Bill?

I have a couple of general questions on cyber-security. Will a GoCo be responsible for maintaining the highest level of cyber-security throughout the supply chains of companies working on defence projects? If so, who will check that that is happening? Indeed, has the Minister included criteria within the invitation to negotiate to ensure the necessary level of cyber-security?

Can the Minister confirm that the clause is not effectively just setting up three tiers of bureaucracy? There would appear to be one tier of bureaucracy in each of the following: the requestor pillars have one tier, with procurement experts sitting within it so that they have some idea of what they could buy for their budgets; there will be one highly professional and very well paid tier sitting within DE&S, with some 7,000 or 8,000 employees being transferred over; and there will be a tier of people with procurement expertise sitting alongside the governor, to ensure that the Secretary of State has somebody keeping an eye on what is going on in the GoCo. However, if there are pay limitations for the bodies on either side of the GoCo—and one of the drivers for setting up the GoCo is to ensure we have expertise in the right place—surely this will perpetuate the problem the GoCo seeks to address. There will be two sets of civil servants paid and skilled on a different level from those in the GoCo.

The Minister does have some serious questions to answer. In particular, given that I have not received an answer to the parliamentary question I tabled in September, will he let me know whether a report was recently requested by one of the big four—Deloitte, PwC, Ernst and Young or KPMG—on whether the GoCo is sustainable? If such a report was commissioned—I have it on reasonably good authority that one was—the Minister needs to allow members of this Committee to see it to enable us to decide whether the GoCo is a sensible route along which to proceed. There are now reports in newspapers from serious journalists suggesting that yet again, the Secretary of State is having doubts about the idea and that he may ultimately pull the plug.

We have gone from being pretty open-minded about this model to being highly sceptical in the last few days, partly due to outside comments about the apparent concerns within Government and of Ministers. Although we will not vote against the clause today, because no information has been forthcoming about the alleged

report on the sustainability of the GoCo, we will, having seen it, consider what to do on Report. The Minister and I have had numerous discussions about the position of the GoCo. In part because it was begun under a Labour Government and we had moved towards this model, our view was that it may be part of the answer—not to problems, but to providing the improvements needed to ensure better procurement processes. However, we are now far from happy. On that basis, I will press amendment 3 to a vote and await the Minister’s answers on amendment 5. We will not at this time vote against the clause.

The Parliamentary Under-Secretary of State for Defence (Mr Philip Dunne): It is rather reassuring to be in Committee Room 9, rather than the Boothroyd Room, for this more detailed stage of our deliberations. It is a bit cosier and we can all enjoy the atmosphere better, particularly under your benign chairmanship, Mr Brady.

I will start by congratulating the hon. Lady on retaining her position on the Front Bench and offering commiserations to her and any of her colleagues who thought they might have been elevated to the top slot. If news is forthcoming during the course of our proceedings, I am sure, Mr Brady, you will allow that to reach members of the Committee—if inspiration arrives.

Thomas Docherty (Dunfermline and West Fife) (Lab): I checked the website of the Ministry of Defence this morning. It does not state the new Government portfolios. Will the Minister confirm who will be his immediate boss? Will it be the hon. Member for Broxtowe (Anna Soubry) or the right hon. Member for Rayleigh and Wickford (Mr Francois)?

Mr Dunne: With reference to the issue of the boss, I take your strictures properly, Mr Brady. I stand here as the Minister for Defence Equipment, Support and Technology. I report to the Secretary of State for Defence, my right hon. Friend the Member for Runnymede and Weybridge (Mr Hammond), and I will continue to do so, as far as I know, after this sitting finishes.

I acknowledge the spirit in which the hon. Member for Plymouth, Moor View moved the amendments. Some were clearly probing and others were more substantive. I will address as many of her concerns as I can at this sitting, and draw attention to aspects of the clause’s subsections which the Committee needs to consider before we move on. I shall deal first with the amendments themselves and then with any of the hon. Lady’s points that I have not covered.

I start by picking up on her opening remarks about why we need a GoCo and why we are not comparing it with an “as is” Defence Equipment and Support organisation, rather than a DE&S-plus. In responding to a question on that issue during our evidence sessions from my hon. Friend the Member for Portsmouth North, Bernard Gray pointed out that, as one would expect, as the responsible officer he has a business plan for running DE&S. The current business plan runs to 2015 and he is in the process of preparing another review, which

“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.”—[*Official Report, Defence Reform Public Bill Committee*, 5 September 2013; c. 96, Q204.]

[Mr Dunne]

The hon. Lady will be familiar with the equipment plan because we published it in January. It has a 10-year life and is being updated for an annual iteration. Work is under way for its first review, which will be published in a few months' time. It provides considerable structure for the task of DE&S, which is to deliver the equipment plan, and its organisation is established in the business plan for DE&S itself. That business plan will be the "as is" benchmark against which DE&S-plus and the GoCo are measured.

Mr Jones: Is not one of the possibly naive aspects of Bernard Gray's approach to this subject that somehow we can fix the procurement process now? Some of these projects may take a decade to deliver. Within that time there will be a change of Government, but equipment will also change, as will the demands of our armed forces. Is he putting an artificial straitjacket around innovation and the possible saving of money?

Mr Dunne: I do not see it that way. What we aim to do in reorganising the way DE&S works is not to second-guess the equipment capability changes that will inevitably happen over time, but to ensure that we enter into contracts to deliver that equipment with enough confidence and capability in the project management of those contracts to ensure that they are delivered on time and on budget, in a manner that previous Governments, including Conservative Governments, have not done as well as they should.

Mr Jones: But is it not the nature of defence equipment that it changes over time? For example, if we were sat here in 2001, very few people would be predicting that we would need an entire suite of armoured vehicles to protect against improvised explosive devices in Iraq and Afghanistan. That change is obviously a political decision. How fixed in stone is the equipment programme? Will it allow flexibility to respond to such things?

11.15 am

Mr Dunne: DE&S is an agent of the Secretary of State—of the MOD—so the equipment capability will continue to be determined outside DE&S. It will be the procurement agent that negotiates the contract and ensures that its terms are met. One change, which has taken place since the hon. Gentleman's time in the Department, is the fact that, through the defence transformation, we have provided greater responsibility and accountability to the commands for their own equipment capability setting. That happened with effect from 1 April. Those organisations within each command determine what the operational requirements demand and make changes to the equipment to keep up with the current threat, as perceived.

Mr Jones: The Minister must admit, though, that there is only a finite amount of money in the budget and if changes are to be made within that, that will affect existing projects. Money might move from one project to another: his Government have done that, as did mine. I accept what he says about giving more responsibility to the chain of command, but, from my

experience, I suggest that that will make things worse and lead to commands protecting budgets and over-specifying equipment requirements.

Mr Dunne: I may be guided by the hon. Gentleman's experience of dealing with the commands, which is greater than mine thus far, but what has changed, and what should change their behaviour, is the fact that there will now be a harder relationship between DE&S and the command. If a decision is made to change a specification, which is what he is driving at—

Mr Ellwood: Will my hon. Friend give way?

Mr Dunne: Let me conclude this point. If there is a change in specification, that will come with a priced cost, which the command has to accept. If that leads to greater expenditure, that will come out of that command's budget and it will have to make the decision on where it will find the savings to pay for that increased specification. Hitherto, equipment setting has been undertaken by commands, with individuals in the MOD, but there was no direct accountability for impact on the budget for the changes made. That is one of the driving theories behind what we are trying to do here: introduce more rigour to the decision-making process.

Mr Jones *rose*—

Mr Dunne: The hon. Gentleman has had a good go. I will let my hon. Friend the Member for Bournemouth East intervene.

Mr Ellwood: I am grateful to my hon. Friend the Minister for giving way. The hon. Member for North Durham looks back in time and uses the example of the urgent operational requirement that went through because improvised explosive device vehicles were needed, but does my hon. Friend agree that lack of consistency led to that lack of accountability and to so many different vehicles being purchased off the shelf? That is exactly what we want to avoid, which is why we are introducing this new system of accountability and of connection with those who make decisions on the front line.

The equipment that the hon. Gentleman referred to was purchased for Kosovo and Bosnia, then sold off because there was no awareness that it would be needed subsequently. However, six vehicles were procured during our time in Afghanistan. I hope my hon. Friend agrees that that is exactly what we need to avoid here.

