PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

DEFENCE REFORM BILL

Ninth Sitting

Tuesday 15 October 2013

(Morning)

CONTENTS

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

£6·00

PBC (Bill 084) 2013 - 2014

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

The Committee consisted of the following Members:

Chairs: † Mr Graham Brady, Albert Owen

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

John-Paul Flaherty, *Committee Clerk*

† **attended the Committee**

Public Bill Committee

Tuesday 15 October 2013

(Morning)

[Mr Graham Brady *in the Chair*]

Defence Reform Bill

Clause 13

Single Source Regulations Office (or "SSRO")

8.55 am

Alison Seabeck (Plymouth, Moor View) (Lab): I beg to move amendment 30, in clause 13, page 9, line 20, leave out 'good'.

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

Amendment 29, in clause 13, page 9, line 21, at end insert—

> (aa) that government expenditure on qualifying defence contracts shall be made with due regard to promoting the growth of the UK defence industrial base and its associated supply chains; and'.

Clause stand part.

Alison Seabeck: It is good to have you back, Mr Brady. Last week, you oddly morphed into Mr Amess, which was really quite disturbing, but never mind.

I have tabled a probing amendment to enable debate on the Single Source Regulations Office, which, as with part 1 of the Bill, is key to this part. Clause 13 establishes a replacement for the "Yellow Book" arrangements which have been in place since 1968, and is based on the work undertaken by Lord Currie. This new body, an executive non-departmental public body replacing the existing Review Board for Government Contracts, will have a wider remit and it is important that it be seen by both industry and Parliament as transparent and independent.

More than 40% of Ministry of Defence procurement in the past five years was accounted for under the single-source arrangements, so any proposed change needs to be given very careful consideration. Lord Currie is to be congratulated on the review he undertook, and it is a great shame we were unable to question him during the witness sessions. His view is that, although some practices could be updated and transferred to a new body, there are areas in need of significant change because the world has obviously moved on since 1968. These days, contracting is carried out in other sectors, including construction, on a much more open-book basis, and that approach needs to be carried across into the MOD. His view is that the "Yellow Book" is a limiting concept that is out of kilter with wider and better practice. His report on Government accounting conventions states:

> "The GACs were not initially designed as a comprehensive statement of costs allowable in government contracts but have come to be used in this way, and have developed over years in response to particular issues. Hence the conventions lack clarity and coherence, which can lead to confusion and delays in rates and agreements and pricing."

Therefore, he came to the view that they need to be updated and designed in a different way.

Lord Currie was critical of the Cost Assurance and Analysis Service, which we debated in considering part 1 of the Bill. I am sure the Minister will revisit Lord Currie's concerns; perhaps he can explain how things have moved on. The Opposition of course welcome proposals to improve the way the MOD procures equipment to ensure that it does not pay above the odds, particularly for equipment procured through a single source. However, although we have no objection to the creation of an SSRO, we still have some issues with the way it will be set up and operated. These will emerge during this and subsequent debates.

As a starting point, can the Minister tell us how much has been spent to date in preparing the ground for the establishment of the SSRO—work which I believe is already under way? We all understand that these higher value contracts carry a greater risk to value for money—the impact assessment was clear on this—so we need to put in place greater protections. It would also help if the Minister set out clearly, as I am sure he intends to do, the significant differences between the previous system under the "Yellow Book" and that proposed in the establishment of the SSRO, in delivering value for money for the taxpayer, as set out in subsection 2(a).

Can the Minister also confirm that the regulations will continue to allow us to operate the exemptions set out in article 346 of the treaty on the functioning of the European Union, and will ensure that UK defence contracts—which by their nature are highly specialist, using advanced technology, and are essential for the maintenance of skills in the UK—are protected for good strategic reasons? Can he also confirm that in setting up the SSRO, he intends that, in standardising contracting to bring stability to the process, it be able to bring a greater degree of certainty to the contracting processes, which should in turn enable companies to cut their up-front costs? At the moment, costs are weighted against additional risk and the front end is pump-primed.

The Opposition welcome measures that reduce uncertainty for industry, as does the industry itself, but there are concerns and later amendments to this part of the Bill have been tabled to enable the Minister not just to defend the position the Bill sets out, but to allay concerns. Lord Currie felt that some of the inefficiencies in single source MOD spending arose

> "from inefficiencies on the side of industry and from a skilful deployment of Yellow Book regulations to secure returns that, although within the regulations, have not been appropriate."

Does the Minister agree with Lord Currie's assessment?

This part of the Bill relies heavily on guidance which we received only last Monday. It has been almost impossible to give it the scrutiny it deserves in such a short time because unlike the Minister, I have one researcher behind me, not a whole civil service; such are the joys of opposition, of course. I will therefore be asking a series of questions of the Minister which I am sure he will answer patiently and tolerantly. In addition to the regulations, will the SSRO need to consider separate

commercial guidance, whether from the MOD or industry, which feeds into and supports the general operation of the framework being set up? I think I am correct in saying—doubtless the Minister will put me right if necessary—that the MOD's acquisition operating framework is one type of non-statutory guidance. I should welcome his advice on that. Is any of this additional guidance likely to be made public?

In tabling the amendment we sought not only to prompt this debate but to find out exactly what is meant by the term "good". It is probably one of those words that are defined by what is known as common usage. I do not think it has a legal definition per se; rather, the idea is that generally, people understand what "good" means. Does the phrase "good value for money", which seems subjective, have legal substance? Will the SSRO's interpretation of it be the same as the Department's? Will reference be made to "Erskine May", for example?

Is the intention in subsection 2 to give precedence to "good value for money" for the Government over paying a "fair and reasonable" price to the contractor? It is a primary duty of the SSRO to somehow allow both, but it can of course deviate from statutory guidance from the Secretary of State if it feels it has good reasons. To whom must it justify those reasons? I am sure the Minister will explain all this in due course, but will he clearly state whether there is a primary aim for the SSRO, or is it expected to strike a balance?

Before moving on to amendment 29, which is in the name of my hon. Friend the Member for Barrow and Furness, I should like to give his apologies. Unfortunately, he and his family are far from well, hence his absence. If the Committee will bear with me, I will try to make the case he intended to make for the amendment. The impact assessment makes it clear that legislation and regulation are necessary because the industry is

"unlikely to comply with recommendations that are not statutory".

Given the long-standing and important relationships between some of these contractors and Government, is the Minister confident that they now accept the need for this change and the establishment of the SSRO, and understand fully what is meant in subsection 2(b) by "fair and reasonable"?

Amendment 29 serves a very simple purpose that my hon. Friend the Member for Barrow and Furness feels particularly strongly about, given his close association with the defence sector, which is so crucial to his constituency's well-being. Every member of the Committee will agree that we want a defence procurement system that serves the national interest, and there are three strands to securing that interest. The first and most important is to ensure that the courageous men and women who serve in our armed forces are supplied with the equipment they need to do the dangerous job they do in as safe and effective a way as possible. The second is to secure value for money for the taxpayer. The third, which amendment 29 seeks to address, is to ensure that the UK's world-leading defence industry and the huge range of linked industries obtain the jobs, investment and skills base that come from home-grown orders.

The scope and scale of Britain's defence sector is remarkable: it accounts for 100,000 jobs, the bulk of which are high skilled and high value, and has a turnover of more than £22 billion each year. Many members of the Committee will be painfully aware, thanks to frequent and well-argued reminders from my hon. Friend the Member for Barrow and Furness, of the scale of the supply chain that supports the construction of Royal Navy submarines in Barrow alone. I am sure that others present, from Portsmouth and Plymouth, could do the same. Barrow alone consists of 1,200 firms spread to every corner and nation of the United Kingdom, encompassing a huge range of industries, from steel manufacturing to software engineering. The same supply chain effects apply to naval ships built on Clydeside, armoured vehicles in Gloucestershire and military aircraft in Lancashire—all told, there are tens of thousands of skilled jobs in the supply chain. Those are what the amendment seeks to promote.

The amendment would simply place a requirement that due regard be given to promoting the growth of the UK defence industrial base and its supply chains when contracts are placed with a single source or through the GoCo. It was not my hon. Friend's intention in drafting the amendment to tie anyone's hands. It would not force people to buy locally, and there are times, regrettably, when the two other strands of the national interest—the best provision for our armed forces and the need for value for money—may stand in contradiction to the desire to support the UK-based sector. The amendment would establish a requirement that consideration be given to the impact on UK jobs, investment and skills when decisions are taken about contracts, in this case by the SSRO.

The formulation of requiring "due regard" is common enough legal usage and the limitations are well understood. The Public Libraries and Museums Act 1964 requires councils to have regard to the desirability of holding a large range of books and gramophone records, but no one expects them to rival the British Library. The Natural Environment and Rural Communities Act 2006 requires public bodies to have regard to biodiversity, which has not prevented plenty of planning permission for offshore wind farms.

This is not the first time the issue of supporting the UK defence sector has been raised in Committee, and I want to touch briefly on remarks the Minister made previously. I suspect he will make a similar response to the amendment tabled by my hon. Friend. On the first morning of our line-by-line consideration of the Bill and specifically the GoCo, my hon. Friend the Member for North Durham asked the Minister why there was nothing in the Bill to promote and protect skills and jobs in the UK defence sector, and to guard against cost drivers where skills and expertise are available cheaper offshore. The Minister said:

"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."—[*Official Report, Defence Reform Public Bill Committee,* 8 October 2013; c. 131.]

The Minister is right in one respect: policies and Governments change—and obviously I hope the Government will change sooner rather than later. However, I am struggling to conceptualise the possibility of a Government being elected who do not want to promote UK jobs, skills and the national industrial base through one of the largest Government procurement budgets. Four parties are represented on the Committee. I do not want to be presumptuous, but I think I can say that not one of us, on finding ourselves in government, would

[Alison Seabeck]

support that principle. On the basis outlined by the Minister in response to my hon. Friend, no Government would ever pass any legislation because a future Government might wish to take a different course.

In this Parliament—and any conceivable future Parliament—there is consensus that we wish to support the UK defence sector. There is no reason not to put that in the Bill and apply it to the SSRO's attitude to setting prices and contractual arrangements, and to the GoCo. If a hypothetical future Government no longer wished to support the sector, they would have every right to amend the law.