Mr Dunne: The Committee benefits enormously from the experience of some of its members, not least those who have been on active service in operations. I am grateful for that prompt reminder of some of the problems we had in procuring equipment.

Alison Seabeck: That discussion brings me back to one of my final points: the necessary expertise that will sit within each of those service columns, on procurement and on the technical side. How will the Minister ensure that the people who sit there have the skills to reach decisions on behalf of those service columns that achieve value for money, but do not lead to those decisions being overruled or misused and abused by people in a GoCo, who might be paid a lot more?

Mr Dunne: That is about how we stand up the intelligent customer, within the MOD or within the services. As explained to the House, since 1 April the capability team within the MOD has essentially been separated, with roughly half the personnel going down to each of the service commands and roughly half remaining in the MOD. Our intention is that some individuals in DE&S, either who have responsibility for certain activities that will not go in scope or who have some capability skills, will be retained by the MOD. We will come to that when we talk about scope.

Mr Jones: Will the Minister give way?

Mr Dunne: For the last time; I will then make progress if I may.

Mr Jones: I thought that the purpose of the Committee was to scrutinise the Minister, but if he does not want to answer questions, that is fine. On budgets, the point is not the intelligent customer, but political decisions that will have an impact on the lifetime of projects. There are at least two such decisions that the Government have made. One is the delay in the main gate for the nuclear deterrent, which, for political reasons, has added about £100 million to the budget. The other is the fiasco of cats and traps on aircraft carriers—a political decision that had a major impact on the delivery of the carrier project.

How will the Minister ensure that a GoCo—a separate negotiating arm—is insulated from such decisions? Do not all such decisions come down, quite rightly, to a Minister making priority decisions?

Mr Dunne: Clearly, the plans we have put in place to try to reform how procurement takes place go back, ultimately, to ministerial decision making. We have sought to introduce rigour by having a 10-year equipment plan that will be determined year on year, so it will be reassessed and approved at ministerial level each year. As the hon. Gentleman might recall, that will be by domain, by capital equipment and by support, and by year. Within each domain, the major categories are identified, so we have surface ships, we have submarines—

Mr Jones: You have not published it.

Mr Dunne: We have published it. It was published in January this year—*[Interruption.]* Yes, it was. Another iteration will be published. I cannot promise that it will be this coming January—it may be the end of this year; we will have to see—but it will be in a few months' time.

Mr Julian Brazier (Canterbury) (Con): I thoroughly endorse what my hon. Friend has said. It should perhaps be put on the record that the central problem with the cats and traps was the previous Government's decision not to go for nuclear propulsion. That meant that there was no affordable, proven option for cats and traps, which has left us with a single choice—*[Interruption.]*

The Chair: Order. Before the Minister replies, I remind hon. Members that if they wish to intervene they can seek to do so, and that if they wish to seek to catch my eye subsequently they may be fortunate in doing so.

Mr Dunne: Thank you, Mr Brady.

The aircraft carrier decisions illustrate the scale of the problem here—*[Interruption.]* Under both Governments. I am going to rehearse, if I may, why I believe that to be the case. In 2009, the decision was taken to slip the delivery dates of the aircraft carriers, without sufficient understanding of the costs that would be incurred. In the end, that decision cost some £1.5 billion—more than double the original estimate put to Ministers by the procurement executive, DE&S. That was £1.5 billion of extra cost for no increase in capability. If decision makers had known at the time the full cost of their decisions, they might have made different choices.

Similarly in 2010, under this Government, the decision to switch to catapults and arrestors for a CV carrier was made on the basis of inadequate and immature costings. Once the costings had become clearer, it was obvious that that choice did not represent value for money. Time, money and effort could have been saved in both cases if decision makers had had adequate information, including the information that what data were available were not of a quality to make decisions of that magnitude. That is the issue we are trying to put right through the GoCo or DE&S-plus.

Mr Ellwood: Further to that, and linking up with what my hon. Friend the Member for Canterbury said, the issue goes back to the decision on how to power the aircraft carriers—

Thomas Docherty: No.

Mr Ellwood: If the hon. Gentleman bears with me, I will play the argument out. As the carriers are not nuclear, there is no steam on board. If there is no steam on board, the carrier cannot run cats and traps. If the carrier cannot run cats and traps off steam, there has to be a new system—the electromagnetic aircraft launch system—which, as some hon. Members are aware, has yet to be procured properly. That did not happen.

We had to move from the C class to the B simply because the Labour Government ran out of money and burned £38 billion from the MOD's budget. That meant that we had to resort to the cheaper B variant. *[Interruption.]*

The Chair: Order. Before the Minister responds, it might be helpful if I point out the fact that we are scrutinising the Bill, not the procurement programme itself. It might take some of the high excitement out of the exchanges if we focus on the matters before us.

Mr Dunne: Thank you, Mr Brady. I am sure that the Committee is energised by these discussions, which are keeping us all awake for what is quite a technical Bill. I do not want to discourage colleagues from keeping awake and alert.

As we are on the subject of maritime, and before I get to the detail of the amendments, I want to pick up one of the questions asked by the hon. Member for Plymouth, Moor View: why maritime was chosen for the first phase. Quite reasonably, she asked us to explain the rationale behind that.

The intent, in the event that we go down the GoCo route, is that maritime, along with the common resource platform, by which we mean finance, legal and other

[Mr Dunne]

professional services provided within DE&S, would go in phase 1. Maritime accounts for some 45% of the planned DE&S expenditure over the next decade. That is contained within a relatively small number of large projects, compared with the other domains. The sooner that such projects can get the benefits associated with an improved procurement system, the faster the impact of undertaking the change.

Also, the maritime domain raises a number of issues that the hon. Lady has been raising—some of the more substantial questions posed by adopting a GoCo model, such as dealing with international partners, which I will talk about later. We had to make a choice between four domains—the joint domain being the fourth—and it was quite finely balanced. There were arguments on both sides. Ultimately, we concluded that, because of the impact and the fact that it would test a number of challenging areas, that was the right way to go.

John Woodcock: Will the Minister share his thoughts on the tricky issue of nuclear safety and the expertise that has been built up in the Royal Navy and the Department? Is he satisfied that that responsibility can be effectively transferred to a GoCo?

Mr Dunne: I will address that straightaway, as it is a specific question and clearly relevant to his constituents and the constituents of Government Members. Our intent at the moment is that the nuclear safety activity will be within scope of GoCo. We will test that as we take it forward. If the hon. Gentleman has specific concerns, I will be happy to discuss them outside the Committee, so that we can get the benefit of his expertise on the matter.

Mr Jones: The Minister is suggesting that he will transfer responsibility for nuclear safety to a private company. Where does that leave our arrangements with the Americans on transfer of information? Will that be included in the transfer? If so—information on nuclear deterrent is a Government-to-Government contract—are the Americans content that that should be handed to a private entity?

Mr Dunne: The hon. Gentleman is encouraging me to address issues that I was going to come to later. As he is well aware, the Atomic Weapons Establishment, which handles some of the most sensitive nuclear material, is already in a GoCo arrangement. The safety considerations are adequately and regularly addressed within the overall framework of a nuclear safety regime that applies to civil and military installations in this country.

11.30 am

Thomas Docherty: Just on the point about the AWE, it has been a while since I worked with the nuclear industry, but can the Minister remind me what safeguards there are about ownership? Is he content that exactly the same safeguards are being put in place for the GoCo, or is he open-minded about the proposals being put forward by my hon. Friend the Member for Plymouth, Moor View?

Mr Dunne: I am afraid I will come on to that later, because the way in which conflicts of interest and transfers of ownership are dealt with is a separate issue and is not directly relevant to nuclear safety. I now turn to the amendments.

Mr Jones: Will the Minister address the issue of the transfer of nuclear information between the United States and the UK?

Mr Dunne: We are reviewing with the United States any aspect of our relationship where they or we feel it is appropriate to continue to have Government personnel with primary responsibility. We are reviewing the whole range of our relationship. I was asked—by either the hon. Member for Plymouth, Moor View or the hon. Member for North Durham himself—whether we have examples of test cases that we have taken through with the US. We are doing that when the relationship would be affected by the GoCo. If we identify something that requires a Crown servant to be the responsible officer, we will ensure that that is in place.