Both amendments are probing ones, but we may wish to divide the Committee on amendment 29, tabled by my hon. Friend the Member for Barrow and Furness, depending on the Minister's response.

Mr Kevan Jones (North Durham) (Lab): It is a pleasure to serve under your chairmanship, Mr Brady.

As my hon. Friend has outlined, the amendments are probing in nature but, on looking at clause 13 and the related schedule 4, it appears that some answers need to be teased out from the Minister on exactly how the clause will operate. No one could object to oversight of single-source contracts, but we must be careful: where contracts are entered into, defence industries and equipment providers should have the confidence that they will not be unpicked at a later date, bearing in mind the Secretary of State's power under schedule 4 to direct the organisation to do so.

I have a few questions, the first of which is about the SSRO itself. The Government have championed the abolition of quangos, but the Cabinet Office's rhetoric has exceeded their actions and ability to abolish quangos while avoiding the temptation to set up new ones. This is a new quango. What advice has the Minister received from the Cabinet Office about the Government's policy on setting up quangos? Does this proposal fit in with Government policy, and has it been agreed with the Cabinet Office?

Schedule 4 sets out how the SSRO will run in practice. We spent quite a bit of time the other day discussing conflict of interest. The schedule deals with non-executive members' pay and other things, but it does not deal with conflict of interest. Will somebody be able serve on the SSRO if they hold a directorship of another defence-related company?

On my hon. Friend's point, how will the SSRO deliver good value for money? One person's impression of value for money in defence might be very different from another's. The schedule does not give a definition of value for money. Will guidance be published at a later date to mitigate the controversy around the contracts, which have been seen as good value for money by some and as bad value for money by others?

The SSRO will report to Parliament and will come under the aegis of the National Audit Office, which will ensure that the SSRO works properly and delivers value for money. What discussions have been had with the National Audit Office about how it will measure value for money? A lot rests on this issue because companies have entered into single-source contracts with the Ministry of Defence in good faith, and part way into those contracts a body may come along and say that the contracts are not good value for money for the taxpayer. How will future contracts be determined? Clearly the definition of good value for money will be determined not only by this body but by the people who write the contracts. If they get it wrong, the system will be deemed to have failed. We therefore need an explanation of how value for money will be determined.

The schedule gives the Secretary of State a lot of power to direct the body. Will it be free to determine its own view of value for money, or will it be under the direction of the Secretary of State? Will it make recommendations to the Secretary of State about contracts that it considers might be within its remit, or will it simply be directed by the Secretary of State to look at certain contracts?

Amendment 29 was tabled by my hon. Friend the Member for Barrow and Furness. On behalf of the Committee, I wish him all the best and a speedy recovery. As colleagues know, he has not has had an easy year, in terms of his health. We touched on this important amendment the other day; again, it is about good value for money and the interests of not just UK defence but UK plc. The point made by my hon. Friend the Member for Plymouth, Moor View, is correct: the main aim has got to be that we get the equipment and kit that our armed forces require. However, we cannot do that in isolation without looking at the wider implications for the UK defence industry. It is not just about jobs related directly to defence, because many businesses—certainly small and medium-sized enterprises and technology companies—will have only a small part of their business in the defence sector. The innovation that we get from those SMEs is vital for the major primes. We must ensure that we get the innovation that is needed.

9.15 am

There are international comparators. If we look at the United States defence market, the United States is very clear, sometimes to the detriment of its defence capability, about ensuring that local suppliers are taken into account. I am not suggesting for one minute that we get into the pork barrel politics of the US procurement process, but that should be taken into account. If we look at our European partners, such as the French, the idea that, in the procurement of defence equipment, they would not take into consideration not only their native industry but also that of their friends and allies would be unheard of. To ensure that we consider both SMEs and the wider implications for UK plc, we require some assurances about the Bill.

As I said, my hon. Friend made it quite clear that the remit and first priority must be to provide the equipment that our armed forces require. However, it would be ludicrous if the provision of that equipment led to huge costs elsewhere in Government—not in the MOD, but perhaps in the Department for Business, Innovation and Skills or the Department for Work and Pensions—because of redundancies and a lack of innovation. Innovation is really important. Anyone who has been involved in the defence field knows that trying to improve our capability is an ever-moving agenda. That could be stymied if all we are doing is looking at "good value for money", as addressed by amendment 30. We could see good value for money for the MOD, but not for the Government as a whole or UK plc more widely.

The Parliamentary Under-Secretary of State for Defence (Mr Philip Dunne): It is a great pleasure to see you back in the Chair this morning, Mr Brady. I am sure that we will have an interesting sitting considering part 2 of the Bill, to which there are a large number of Government and Opposition amendments. I shall start by setting part 2 in the context of the overall reforms we propose making to defence acquisition.

As the Committee is aware, part 2 creates a statutory framework for the single-source procurement of defence capabilities. Single-source procurement is common in defence, and the MOD spends on average £6 billion a year in that way. That is 45% of the MOD's annual procurement, which represents some 5% of total central Government procurement—no mean sum.

In the context of the scale of single-source procurement, it might be helpful to give the Committee some sense of the number of contracts that might be caught by the proposals in the Bill. At the end of 2012, we had approximately 1,400 single source contracts, with a total contract value outstanding of £45 billion. Some 79%, or 1,100, of those contracts were below £5 million in value, yet they accounted for just £1 billion, or 2% of the total contract value. Some 14%, or 200, of the contracts were between £5 million and £50 million in value, and accounted for £4 billion, or 9% of the total contract value. That leaves just 100 contracts, or 7%, that were above £50 million in value. They accounted for £40 billion, or some 89% of the total contract value. Those are the contracts that are, in essence, caught by the regulations. They are small in number, but of high value. Just 11 suppliers accounted for over 80% of the total single-source contract value with £37 billion of contracts. I hope that that provides some context for the volume of contracts that will be included in our regulations.

Ministry of Defence and Government policy is to use competition when possible, but sometimes there is only a single provider of a capability we require, and the need to maintain industrial capabilities or sovereign control of the intellectual property in equipment programmes requires us to place contracts with UK companies without competition. Those industrial capabilities support the development of some of the UK's most important defence capabilities, including the nuclear deterrent, our fast jet fleet and our warship programme.

It is not just large military equipment that is procured in this way. We also use single-source procurement for testing and evaluating facilities to determine the limits of our military equipment—information that we clearly want to keep within the UK for national security reasons—and for our complex weapons, such as missiles, as we wish to maintain our current operational advantage and do not want our freedom of action to be dependent on an international supply chain. The UK is one of the few nations that can boast an industrial sector capable of manufacturing some of the most advanced equipment in the world. The new Astute class attack submarine, for example, is considered by many to be more complicated than the space shuttle.

The UK's defence sector represents a sizeable proportion of our manufacturing sector, and is responsible for considerable innovation and export revenue. I am sure the Committee agrees that it makes a considerable contribution to the UK as a whole, and is an asset for our nation.

Much of our single-source procurement, although not all, is in the UK. We have important industrial facilities throughout the country—for example, in the constituency of the hon. Member for Barrow and Furness. I join the hon. Member for Plymouth, Moor View, in wishing him well and regret that he is not here to speak to his amendment.

Mr Jones: I understand what the Minister is saying about large capabilities such as submarines, but what about smaller contracts for complex munitions, such as for munitions supply under the BAE Systems contract at the new facility in Washington? They are important to ensure supply when we need it, and we have been caught short in the past. For example, during the Falklands war, the Belgians refused to sell hand grenades. Where contracts are not just about sovereign capability, is he confident that he can ensure that when we need equipment, it will not be squeezed out by the process?

Mr Dunne: I had hoped that the figures I gave to the hon. Gentleman a few moments ago would help to reassure him that although many of our single-source contracts are substantial, many are of much less contract value—under £5 million—and many of them relate to a specific niche capability. On munitions, he will know from his days in the Department that we maintain a not inconsiderable stockpile of critical capability required by our armed forces.

Mr Jones: I accept that; we certainly used to, but given the current Secretary of State, who I think even counts paperclips in the Department, one wonders whether some of those inventories have been reduced. Will the SSRO look at smaller contracts, not just in terms of value for money, but in terms of their importance in ensuring continuation of supply when we need it?

Mr Dunne: I am sure that the hon. Gentleman does not want to get into an extended debate on the relative merits of the inventory management systems that apply now and when he was part of the Administration, and the steps that were taken to try to get this system under control. There is many tens of billions of pounds-worth of inventory within the Ministry of Defence's remit, and it is only in the past two years that we have started to get a proper handle on this, as a result of poor inventory control in previous years. However, he needs to recognise the distinction between the policy that the commands have for ensuring that they have the capability they require, and the responsibility of the single source regulations office, which is to manage the procurement of equipment of the capability set by the commands. It is not in the responsibilities of the SSRO to ensure that there are adequate stocks, for example, of grenades. That is a matter for the commands.

I shall make a little progress after that interesting interlude. I endorse the comments made by Opposition Members about the importance of industrial capability at places like Barrow and Furness, but is not just Barrow that makes the submarines, of course. There is also critical manufacturing capability relating to our submarines—and our aircraft and nuclear cores—in Preston and Derby. We also have some critical national infrastructure in our ports, which are of great significance to members of this Committee who represent ports

[Mr Dunne]

such as Devonport, Portsmouth, Rosyth and Faslane, where ships are built and maintained. There are other very large sites, such as Stevenage, Yeovil and Filton, all providing key capability to our armed forces. Many thousands of UK jobs are sustained by Ministry of Defence single-source procurement at not only these sites, but down the supply chain—an area where our small and medium-sized enterprises contribute so much.

Single-source procurement plays an important role in the maintenance of our critical national industrial capabilities, but the decision to use single-source procurement should not be taken lightly, because there is a cost to this as well as a benefit. The absence of competition means that there is no market incentive for single-source suppliers to price competitively. The absence of an alternative provider means that a supplier may be confident of winning future work even if costs are high or performance is poor.

This lack of an alternative also undermines our commercial leverage. We cannot walk away from the contract without also walking away from the military capability we need, which in most cases means that this is simply not an option. The market incentives that drive efficiency and value for money are largely absent in single-source procurement, and that puts value for money at risk—risk that applies to £6 billion-worth of annual Government procurement. That is not to the long-term competitive benefit of our single-source suppliers; people want to do a good job and suppliers want to be efficient market leaders.