We intend to continue to have a number of military personnel on secondment in the GoCo. I wrote to the Committee during the recess to give an indication of the numbers that we expect will continue to be on secondment to the GoCo. Those individuals will remain Crown servants and will be part of the military command chain.

Mr Jones: That is very interesting. Will the Minister tell the Committee when those areas will be agreed with the Americans? Are there any red lines that they will not accept? The other thing is, if there are Crown servants in the GoCo, who will they be answerable to?

Mr Dunne: As I have said, we have a continuing dialogue with the Americans to ensure that they are comfortable with the proposals. At this point, I can honestly tell the hon. Gentleman that no red lines have emerged from the discussions. If red lines emerge, we will ensure that the Americans are satisfied in a way that will allow us to proceed without disrupting our relationship with them. That is an extremely important part of the arrangement. In the event that we hit a red line—I am being hypothetical here—or if there is something that causes the Americans particular concern, we will look at the scope of the GoCo and seek, if necessary, to remove it.

Mr Jones: The very strange situation is that the Minister proposes to give the GoCo responsibility, for example, for the contract for the nuclear deterrent in the constituency of my hon. Friend the Member for Barrow and Furness, but he has not yet negotiated the agreements with the Americans. I would have thought that that was a fundamental thing to do before the Bill is enacted. Can he tell the Committee—either now or in writing later—which areas have been discussed so far, and which still need to be covered? Will he also answer my question about who Crown civil servants in the GoCo will be answerable to—the GoCo management or the MOD?

Mr Dunne: I am not going to commit to giving the hon. Gentleman a list of issues that are being discussed.

This is an ongoing process in parallel with the legislative process and the competition to run the GoCo. The intention is to make decisions in the spring.

Perhaps I should have started with this reassurance, which was mentioned by me and others Government Members in the oral evidence sessions. We are engaged in discussions today on an enabling legislative process, which is parallel to a commercial competition to identify the best proposal for a GoCo, while at the same time looking at an enhanced DE&S within the public sector. Given the competition timetable, it will be only in the spring of next year that we will be clear about the benefits and costs of undertaking a GoCo following the competition and be able to compare it with DE&S-plus. That will be the point at which we decide which route to go down. It is not appropriate to negotiate contracts with international partners at this stage, until we know which route we will go down.

Mr Jones: I am sorry to say that this is not about contracts negotiations at all. It is actually about getting fundamental agreement with our closest allies on one of the most strategic, important pieces of our defence, the nuclear deterrent, to ensure that it is content on particular matters. The idea that the Bill is being brought forward without that is remarkable. I again challenge the Minister to publish the areas examined so far, the outstanding areas, and whether there have been any objections from the Americans. I am sure that there are some people in the United States who will be very concerned if some of the responsibility is given to a private sector organisation. Will the Minister also answer the point about Crown civil servants?

Mr Dunne: Crown civil servants have a dual reporting line. While they are on secondment to DE&S today they report through the reporting line in DE&S. They also have a military chain of command. In the event of their operating on secondment within a GoCo, there would be a rather harder dual reporting line than the current dotted line. While DE&S is within the MOD, the military chain of command can take place.

As far as discussions with the Americans are concerned, it was made clear in the oral evidence sessions that there is continuous dialogue, with periodic meetings and more regular teleconferences, between the teams in the UK and the US, in which the whole range of relationships we have, both contractual and in treaty with the US, are discussed. It is not appropriate to give a running commentary on how that is going. I have already reassured the hon. Gentleman that no red lines have been raised that have not been dealt with by the Americans so far. It is obviously critical in relation to the nuclear deterrent that the Americans are content with the arrangements put in place. If they were not content, the matter would be taken out of scope of the GoCo.

Oliver Colvile (Plymouth, Sutton and Devonport) (Con): May I thank my hon. Friend for his answers? As he is aware, I represent Devonport, which is a nuclear licensed dockyard. He has talked eloquently of how nuclear activities will be a responsibility of the GoCo. However, will the GoCo also be responsible for developing the nuclear engineering skills base for defence? He might not be able to answer that now but it will be fine for him to write to me. Hon. Members may be aware that there is some concern that nuclear engineers are

likely to be drawn to Hinkley Point C when that is in place. I need to ensure that we maintain that important skills base in my constituency.

Mr Dunne: I think I can give some reassurance to my hon. Friend straightaway. Each entity engaged in both civil and military nuclear activity in the country has responsibility for ensuring that it has sufficiently qualified personnel. That applies within the military sphere through the Atomic Weapons Establishment, which is already in a GoCo. It applies in each of the services that have responsibility for our deterrent. It applies within DE&S at present where we are undertaking the procurement of nuclear equipment, and that will not change. Each organisation will continue to be required to maintain capability relevant to the activity that it is undertaking. It also applies to all the companies supporting the nuclear activity, including the company that is the largest employer in the constituency of the hon. Member for Barrow and Furness.

John Woodcock: I thank the Minister for giving way again; he is being generous with his time. The important point made by the hon. Member for Plymouth, Sutton and Devonport raises a wider issue about the defence industrial base. The Government have—some would say not before time—brought out a growth strategy that talks about the skills issue and the need to maintain the base. Nothing in the Bill will direct the GoCo to have regard to the promotion of the UK's industrial base, including skills. Does that concern the Minister, and is he willing to consider it?

Mr Dunne: I have to get on to my prepared remarks on the amendments tabled by the Opposition, because many of the points that have been made are addressed in them. On the hon. Gentleman's point about skills, I am pleased that he welcomes the defence growth partnership report, which was published last month. Skills are one of the core pillars that the industry and the Government are looking to develop together in the defence industry. Responsibility for policy—the defence growth partnership is a policy matter, as far as the MOD is concerned—will reside with the MOD. In engaging with its agent the DE&S, whether in a GoCo or as DE&S-plus, the MOD can and will direct the agent to have regard to various policy initiatives, whether those are on skills, exports or SME engagement. That will be a fundamental part of the relationship the MOD will have with the agent. It does not need to be legislated for, which is why it is not specifically referred to in the Bill.

Heather Wheeler (South Derbyshire) (Con): It is a pleasure to serve under your chairmanship, Mr Brady. I am pleased to hear the Minister's last statement, because manufacturing jobs, particularly nuclear energy jobs, are absolutely key going forward. We in Derbyshire have a superb growth fund recovery area, and his reiteration that future jobs and specifications will take the manufacturing base of our country into account is important to the midlands, so I thank him very much.

Mr Dunne: I am grateful to my hon. Friend, who advocates her constituency interest eloquently. She endorses the genuine concern expressed by my hon. Friend the Member for Plymouth, Sutton and Devonport. The advent of a renewed civil nuclear build programme will

[Mr Dunne]

undoubtedly place some additional pressure on securing suitably qualified people within the military sphere and the defence industry that supports it.

Mr Jones: Will the Minister give way?

Mr Dunne: I would like to move on. I suggest to the hon. Gentleman that this be his last intervention on this subject.

Mr Jones: The answer to the question asked by the hon. Member for Plymouth, Sutton and Devonport is no, because there is no requirement to ensure local provision of labour in the GoCo contract. I accept that the GoCo may take regard of the provided general Government policy, but if the GoCo has a cost driver and it can get labour or expertise cheaper elsewhere, there is nothing to prevent it from doing that. Why does the Minister not ensure through the Bill that skills that are important to the constituencies of the hon. Members for South Derbyshire and for Plymouth, Sutton and Devonport, and that of my hon. Friend the Member for Barrow and Furness—as well as to defence contractors more broadly—are protected? That is the only time he will have the power to determine that.

Mr Dunne: The hon. Gentleman, unusually, is wrong. The time at which the Ministry of Defence will have influence over the GoCo contractor, if that is the route we go down, is during the negotiation of the contract, not during the determination of the Bill. The relationship between policy and execution will continuously evolve. Policies change and, dare I say it, Governments change. They may bring in different policies. It is not appropriate to put policy directives into the Bill given that they may change substantially over a period of time. We are trying to set a framework for a relationship between the MOD and its procurement arm that will endure beyond the changes of Government, if we get the support of the Opposition. Hopefully that will be done on a consensual basis, which is clearly what the industry is looking for. It is not appropriate to introduce policy aspects into the Bill.