Operating in an environment with misaligned incentives creates internal tensions. For example, the current system gives financial reward to suppliers who keep facilities going even when they are no longer required. They can charge their costs, and receive a profit on top. That encourages waste, which serves no one. Greater industrial efficiency is good for industry, in particular making it easier to compete in the global export market. The current system also puts the onus on the Ministry of Defence to check the validity of supplier costs. Rather than suppliers having to show us that their costs are reasonable, we have to show them that they are unreasonable. That gives suppliers a direct financial incentive to charge us as much as possible, and then hope that we do not uncover that—hardly a regime that encourages value for money.

It was this essential conundrum that Lord Currie was asked to address when he undertook his review. I join the hon. Member for Plymouth, Moor View, in thanking him for the work he did in the review, published in 2011, and regret that he was not available to address this Committee when we took oral evidence last month. He has made a great contribution to this work and, frankly, this part of the Bill is very much modelled on most of his recommendations.

Unfortunately, this dilemma is not just a theoretical problem. Each year, we uncover £100 million to £200 million-worth of inappropriate charging. I will not identify individual contractors, but I will give illustrations of some of the charges that the Ministry of Defence has found, just to help the Committee understand the problem we have. In the last couple of years, for example, we have found some £50,000-worth of charges for anticipated car accidents; £32,000-worth of charitable donations made by suppliers; £24,000 for ceremonial mugs; and £2,000 for a children's party, all charged back to the taxpayer.

9.30 am

Alison Seabeck: I am grateful to the Minister for giving us some specific examples. What is the current process for redeeming some of those costs, and how will that change?

Mr Dunne: The hon. Lady's question gets to the heart of what we are seeking to do here. At present, the Ministry of Defence can challenge costs that have been submitted to the Department only after a contract has finished. For a two-year period after the end of a contract, we can look back, request further information on charges that have been submitted and costs that have been paid by the Department, and seek reimbursement from the company. Under the new regime, for contracts that meet the criteria, we will have the ability to request more routine reports. We will get into that later. First of all, we will have the opportunity to request that a set of standard reports be provided to justify a cost charged. If we have a particular problem, we can request that the SSRO undertakes an investigation.

As well as those relatively small examples, there are some far larger cost items. For example, there is a multimillion pound charge for development costs for a piece of equipment entirely unrelated to defence. These may be isolated incidents, but they show that this is not a purely theoretical issue. The framework outlined in part 2 is designed to replace some of the missing competitive market pressures and get value for money in single-source procurement. There is nothing in the framework that influences or constrains the decision to use single-source procurement in the first place. That decision should be based on an assessment of our defence needs, and it rests with the MOD and our commands. The single-source procurement framework takes effect only once the acquisition decision has been made.

Although the provisions of the Bill may be technical and some, including myself, have described them as dry, they are important. Lord Currie, in his independent review of our current single-source framework, put it this way:

> "The reward is a more stable environment for the single source defence sector, where industry is more cost competitive in export markets...with benefits to the MOD and industry, including SMEs…The real prize of a more effective single source procurement process will be better value for money for taxpayers and a better equipped front-line."

That encapsulates why we are making the reforms outlined in part 2.

The proposed new single-source framework has two components: a set of rules to be applied to single-source contracts and an arm's length body to oversee the framework, known as the single source regulations office. The rules cover pricing and transparency. One of the aims of the framework is to ensure a fair and reasonable price, so part 2 sets out how to price single-source contracts. The price is based on a formula, namely allowable costs plus a given profit rate. This profit rate is determined using generic rates, to be published by the Secretary of State based on recommendations by the SSRO, with some additional adjustments, such as for risk. The allowable costs will vary according to the

contract, but the rules set out that they must always be reasonable in value and appropriate in nature, and must relate to the contract.

In exchange for that fair and reasonable price, our single-source suppliers must provide us with the transparency we need to ensure value for money. We have open-book provisions that grant us access to suppliers' records, and which require suppliers to provide us with standardised cost reports. Suppliers must also proactively notify us if they become aware of material changes or risks to the cost of performance under the contract.

To enforce those provisions, we have introduced a civil penalty compliance regime. If the Ministry of Defence considers that there has been a contravention, such as a report not having been provided, it may issue a compliance notice. If the report is still not provided, the Department may issue a penalty notice. The supplier may appeal that to the SSRO, whose decision is final and binding on both parties, subject only to judicial review.

That brings us on to the SSRO. It will be a small, arm's length body of about 35 people, whose job will be to monitor and maintain the single-source framework.

Mr Jones: The Minister has outlined the appeal mechanism for dealing with disputes, and he has made it clear that the SSRO will be the final arbiter. Is there not a legal problem, however, if the Secretary of State directs and controls that body? It might be argued that there is a conflict of interest, because the body is not independent from the Secretary of State's direction.

Mr Dunne: The hon. Gentleman made some comments earlier about the powers of the Secretary of State under schedule 4, and we will come on to that issue as we debate the schedule. Unusually, he appears not to have read the schedule as closely as he is wont to. The Secretary of State has very few powers under schedule 4. Essentially, he has power to appoint and remove the chairman of the SSRO and the non-executive directors. Aside from that, however, most of the powers included in schedule 4 relate to the SSRO. In relation to independence, if the hon. Gentleman will bear with us, I would prefer to discuss that when we debate schedule 4.

Mr Jones: I accept that I am skipping forward, but the Minister must agree that the power to appoint and remove members of the organisation is quite a significant one. It prompts the question: how independent from the Secretary of State's actions will the organisation be?

The Chair: Order. Given that the hon. Gentleman has accepted that the matter comes under schedule 4, I think the Minister's inclination to deal with it at that stage is appropriate.

Mr Dunne: I am grateful for your guidance, Mr Brady. That is exactly how I intend to respond to the hon. Gentleman's query. I will, however, pick up one of his earlier questions about the extent to which the Government seek to reduce the number of quangos or executive non-departmental bodies. He challenged whether the proposal flew in the face of that wider Government commitment. Although we are creating a new executive non-departmental body, we are also replacing the "Yellow Book" review board, which is an executive non-departmental body, so it is a "one in, one out" proposal.

The hon. Gentleman also asked whether the Cabinet Office had approved the proposal. I reassure him that not only was the proposal approved by the Cabinet Office, but it received full cross-governmental support when it was put to the relevant Departments.

The SSRO will be independent of the Ministry of Defence and the defence industry, and it will be free to determine its own procedures except where they are specified in the Bill. It will have a board consisting of a chair and four other non-executive directors, together with a chief executive officer and a chief operating officer. We expect the SSRO to cost less than £4 million a year once it is fully up and running, with costs shared evenly between the MOD and single-source suppliers. The MOD has, however, agreed with industry to bear the full cost for the initial period to March 2017, so that the initial few contracts do not bear a disproportionate burden.

The SSRO must keep the framework under review, including making recommendations to the Secretary of State to support the five-yearly review of the regulations. To ensure an appropriate use of parliamentary time and that we maintain the flexibility required to allow the framework to operate effectively, elements of the regime that are likely to be amended over time, such as reporting requirements, have been put into secondary legislation. Those are the single-source contract regulations, to which the hon. Lady referred and which were provided to the Committee over a week ago, and the separate penalty regulations that I have recently provided in draft.

The SSRO also plays an important adjudication role. In addition to being the appeal body for the civil penalties, it may also be called upon, by either the MOD or single-source suppliers, to provide opinions and determinations on various matters. The purpose of the opinions is to clarify the rules as they apply to a specific case, and the determinations will ensure that the pricing rules are followed.

Most of amendments we are considering this morning relate to a small number of key themes that have been raised by industry, such as those in ADS's oral and written evidence to the Committee and in the recent written evidence submitted by the CBI, and by hon. Members during the Secretary of State's oral statement in June and on Second Reading. The principal themes of the amendments are the independence of the SSRO, which we have just touched on, the application of the framework to overseas suppliers, the need to protect SMEs and the need to protect industry's information. The power to change the price of a contract has also been raised a number of times by hon. Members and industry. I assure the Committee that I will be addressing each of those issues in some detail in the course of discussing the relevant amendments, so there will be plenty of opportunity to debate them fully over the coming hours.

I turn now to amendment 30, and I will endeavour to respond to the questions of the hon. Lady and hon. Gentleman as I go through. As the hon. Lady indicated, this is a probing amendment that aims to uncover what we mean by good value for money. As the clause relates to the functioning of the SSRO, it is not my opinion that matters but that of the SSRO. However, value for money has been interpreted before in government, so it is perhaps worth considering that, as the SSRO may also look at previous interpretations.

[Mr Dunne]

Her Majesty's Treasury, which is closely concerned with value for money across all Government Departments, has defined value for money in terms of three concepts: economy, efficiency, and effectiveness. Economy means ensuring that the raw materials, or inputs, are bought at a good price. In our context, that will mean that the steel, engineers or plant and machinery that a supplier uses for the contract are bought in or paid for at market rates. Efficiency means how well the inputs are converted into outputs. For single-source suppliers, that will mean ensuring that waste is kept as low as possible, that processes are streamlined and that overheads are minimised. Effectiveness refers to how good the output is—how useful the tank, or ship, or submarine is to delivering our defence outputs. The true effectiveness of the goods produced by our single-source contracts will depend on many things outside the SSRO's or even the supplier's power. They depend on the training of our armed forces and the nature of their deployments. In the context of single-source procurement, effectiveness will mean whether the contract delivers on time and whether the requirements of the contract have been met.

Although I cannot speak for the SSRO, I suspect that it will interpret its aim as balancing the achievement of a fair and reasonable price with looking at whether a supplier's bought-out and in-house materials and skills are competitively priced, whether it is running an efficient business and whether the outputs are delivered on time. That seems a reasonable aim.

9.45 am

Mr Jones: I know that independence is a strange thing in politics. It seems that we confine individuals who are completely independent from any influence. I am rather sceptical of that approach. Is the Minister really suggesting that this body will be completely independent of the MOD? What will happen if its interpretation of efficiency is different from the MOD's?

Mr Dunne: As I have already explained, and will do again when we talk further about independence, the SSRO will be the arbiter of the issues it has been asked to determine. The MOD will be able to put issues to the SSRO in relation to the pricing of a contract. If the SSRO determines that the pricing has been fair and reasonable, that will be the price that the MOD will be obliged to accept.