11.45 am

Mr Jones: Is the Minister telling the Committee that once the contract is negotiated, there will be an onus on the GoCo contractor to protect local skills and ensure that skills are maintained in the UK? That is very different from what he said 10 minutes ago when he told us that there would be a general duty to provide enough skills for the work force. They could come from anywhere.

Mr Dunne: The contract between the MOD and the GoCo will include provisions in certain specific areas; where there is a requirement to have a skill, it will cover that requirement. That is not, generally speaking, the case across industry. If, for example, nuclear safety is in the scope of the Bill, there will be a requirement to ensure that the standards set for maintaining nuclear safety are met.

Mr Jones: That is not the question that I asked.

Mr Dunne: The hon. Gentleman's question was intended to push me towards encouraging the GoCo contractor to commit to UK jobs for individual contracts for individual procurements. That is not something that the Government believe we should be doing. Indeed, in the White Paper that was published 18 months ago, we explicitly discussed the concept of open competition as being the best way to ensure that we have a defence industry that is fit for purpose and can compete internationally. It should not have Government diktat telling it which jobs need to be put in place and where.

I shall try to make a bit of progress, because we are straying way beyond the amendments tabled by the hon. Member for Plymouth, Moor View. It is important that we discuss the clause as a whole and those amendments. Clause 1 is the key enabling clause that will allow the Secretary of State to contract with the company for the provision of defence procurement services, should that be the decision that we take when comparing that with the public sector comparator. It is also the clause on which most of the rest of part 1 hangs. The amendments have highlighted some important issues, and the hon. Lady has clearly and comprehensively covered the reasoning behind them.

Before I respond in detail to the points raised and go through the specific amendments, it might be helpful if I set out some of our thinking behind the clause and what it is intended to achieve. That may assist in putting our consideration of the amendments in a wider context. Clause 1 allows the Ministry of Defence to enter into a contract with a public company to provide defence procurement services in future, and for that company to acquire rights over premises currently used by the DE&S organisation and become the employer of the existing DE&S staff.

The clause is drafted to accommodate a one or two-company GoCo structure. The contracting model in consideration for the first nine-year term is a two-company structure, with the contracting entity consisting of a management company and an operating company. The operating company will become the employer of the existing DE&S staff and will deliver the defence procurement services contract. The management company and the operating company will be public companies, but in this context that does not mean a company whose shares are quoted on the stock exchange. In the case of the management company, its shares will be held by its parent companies. In the case of the operating company, the shares will be held by the management company for the duration of the contract but, in accordance with the terms of its articles of association, they must be surrendered to the Ministry of Defence on expiry or termination of the contract, at no cost to the Ministry of Defence.

Although there is no mention in the clause of a GoCo, the clause is there to enable the Secretary of State to contract out defence procurement services to a GoCo in the future, should that be the way forward that is agreed next summer once the commercial negotiations are concluded and the comparison with the DE&S-plus option is complete. We have been clear that our preferred option is the GoCo, because we believe that it will deliver the step change needed in freedoms and commercial incentives to overcome the problems with defence procurement that have plagued successive Governments. However, we have also been clear that that option must

be rigorously tested against a public sector comparator and must take into account the outcome of the commercial negotiations that are currently under way.

Clause 1 is largely an enabling clause, and it mirrors a similar provision in section 1 of the Atomic Weapons Establishment Act 1991—the AWE is also a GoCo. I would like to draw the Committee's attention to the scale of the activity within DE&S. If it were to become a GoCo alongside the other substantial GoCos that are out there, it is important to recognise that, because the GoCo would be an agent of the MOD, the operating cost of the GoCo and the personnel involved would essentially be transferred into it. That is the relevant size criterion. The programme is being managed on behalf of the MOD, but its whole size would not be transferred into the GoCo, just the management.

If we compare the proposed two phases of transfer of the GoCo, we are talking in the first phase about transferring some 3,800 people with an operating cost and capital spend of less than £400 million. In the second phase, once all the domains have transferred, we will be transferring some 9,000 people with a cost of under £1 billion. That is directly comparable to the scale of the AWE, which has some 6,500 staff and contractors and an operating cost and capital spend of £850 million a year. It is also smaller than, for example, Sellafield, which has about 10,000 employees and some £1.6 billion of operating costs. The idea that the scale of transfer is unprecedented is, I think, a misapprehension. I wanted to put that on the record.

Thomas Docherty: The Minister mentioned Sellafield. It is probably fair to say that anyone who is at all familiar with the west Cumbrian situation would say that it is not exactly going well. Does the Minister not think that it would be better to stop and talk to the Department of Energy and Climate Change about learning the lessons before proceeding with this type of transfer?

Mr Dunne: I am not suggesting that Sellafield is a model for this transfer; I was just giving a comparison of the scale of activity in Sellafield compared with the AWE or the proposed GoCo. They are of similar scale.

Mr Jones: Sellafield is not a good comparison because it is a single contract dealing with two things, mainly decommissioning. Here, we are talking about a large number of contracts with a large number of suppliers. Looking at things just in terms of scale is not the way to do it—the complexity of the procurement is what is important. I must also say that if the Minister wants to use Sellafield as an example, he should look at some of the headlines that have appeared in the west Cumbrian press in the past few weeks about executives using taxis to get their cats home from the Sellafield site.

Mr Dunne: I am going to move on.

The Secretary of State has the power to enter into a contract with a GoCo using common law powers, but we believe that the scale of what is proposed in both money and people and the important nature of the work that DE&S undertakes, as the hon. Member for North Durham reminded us, are such that it would be appropriate for Parliament to have the opportunity to scrutinise and agree the proposals through specific

legislation. An important and hopefully long-lasting change such as this should be done with the consensus of all parties and with the express approval of Parliament. It is right that we chose that approach. Clause 1 is the main provision for that debate and we have already had a wide-ranging discussion about some of its implications. I look forward to moving this matter forward.

The clause also covers arrangements for the transfer of procurement services once the initial, and any subsequent, contract comes to an end. It allows for the transfer of DE&S services to the GoCo in a phased way. The first part of DE&S to transfer to the GoCo will be the maritime area, as we discussed, together with some key support services.

The clause also provides the basis on which the other provisions in part 1 work. For example, the exemptions in schedule 1 apply to premises used by a contractor under the arrangements in the clause. The clause also includes many of the definitions used in part 1. The hon. Member for Plymouth, Moor View said that her amendment, which seeks to exempt some phrases, was tabled to get a debate going; I take it that she is therefore unlikely to press it to a vote. *[Interruption.]* She has acknowledged that, so I am pleased to say that I will not therefore go into any great detail on the amendment—that will be of relief to the whole Committee.

However, the hon. Lady did raise some questions about the use of property. It is important to set the record straight here. Although the GoCo will be given the right to use existing DE&S property, the ownership of the assets will not change. Her concern was that the office premises at Abbey Wood, for example—when built, I think it was the largest office complex in Europe—might become surplus to requirements and be sold for the benefit of the GoCo operators.

Alison Seabeck: Perhaps I was not entirely clear. My concern was not that a GoCo could sell those properties, but that they could be used for purposes that, technically, are defence purposes, but that might not be those of the MOD. Under the terms of the Bill, is it feasible that, if a GoCo could not meet the running costs and wanted to save money—Abbey Wood is just a hypothetical example—it could shift staff from one building to another, and the MOD would be left with an empty building to monitor?

Mr Dunne: Our intention is that all the premises currently occupied by DE&S staff, which are in scope, will be made available to a GoCo operator on a contractual basis.

Alison Seabeck: I thank the Minister for giving way again and bearing with me. He says that the buildings and premises will be made available to the GoCo, but technically it does not have to use them. Therefore, in the worst case scenario whereby a GoCo decides that it will move everybody out—of Abbey Wood, for example—and stick them elsewhere, there would be a major socio-economic impact on the towns and cities around any such premises. Is the contract between the Government and the GoCo not likely to state that if that is to happen, we expect to understand that and to be consulted fully before the decision is taken? That could be a cost-saving measure on the GoCo's part.

Mr Dunne: It is difficult to foresee precisely what might happen over the duration of the nine-year contract. There will be a lease, in relation to occupation of the property, which will be a conventional lease as one would expect to find in the civil sector, under which the tenant will be responsible for its obligations. Those might include repair obligations for the properties and so on. In the event that the GoCo operator decided that it did not wish to continue to operate in certain facilities—because it has some of its own nearby, or because the activity ceases to be relevant—if it wishes to release itself from its obligations under the lease, it will have to go through that lease's termination arrangements in precisely the same way that would apply in the commercial world. The contract that will be entered into will have some clear clauses in relation to the use of premises, the cost of using those premises, and the requirement to negotiate with the MOD in the event that the operator wishes to relieve itself of those obligations, because the MOD will continue to be the landlord. That relationship will be managed as it is now—through the Defence Infrastructure Organisation, which is within the MOD.

12 noon

Mr Jones: In terms of the competition for the GoCo provider, part of the contract is going to say, “You must take on a lease of Abbey Wood.” Will the MOD stipulate the amount right at the beginning? Otherwise, how will potential competitors for GoCo be able to draw up their costings?

Mr Dunne: We are not seeking to introduce the kind of disruption that the hon. Member for Plymouth, Moor View was fearful of—encouraging the GoCo operator to identify alternative premises. As I said earlier, we are expecting GoCo operators, as part of the competition, to assume that they are taking on all our existing premises as identified. The price of occupation will form part of the negotiation over the fee arrangements between the MOD and the GoCo operator. There will be termination clauses, penalties and so on within the lease contract in the normal way.

Sir Nick Harvey (North Devon) (LD): How are we expecting the commercialised operator of the enterprise to make any sort of cost savings if we are going to tell them specifically where they have to carry out their business from?

Mr Dunne: The operating costs of the GoCo are some 8% of the total contract value that the operator will be managing. We are looking for savings to come primarily from greater efficiencies in managing the procurement process for the underlying equipment, rather than looking to extract large savings out of the operating costs of the DE&S itself. Specific efficiencies may arise, and some of that might come in a property area, but we are not anticipating that that would make a major contribution to the efficiencies and savings.

The same applies to the issue of personnel raised by the hon. Member for Plymouth, Moor View. There may be personnel changes; we are currently seeking to fill quite a substantial number of vacancies in DE&S. There is a regular turnover of staff. During the period of a nine-year contract, there may well be quite a significant turnover of staff. However, the issue is not about jobs; it is about upskilling the organisation, rather

than seeking to make savings through greater efficiencies either in jobs or in premises, other than those that are appropriate and as agreed with the MOD.

Mr Jones: The GoCo operator, as an organisation that has to make a profit, will be looking for efficiencies. One of those efficiencies will obviously be headcount, because in any organisation, people are expensive. Throughout the lifetime of the contract, if the GoCo decides, for example, that it can make efficiencies in terms of numbers of people, it will therefore not need the office space as outlined. What assurance can the Minister give that the MOD will not be left with part of the DE&S site in Abbey Wood to pick up?

Also, will the Minister return to my earlier question? When the competition is launched, will there be a fixed price that each competitor has to meet in terms of costs—for example, the rent of Abbey Wood and other buildings?

Mr Dunne: On the first point, if a GoCo contractor wants to change the space that they are contracted to occupy, it will need to make a business case to the MOD, and the MOD will have the right to say, “You have a contractual obligation. If we are unhappy about you moving out, you cannot do it.” We will have a right of veto over continued occupation in the duration of the contract. That does not mean to say that if we thought that the business case made sense, we would be encouraging them to do so. Given how the fee arrangement will work, it will be gain share, pain share, so in the event that the contractor is able to deliver the services more cheaply, the MOD will clearly benefit, which will be an important factor in the business case.

As for the question about the contract terms specifying penalties for extraction from lease obligations, I cannot answer at this point. We are not anywhere near that level of detail in our discussions. The negotiation around the gain share, pain share performance fee is in the next stages of discussion—we are looking to get proposals in November, and we will then be negotiating through until March, when the final proposals will emerge. We will discuss precisely how the fee arrangements work only in those later negotiations. The hon. Member for North Durham has made an interesting point, so we will feed it into those discussions and can then decide on the appropriateness of isolating that as part of the fee.

Amendment 2 covers much of what we have just been discussing. I support the intent behind it, but it is not required. As I tried to identify earlier, the issue will be in effect—and better—addressed in the contract between the GoCo and the MOD, case by case in the individual leases or agreements, and subject to change through business cases put to the MOD for approval.

The premises and property occupied by the GoCo will remain the property of their existing owners, which in the vast majority of cases is the Ministry of Defence, although in a small number we are a tenant. The GoCo's rights and obligations in respect to using those assets will be agreed with the MOD and set out in the GoCo contract and the relevant lease or agreement. That will include conditions on maintenance and upkeep, as is usual in a commercial contract or lease. Maintaining that flexibility through the contract, rather than through

statute, makes sense. I hope therefore that amendments 1 and 2 will not be pressed by the hon. Member for Plymouth, Moor View.

The purpose of amendments 3 and 4 is twofold. First, they seek to put in place additional security arrangements should the contractor be a non-UK company. Secondly, they seek to disqualify from the directorship of the GoCo any individual who is involved in the provision of defence equipment or services in any other company in the defence industry. I reassure the Committee that, although we have concluded that the amendments are not required, it is because extensive, effective checks and balances are already in place, or will be put in place, within the GoCo contract, so the risks in question are already being effectively managed through more appropriate means.

The amendments also seek to ensure that the GoCo cannot take advantage of its privileged position to exert influence over British defence interests and to prevent the company's directors—whether or not UK registered—from having conflicting interests in other defence companies.

Amendment 3 seeks to make it necessary for the GoCo to include a number of mandatory obligations on the contractor. The first requires that non-UK companies must establish “special security arrangements” for the operation of the contract. Amendment 4 provides a definition of such arrangements as

“a proxy board or special security agreement set up to prevent foreign influence over British defence interests”,

which is fairly imprecise. The second and third obligations seek to disqualify from appointment to the GoCo directors who have conflicts of interests, because they are also directors of or have financial interests in other defence companies. For example, that would mean that an executive director of BAE Systems could not hold a directorship within any company associated with the GoCo.

The MOD governor will monitor any changes to share ownership and directorship to identify any major changes that might introduce conflicts of interest over the duration of the contract. Ultimately, should it be required, the MOD will retain and be able to use appropriate change of control provisions within the articles of association—at the operating company level in a two-company structure. The contract between the MOD and the management company would contain similar provisions. I do not think the amendments are necessary, as the issues are already covered by provisions in the anticipated contractual documentation.

Mr Jones: Will it be possible for someone to be a director of the GoCo and, for example, to have major non-defence interests in parts of the former Soviet Union or China?

Mr Dunne: I am intrigued that the hon. Gentleman raises the “reds under the bed” analogy, which was also raised yesterday in the *Financial Times* by his former boss, who highlighted his concern that the business might be acquired by either Russian or Chinese interests. It beggars belief that such a suggestion is taken seriously by Her Majesty's Opposition, in particular by individuals who have had responsibility for defence. To suggest that this Government or this MOD would not protect themselves against nations seeking to acquire our procurement agency indicates that the Opposition have not been reading the Bill very carefully.

Mr Jones: I am talking not about nations but individuals. Will the Minister explain how he would stop somebody with major interests in, for example, China or parts of the former Soviet Union—not a direct agent of their Government but having close relations with them—from being a director here or owning any part of the GoCo, at the beginning, or later if they took over one of the companies that formed part of the GoCo?

Mr Dunne: When we started this process, we set in train a series of protections of confidentiality and conflicts of interest. Each entity that registers interest in being considered as a bidder for the GoCo first had to enter into a bid participation agreement. The bid participation agreement had confidentiality clauses and declarations of perceived conflicts of interest within it. Any party that was prepared to enter into a bid participation agreement but was not deemed by us to be appropriate was ruled out at that stage.

Anybody who had signed the bid participation agreement then had to undertake a pre-qualification questionnaire and respond to questions about a whole host of things, including issues such as their security clearances and so on. Any individual who is to become a director of a GoCo would need to pass the security vetting arrangements that we have in this country. It is extremely unlikely that the sort of individuals that the hon. Member for North Durham raises as a spectre would pass British security vetting procedures.