Mr Jones: Does the Minister accept that the SSRO will determine what happens if this Secretary of State or a future one does not accept its definition of good value for money?

Mr Dunne: As we will come on to discuss, there is a clear pricing formula set out in the contract. Provided that the costs that are attributed to the procurement are deemed by the SSRO to be fair and reasonable, the MOD will be obliged to pay according to the pricing formula determined by the SSRO. Perhaps I have taken this a little too literally, but I was endeavouring to explain what is meant by the term "good value for money" in the Bill, rather than get into the detail of the procedure of how the SSRO will function.

Mr Jones: So the sole arbiter of value for money in future will be the SSRO and not the Secretary of State.

Mr Dunne: We are talking about the pricing formula to be applied to single-source procurement contracts. In the event that there is a dispute, either from the MOD or the single-source supplier, the SSRO will be the arbiter of the price to be paid.

Mr Jones: What happens if the Secretary of State does not agree with the SSRO's definition of value for money on a certain contract?

Mr Dunne: There is the possibility of judicial review. It is most unlikely in my view that the Secretary of State will take the SSRO's decisions through a judicial review process, but that power is there on both sides, in the event that the decision is not satisfactory. If the hon. Gentleman will bear with us, we will get to some of the issues about independence and the powers of the Secretary of State as we go through the Bill. I would like to address some of the questions—

Mr Jones: Will the Minister give way?

Mr Dunne: I will give way for the last time on this point, then I will get on to addressing questions.

Mr Jones: I accept that we are going to cover a lot of this in schedule 4, but this is about value for money. It is a pretty fundamental point that the Government appear to be completely handing over their definition of value for money on contracts to this organisation. If I am picking it up correctly, the only way in which that can be challenged by a Secretary of State is through the judicial review process. Is that the case?

Mr Dunne: The hon. Gentleman, not for the first time, is trying to have it both ways. On the one hand, he is arguing that the SSRO needs to be independent of the Government but, on the other, he is castigating the Secretary of State for giving up the power to determine what is good value for money. I have made it clear that the SSRO will be the determinant; it will manage the fair and reasonable interpretation of the formula. It will be guided by securing good value for money for the taxpayer.

Oliver Colvile (Plymouth, Sutton and Devonport) (Con): I thank you, Mr Brady, for chairing today. Is it not the case that the Public Accounts Committee and the Defence Committee can both look long and hard at the decisions that the Secretary of State makes?

Mr Dunne: My hon. Friend is right to draw the attention of the Committee to the parliamentary oversight that will continue through the functioning of the SSRO. The Defence Committee and the National Audit Office will remain entitled to investigate any contracts that have been entered into by the MOD, and the pricing could well form part of any such investigation. That is absolutely right. There will continue to be an accounting officer through the GoCo, if we go down that route, who will be accountable to Parliament for contracts placed through the SSRO regime, as well as contracts placed in open competition.

Mr Jones: I am very pleased that the hon. Member for Plymouth, Sutton and Devonport has raised that point. The Public Accounts Committee and the National Audit Office usually give parliamentary oversight to decisions made by the Secretary of State. Will the SSRO be accountable to the NAO? It might make a decision that the Secretary of State did not agree with, and the Secretary of State would not be responsible if the SSRO were setting the contracts. Will the SSRO be directly accountable to Parliament through the Public Accounts Committee and the National Audit Office?

Mr Dunne: No. The National Audit Office, as set out in schedule 4, will be responsible for auditing the SSRO's annual report on itself. That is the nature of the relationship between the NAO and the SSRO. Contracts that are placed by the Ministry of Defence with contractors will be scrutinised through the Ministry of Defence, not the SSRO.

Mr Jones: But what if the Secretary of State did not agree? He or she would not be the arbiter of the final contract price and what was deemed good value for money—that responsibility would be given to the quango.

Mr Dunne: I think the hon. Gentleman needs to bear with us to understand more about the role of the SSRO, which is to fairly employ the pricing formula that applies to single-source procurement and that is set out in the Bill. Ensuring that procurement is handled appropriately remains the responsibility of the Ministry of Defence and its commands for capability setting through the procurement entity, whether it is DE&S-plus or GoCo. The external body will review the pricing to ensure it is fair and reasonable, but the responsibility for making the procurement and agreeing the contract will remain with the Ministry of Defence. It is not appropriate for an external, independent body to be held accountable to Parliament for decisions that have been made by the Ministry of Defence and its commands. I am sure the hon. Gentleman approves of that.

Mr Jones: The Secretary of State will not have the final decision, because the body will be responsible for agreeing it. We have been talking about contracts being overpriced, but what would happen if a contract was deemed after a period of time to be underpriced? Would it be reviewed, and would we be able to put the contract price up?

Mr Dunne: If a contractor believed that a contract was underpriced, to use the hon. Gentleman's term, it would be up to the supplier to challenge whether the formula had been applied on a fair and reasonable basis. The relationship between the MOD and the supplier is balanced; they can both appeal to the organisation that runs the regime if they feel that contracts have not been fair and reasonable.

I would like to make some progress and respond to some of the hon. Lady's questions.

Mark Pawsey (Rugby) (Con): The new arrangements are a step forward. The Minister could have done a further revision of the "Yellow Book", which goes back to the 1960s. Can he spare a moment to explain why and how the arrangements will be better than continuing with the facilities that existed under the previous Government?