Mr Jones: What would happen, for example, if Serco were taken over or if an entity from China or the former Soviet Union were to buy a whole slug of shares or the entire company? Is there anything in the contract to stop either a sovereign wealth fund or something else taking over one of the existing companies?

Mr Dunne: That is a much more serious concern and a very relevant one. I am pleased to be able to confirm to the hon. Gentleman that, absolutely, yes there is. There will be change of control provisions in the contract, which will give the MOD the right to approve any changes of control in the ownership of the management company. There is, within the operating company, a special share which requires the MOD's approval to vote in favour of any suggestion of changes in the ownership of the operating company by the management company.

Through the articles of association of the companies, through the contract between the MOD and the contractor, and through our security vetting procedures and all the paraphernalia that apply within military procurement, we think we have a very tight grip on ensuring that we are dealing, as the MOD, with an entity that is appropriately owned and controlled.

12.15 pm

Mr Jones: But what will happen if an individual or a sovereign wealth fund does not take control of a company such as Serco but takes a substantial part of it? It could have an influence over that company not by having direct control of some 50% of the shares but by having a major influence within it. How will the MOD deal with that situation? In such circumstances, would the contract be severed? If so, what compensation would be payable to the contractor with the GoCo?

Mr Dunne: There are arrangements that will preclude the passage of information from one tier to its parent tier. In terms of protecting confidential information available to the operating company, there are clear procedures to prevent the piercing of the corporate veil, if we like.

As for influence on the company, it is fair to say that there is a risk with regard to small minority shareholdings in public companies owned by people who do not have a direct relationship with the MOD. That is a risk that the Government take every day in entering contracts with public companies. In this case, we are talking about consortia of very substantial companies. We have a direct say as to whether they have a shareholding in the management company and therefore have influence over the operating company. The management company itself will be owned by a consortium. A minority stake in one member of a consortium would have little influence over the management company itself and would have no influence directly over the operating company.

Mr Jones: I would argue that this situation is different because we are dealing with national security. There is nothing at all to stop the sovereign wealth fund of China from buying, say, 25%, 30% or 40% of Serco, if it was part of the successful bidder for the GoCo.

Mr Dunne: If the MOD perceived there to be any potential threat to national security interests through the GoCo, we would be able, through the contract, to take action to prevent the party concerned from continuing to be a shareholder in the management company. There have been changes in ownership of the participants in the Atomic Weapons Establishment GoCo.

We will have provisions in the contract for the transfer of interests. It is possible that individual companies will wish to cease to continue with the relationship during the duration of the contract. We do not want to put a GoCo into a position where it fails in the event of one shareholder being unable to continue or indeed becoming part of a group that is undesirable. We will have change of control provisions that will apply within the contracts with the management company. The hon. Gentleman's concern about small shareholdings is not something that it would be reasonable for us to seek to impose on the major groups that we are talking to.

Mr Jones: I am not talking about a small group. Let us say that 40% or 45% of Serco is taken over by, for example, the Chinese sovereign wealth fund. What percentage of one of those companies would the Minister deem to be concerning enough that that company would no longer be seen as a credible part of the GoCo? Should such a case occur, what would be the compensation arrangements for the company?

Mr Dunne: The example that the hon. Gentleman cites would trigger one of the change of control provisions within the contract. [*Interruption.*] I cannot give him a figure, because I have not negotiated that aspect of the contract.

The hon. Gentleman raises an interesting point. I am happy to take it away and perhaps to write to him during the passage of the Bill to give him a little more comfort that the change of control provisions will be

sufficient. We have the ability to declare a shareholder in the management company an inappropriate shareholder, and the termination arrangements would then require the consortium either to absorb those shares among existing members or to bring another party into the consortium.

Mr Jones: I thank the Minister for that, and I look forward to his explanation in writing. What about directors of the GoCo? The Bill clearly lays it down that directors cannot have directorships in competitor defence companies, but what would happen if someone had a directorship in several Russian or Chinese companies that had nothing to do with defence? Would that be allowable under the procedure?

Mr Dunne: The individual directors of the GoCo will be subject to vetting procedures and will need to identify any conflicts of interest that they have. If any of those are deemed unsuitable by the Ministry of Defence, they will not be considered suitable individuals to be appointed directors of the company.

Mr Jones: Would the MOD deem it inappropriate for a director of the GoCo also to be a director of a Chinese or Russian company, or a company about which we as a nation felt uncomfortable?

Mr Dunne: I have already answered that question. They would be subject to British security vetting procedures, and in those circumstances they would be most unlikely to pass those procedures.

Mr Jones: Will the MOD have a list of countries in which people cannot be directors if they are to be a director of a GoCo? China is an obvious one. There are many Chinese companies with UK directors. Will there be a prescriptive list of countries, or what?

Mr Dunne: The hon. Gentleman, having been a Defence Minister, has greater understanding than perhaps most members of this Committee of how British security vetting processes work. We will not be publishing a list of countries regarded as inappropriate, not least because countries change regimes, and one regime may be more acceptable than another. It is an iterative process that changes all the time. He has made a good point, which I thank him for raising. As I said, I will address it in writing.

I will expand a little more on how we intend to manage conflict of interest issues; it is an integral part of the matériel strategy commercial process. I have touched on the pre-qualification questionnaire, in which potential bidders were required to declare any perceived potential or actual conflicts of interest, along with proposals for how they would manage them. In addition to providing information regarding existing or future contracts with the MOD, potential bidders were also required to declare any personal conflicts of interest.

All declared conflicts of interest were reviewed and, if necessary, action was required to be taken before any company could proceed to the procurement phase. Those companies that successfully qualified to proceed to the procurement phase were required to enter into a bid participation agreement, as I said, which detailed the

MOD's requirements for management of conflicts of interests and included an initial list of all conflicts of interest and how the MOD expected them to be managed. Those lists were particular to the individual bidder.

The intention was that the list would become a live document subject to ongoing review that would ultimately be enshrined in the GoCo contract if that bidder were the successful contractor. Within the MOD, all project branches are aware of the companies involved in the GoCo procurement. If they have any concerns about potential areas of conflict, they are to consult the MOD matériel strategy commercial team for guidance before proceeding. Any individual company considered to have unmanageable conflicts of interest may be asked to remove itself from the competition, or from any existing contract that may be the cause of the conflict. As the hon. Member for Plymouth, Moor View mentioned, one non-executive director of a contractor in one of the bidding consortia resigned his directorship, as he was an executive director of a large defence contractor to the MOD. That has demonstrated that our process in managing real or perceived conflicts of interest in this area is working.

Mr Jones: The Minister refers to individuals, but what about companies? Serco is an obvious example: it has substantial contracts with the MOD, and he said that they could be deemed unmanageable. How will the assessment be done in concluding that Serco, which does a host of things for the MOD, is also a fit person to be part of the consortium?

Mr Dunne: I was referring to individual bidding companies as well as to individual directors. The company that the hon. Gentleman mentioned has the largest number and value of contracts with the MOD of those involved in the consortium. Most are in the area of facilities management, rather than procurement itself. That clearly has some procurement features to it, but the company is not actively engaged in much equipment procurement. It is a shareholder in the AWE, but its role is mostly managing the physical facilities.

At this point, any procurements involving Serco within the MOD will continue, and in the event of other Departments deciding that the company should not receive new Government contracts for a period, it would be for the bidding consortium to decide how to deal with that if it withdrew or was compelled to withdraw from the competition.

On the perception of conflict for existing Serco contracts, we believe that we have addressed the issue appropriately. It would be fair to assume that, in the event of any of the bidding contractors being successful members of a consortium that would run GoCo, conflicts of interest would become much more significant for any new contracts thereafter. That is a reason why, for example, one of the companies that is advising the MOD decided not to bid. Jacobs acts as our specialist adviser on delivery, and it took the view that it would not be able to compete for other business in future if it were a shareholder in a consortium, so it decided not to do so. I anticipate that for any successful bidder—unless the conflicts could be clearly identified and managed and so long as, if it bid for another contract, it had no involvement in the decision-making around that contract—such considerations

will have an impact on its willingness to bid for substantial contracts in future and as to the appropriateness of so doing.

Mr Jones: I am grateful for that. Will the Minister refer to the contracts that some parts of the consortium may have with other Governments around the world? Are there any situations in which companies will be debarred because they hold contracts with certain nations to supply certain defence or defence-related equipment or facilities?

Mr Dunne: I am hesitating to think of any that might cause difficulty. Does the hon. Gentleman have something specific in mind?

Mr Jones: Serco does extensive work around the globe, including in the middle east, and could be competing for work in countries we would deem to be security risks. Likewise, an American part of the consortium could be deemed to have a conflict of interest because it had access to information that would help its procurement with the United States Government.

12.30 pm

Mr Dunne: I think that the hon. Gentleman is concerned about conflicts of interest being used to the commercial advantage of members who are shareholders in the consortium. That is a concern. It is standard practice for many of the professional services firms, project managers and contractors interested in the opportunity to have Chinese walls, to use a rather unfortunate term in this context.

Thomas Docherty: Firewalls.

Mr Dunne: Firewalls. I thank the hon. Gentleman; that is better. They have firewalls to separate teams working on a project where there might be a risk of information leaking to a team working for another client and of breaching commercial or national security considerations. Those firewalls will be established and set up. That is part of the purpose: to ensure that conflicts of interest that might be perceived or arise in future are properly managed. Considerable effort is being made to ensure that conflicts of interest are identified and appropriate management arrangements are put around them, so they do not give rise to the problems the hon. Member for North Durham fears.

Mr Jones: On conflicts around security, will there also be safeguards around the consortium's procurement strategy, particularly with regard to computer systems—I hate to come back to China—so as to debar procurement of services and supplies from organisations that we would deem a security risk?

Mr Dunne: The MOD is the capabilities setter, so the MOD and its commands will set out requirements. One of its habitual requirements is not to procure from organisations that might pose a security risk. There will be continuous MOD oversight of the procurements. In the event that the DE&S contractor, whether a GoCo or not, suggests inviting bids from particular companies that might be known or feared to have a problem, it

[Mr Dunne]

would be down to the capabilities setter within the MOD or command to say it would rather that company was not approached.

Mr Jones: I was not thinking about actual programmes; I was thinking about IT and other systems that the GoCo might use in its daily work. A lot of thought at DE&S has gone into protecting computer systems, because we know that is an area prone to hacking and industrial espionage. Will it be clear from the outset of the contract that the GoCo will use the same standards as the MOD and others for computer software and security systems for managing its contract?

Mr Dunne: That comes back to the issue of compliance with MOD or overriding Government policy. It will absolutely be the case that the GoCo will need to act in accordance with Government or MOD policy on all its procurement. That applies to IT systems just as it does to anything else. There is no question but that that would need to be approved by the MOD before the contract was let.

I will return to the amendment. I was talking about the system of handling conflicts of interest through procurement. The invitation to negotiate, which went out to the groups once they had formed into consortia earlier this summer, required both the management company and the operating company of the proposed GoCo to be UK-registered companies. That will ensure that any GoCo contractor will be required to comply with UK legislation, including the obligation to pay UK tax. The GoCo will also be required to conduct its business so that the centre of main interest of the operating company is deemed to be in the UK.

Management of information considered to be commercially sensitive or security-classified will be subject to stringent conditions under the GoCo contract. Such conditions will include, but may not be limited to, restrictions on the extent of information that can be shared between the operating company and the management company, and between the management company and their respective parent companies; I touched on that earlier. These types of restrictions are commonly used by DE&S on MOD contracts when the parent company is not based in the UK.

Mr Jones: I hear what the Minister says about the company being UK-registered, but why do we not require, as US defence contracts do, a stand-alone, separate board that forms—I am not going to say a Chinese wall—a firewall and is separate? BAE Systems America's board is separate from the UK board, for example. Why have the Government not insisted on that when planning the structure of boards?

Mr Dunne: That is where the amendment tabled by the hon. Member for Plymouth, Moor View, was trying to drive the Bill—towards establishing special security arrangements, such as a proxy board. The matter was examined and we concluded that it would not be necessary, as we have enough protection in the Bill already.

Of course, we do not know at this point the nationalities of the companies that will be running the GoCo. As it happens, each consortium has UK and US contractors.

When we set up the process, we were unsure about whether other nations would get involved and give us more of a problem, but we are content that we do not need such a measure. Part of the reason is that the GoCo will be required to comply with Joint Services Publication 440 on security and to meet all other security requirements, such as having personnel cleared to the appropriate level. That would mean, for example, that UK-eyes-only personnel worked on projects deemed by the MOD to require that level of national security. Both the operating and management companies will be required to hold list X approvals to ensure that only those individuals with appropriate security clearances gain access to classified information. Those elements of doing business with the MOD provide sufficient protection; they allow UK-eyes-only personnel to be employed through the GoCo company chain and avoid the need for a proxy board structure.

Before moving on to amendment 5, I want to make some points about the draft articles of association for the GoCo, which we have not yet discussed. The articles will give the Government a special share in the operating company and, along with the Government's provisions in the draft contract, state that the operating company cannot be taken over without the MOD's express authority. MOD approval is also required before the GoCo contract can be assigned or novated. One of the grounds on which such authority could reasonably be refused is national security. The articles of association also specify that, at all times, at least one out of the chief executive and the chairman of the operating company's board must be British. The MOD will be able to veto an appointment that would leave the board with neither of those posts held by a British national. As a fall-back, should the need arise, the MOD will also have the power to remove the chief executive officer of the operating company. Combined, those measures are sufficient to obviate the need to pursue a proxy board or special security arrangements, as proposed in amendment 4.

Mr Jones: Would it be possible, if the MOD was content, for an American company to take over the GoCo?

Mr Dunne: It would be possible, if the MOD was content, for an American company to take over, but the American company would have to employ UK-eyes-only personnel and would have to have either a UK chairman or a UK chief executive. We commonly source equipment from American companies in our procurement. That includes some of the most sensitive equipment, such as the F-35, which the hon. Gentleman mentioned earlier.

Amendment 5 would prevent the Secretary of State commencing the establishment and operation of a GoCo under part 1 of the Bill until they have published guidance on the contract's operation. In particular, the amendment proposes that that guidance should include the system by which available defence contracts will be advertised to potential bidders, how a GoCo will procure, and how it will report annually against progress on an export strategy.

The amendment would address concerns expressed during the oral evidence sessions about a possible lack of visibility regarding how the contract will work and how defence contracts will be placed, and about ensuring that the new GoCo pays sufficient regard to wider defence industrial policy issues, such as the exportability

of equipment or the role of small and medium-sized enterprises. There was concern that the GoCo would be focused solely on delivering equipment more cheaply and would not have to take into account other aspects of our industrial policy.

Our intention is that the GoCo acts as the agent of the Secretary of State when contracting for Defence Equipment and Support. The service commands and the MOD will maintain their capability-setting and policy-setting roles, so will require the GoCo to procure to meet both those objectives.

On advertising contracts, the treaty on the functioning of the European Union, the Public Contracts Regulations 2006 and the Defence and Security Public Contracts Regulations 2011 will still apply in the same manner that they do today. That includes the advertising of contracts in the *Official Journal of the European Union* where required. Further, the MOD commercial policy on advertising defence contracts will also continue to apply. Those adverts currently appear on Contracts Finder and gov.uk websites. It is to be remembered that any contract to deliver defence equipment, support, logistics and services will be entered into by the GoCo as the MOD's agent, so the MOD will remain a counterparty to defence contracts.

Sir Nick Harvey: This is an enabling clause that enables the Secretary of State to proceed, at some future point, with the GoCo idea if he decides to do so. The GoCo will be a commercialised broker working on the Secretary of State's behalf to procure services and manage projects. To what extent will the GoCo have an absolute monopoly in providing those brokerage services? The Minister just mentioned that the three forces will have their own expertise in setting their requirements. Would it be possible for them, if they were making a simple procurement, to bypass the new GoCo, thus saving an unnecessary layer of bureaucracy? At the other end of the spectrum, if there was some particularly specialised procurement to be made, would it be possible for the intelligent customer at the MOD to go to an alternative provider of procurement management or brokerage, if it appeared to make sense to do so?

12.45 pm

Mr Dunne: My hon. Friend makes a characteristically acute observation as regards whether the DE&S in a GoCo environment would face competition, or whether it would have an exclusive relationship. The fact is that there are some existing competing procurement agencies today—within Government, as it happens—from which the Government procure certain equipment. Most of that is commodity services. The Government Procurement Service, for example, which was established in premises in or around Liverpool, is undertaking procurement for the MOD for nine categories of basic commodity services, and that is increasing by a further 16 by the end of the year, so there are moves across Government to buy commodity equipment in bulk where it makes sense to do so. That might range from paper to fuel. We are seeking to consolidate motor fuel, but not necessarily aviation or marine fuel. Where we can agglomerate orders and thereby benefit from economies of scale, we are doing so. That kind of activity will continue.

As to the very specialist procurements, we would envisage that DE&S would continue to be the place of choice for the MOD to go to. Exclusively requiring it to do so would not be a sensible provision to put into a contract because it might help to ensure that the consortium remained alert to the potential for competition. The transfer of domains will be phased—maritime will be the first domain to transfer—so there will be an opportunity when the other domains come in for that to be competed, and that would be an appropriate way of ensuring that the consortia do the best for the MOD.

Thomas Docherty: I am grateful to the Minister for giving way; he is being generous with his time. He has picked maritime, for reasons we all understand. Let us take the forthcoming contract on the Type 26 as an example. BAE still claims that the cost will be £350 million a hull, but if that rises to £450 million, will he think that the GoCo has been a failure?

Mr Dunne: The success or failure of the new procurement arrangements that we enter into will be determined over a period of time. My measure will be whether we are able to deliver the equipment that our armed forces need on budget and on time in a more efficient way than we do at present. I am afraid I will not be drawn further down that route, as I need to make some progress.

Mr Jones: My hon. Friend the Member for Dunfermline and West Fife raises an interesting point. Is the Minister saying that the GoCo will not have exclusivity over procurement? If that is the case, in what circumstances would the MOD procure outside the GoCo? In terms of drawing up the contract with the GoCo and preparing its bid, will that be spelled out clearly at the beginning?

Mr Dunne: As the hon. Gentleman might recall from his time in the Department, the DE&S does not have an exclusive relationship at the moment with commands. They are able to purchase from sources other than DE&S; I have already mentioned some instances of that. This is not an exclusive relationship. However, the expectation is that the first port of call for equipment delivered through the equipment plan will be DE&S. It would be reasonable for the consortium bidders to expect that significant purchases of military equipment would be most likely to go through them.

Alison Seabek: That is an interesting point. The Minister said that large equipment purchases are most likely to go through DE&S. It is not really clear how the contract will be drawn up. How specific will the contract be about the type of equipment and tasks that the GoCo will perform? There seem to be significant grey areas—flexible walls—which enable the services to dip in and out of GoCo, effectively. I am not sure that is particularly encouraging for the bidders.

Mr Dunne: We are engaged with a number of procurement agencies. This particularly applies where we are buying large equipment in collaboration with other countries. The A400M transport fleet that will be joining us next year was procured through the Organisation for Joint Armament Co-operation, which is a European procurement agency. Our relationship with that agency is managed through DE&S.

[Mr Dunne]

This will be a matter of considering each contract when it comes up. We will determine with the GoCo the terms on which it participates in that contract. The expectation is that it will be the entity of choice and will have a preferred relationship with MOD commands.

Alison Seabeck: Will the GoCo be able to appeal decisions if it feels that it had previously delivered a particular product or service quite well, and yet for reasons unknown, a decision was taken not to allow it to take on a similar project in future? How exactly does that work?

Mr Dunne: The relationship with the GoCo is becoming more commercial—it will need to prove with quality of service that it is providing the service that the commands require.

Mr Jones: Will that decision rest with the commands? What if, for example, a command requires a specific piece of equipment for an operation? For example, at one point we suddenly discovered that we needed a large number of quad bikes in Iraq. If the command felt it could get them cheaper elsewhere, could it do so without any reference to the GoCo? Coming back to the point made by my hon. Friend the Member for Plymouth, Moor View, although some contracts might be small in nature, if there were a number of them, they could be quite large in monetary value. What would the GoCo be able to do to appeal against that?

Mr Dunne: The spectre that has arisen here is most unlikely to occur. The procurement for the MOD has to take place through all the paraphernalia of public procurement. The military will have people embedded in DE&S across all domains and activities. In the example the hon. Gentleman gave, it is most likely that a procurement for quad bikes would be set by the Army—perhaps the Royal Marines—which would then undertake that procurement. People who are in the business of supplying quad bikes would participate in that procurement exercise. The hon. Gentleman may be aware of other quad bike procurement entities out there that would wish to compete with DE&S, but I think that most unlikely.

We will have the ability to extract certain activities, as we are doing with the Government procurement service, to ensure that the taxpayer gets best value for money from what we spend on equipment serving our armed forces. That is the principle we will adopt, but the general expectation for bidding consortia is that they would be the entity that is used, although there might be specific occasions when they would not.

I will try to make some progress because we are coming to the end of the sitting and I know that the hon. Member for Plymouth, Moor View will want to wind up her observations before she decides whether to press any of the amendments to a vote. We have covered amendment 5, so I will turn to amendment 10, which would prohibit the sale of financial securities or shares in the GoCo if it is a publicly listed company. We had considerable discussion of this issue earlier, so I will confine my remarks to our intention to prohibit the GoCo from selling financial securities or shares through contractual provisions in the contract with the GoCo managing company and through the operating company's

articles of association. Such provisions should apply not just to the initial contract, but to any enduring contract or new arrangements that come into force.

The Government's special share in the operating company will give specific rights, one of which is the approval of the change of any shareholding. Another is the right to take over the contract in the event of failure to deliver or the perception of a failure to deliver. The objective is to prevent an activity being undertaken by an entity that puts national security at risk. That will not and cannot happen if we exercise our controls properly. I therefore urge the hon. Lady not to press that amendment to a vote. I hope I have dealt with the issues that she raised.

Several hon. Members rose—

The Chair: Order. It will not have escaped the notice of the Committee that I have allowed quite wide debate on the amendments, so it might be helpful if I make it clear now that I do not intend to have a separate clause stand part debate.

Mr Jones: It is a pleasure to serve under your chairmanship, Mr Brady. The Minister's remarks show that there are still many questions to be answered in relation to the GoCo. I have spoken to people in industry and in the military, and we are concerned that this enabling legislation is being put forward without the exact detail being worked out. Many of us are concerned about that.

We need to examine the background. The Minister said that there were two options, with a preference for the GoCo. We have heard a lot about the GoCo, but little about DE&S-plus. I understand that that is the preferred option being pushed by Mr Bernard Gray, although I accept there are people in the MOD who have concerns about it. My hon. Friend the Member for Plymouth, Moor View mentioned the report, which was reported in the press, that expressed concerns about the GoCo, and we need to see that before we conclude our consideration of the Bill. If we agree the provision, we are basically giving carte blanche to the Government to go ahead and make a fundamental change in how defence procurement is conducted in this country.

We cannot treat the procurement of vital defence equipment for the security of our nation in the same way as we would let a contract for a school, for example. I am not saying that schools are unimportant, but here we are talking about our national security. This morning's debate has shown that we are not simply talking about the equipment for the men and women whom we expect to go into the front line to serve and fight on our behalf; as my hon. Friend the Member for Barrow and Furness said, there are important geopolitical and strategic issues such as the nuclear deterrent. Handing that process over to a private entity raises serious questions about not only national security but parliamentary scrutiny and the ability to deal with it once the contract is let.

No doubt Government Members will tell me that Bernard Gray's report was commissioned by the previous Government. It was commissioned by John Hutton, now Lord Hutton. I was in the MOD at the time and I was sceptical. The report raised interesting points about how defence was procured. Partly through the championing

of the former Secretary of State for Defence, the right hon. Member for North Somerset (Dr Fox), it achieved the status of being the true, definitive reason for changing the system so that we do not have the cost overruns or problems we had in the past. I do not accept that.

The report was an interesting piece of work, although a bit naive in parts. It takes the view that simply setting budgets is the way forward. I was unable to be in

Committee when Mr Gray gave evidence, but I have read the transcript. In pushing for the GoCo, his argument seemed to be that people could be paid more under it. I do not accept that.

The Chair adjourned the Committee without Question put (Standing Order No. 88).

Adjourned till this day at Four o'clock.