Mr Dunne: I am grateful to my hon. Friend for taking us back to the purpose of the regulations, rather than pursuing a tangential matter. The "Yellow Book" regime has been in place for 45 years. It was set up at a time when there was a very different defence industrial base in this country, with several suppliers that were in a position to compete for more activities. As a result of the consolidation of the industry, both in the UK and internationally, there are now far fewer potential contractors to compete. The opportunities for single-source procurement for major platforms have reduced, in terms of the number of suppliers that we can go to.

Over the last 45 years, under this Government and previous Governments, when the Ministry of Defence has sought to make contract changes to the single-source regime—a regime established not just for the MOD, but for procurement across government, so that there were rules under which the Government of the day could determine whether a single-source arrangement was appropriate—those changes have been resisted at every turn by the suppliers, unless the changes were demonstrably in their interest. It took years to get changes through.

The one example that springs to mind is a product for which the source material was wood. It was not, therefore, a sophisticated piece of equipment, but it took 10 years for the terms of supply to be amended in the way that the MOD wanted. We are dealing with a system set up under entirely different industrial circumstances with archaic rules that are difficult to change, because they can be changed only by agreement between the suppliers as a whole and the MOD. Lord Currie was asked to investigate that. He produced a thorough report and made a number of recommendations to streamline the process. Those led to part 2 of the Bill.

The hon. Member for Plymouth, Moor View, asked how much has been spent to date on establishing the SSRO. While I cannot give a precise figure, it is in the region of £5.5 million over the last two and a half years. That, I assume, includes the cost of Lord Currie's exercise.

I touched on some of the differences between the "Yellow Book" and the proposed regulations. The hon. Lady also asked whether the article 346 exemptions under the EU treaty are affected by the regulations. The answer, as she will appreciate, is clearly no. The regulations impact only on single-source contracts, and the decision on whether to apply for an article 346 exemption will continue to be made in the same way as it is now.

The hon. Lady pointed out that the regulations were published only last Monday. I committed to publishing the regulations in draft form before our deliberation on part 2, and I am pleased that we could do that. I accept that this provision is complicated. The regulations go into considerable detail, and in our discussions we will elaborate on some points, particularly in relation to the reporting requirements and penalty regimes set out. I will also discuss the extent to which we have consulted with industry on the regulations, and intend to consult on them before they are finalised.

The hon. Lady also asked—*[Interruption.]* Mr Brady, I am afraid that I am operating with one eye with a contact lens and one eye without at the moment, so I

[Mr Dunne]

am a bit slower to pick up incoming advice than I normally would be. The hon. Lady asked whether either of the two principal aims of the SSRO has primacy. The answer is no. They are both equal, reflecting the balance of tensions in single-source contracts.

The hon. Lady also asked whether there will be additional commercial guidance alongside the statutory guidance. The answer is yes. We intend to ensure that our guidance is consistent with any other legal or statutory guidance where relevant. There will also be internal commercial guidance within the Ministry of Defence to guide relations with suppliers under the regime and take account of any policy implications, as there is now. That will be publicly available on the MOD's website.

10 am

The hon. Member for North Durham asked not only about the issue that I have addressed to do with the Cabinet Office and the quango, but whether action will be taken to prevent conflicts of interest among directors of the SSRO. The terms of appointment, when the positions are advertised—we have not yet started that, but intend to shortly—will make it clear that conflicts of interest need to be properly identified. If there are material conflicts of interest, that may well exclude candidates from taking up posts. Obviously, it is critical to confidence in the regime that the chairman, non-executive directors and executives working within it are not perceived to have any conflict in undertaking their duties. I think that I have answered the questions posed on amendment 30. I hope that that helps the hon. Member for Plymouth, Moor View, in her understanding of what we mean by good value for money, and that she will be able to withdraw her amendment.

I shall now make a few observations on amendment 29, which the hon. Lady spoke to on behalf of the hon. Member for Barrow and Furness. The hon. Gentleman is a consistent champion, both in the Committee and in the House more widely, of the important defence contracting contributions made in his constituency, and we wish him a speedy recovery and a quick return to our deliberations.

I have discussed the principles that the SSRO must follow when carrying out its functions under part 2 of the Bill. Those functions are to keep the framework under review, to recommend profit rates and allowable costs, and to have an adjudication and appeal role, and an analysis role. None of those functions have any bearing on the decision to use single-source procurement.

Part 2 only deals with the situation once we have made an acquisition decision, following consideration of all the Government's legal obligations and our policy and processes. Part 2 and the single source regulations office have no remit related to those acquisition choices, which are decisions that should be driven primarily by the need for military capability, and by our industrial policy. Those considerations rightly remain within the domain of the MOD, its commands and Parliament—not with an independent body.

Turning from the principle to the practice, I would like to highlight for the Committee some practical issues that I see with the amendment, the intent of which I understand. If the amendment were adopted, it would place a third aim on the single source regulations office that it would have to consider in carrying out all its functions, yet there would be no functions related to that aim. As an aim without corresponding functions, it would add nothing to the role that the single source regulations office is designed to undertake.

I see no legitimate way in which the SSRO could consider issues such as promoting the UK industrial base in the course of its functions. For example, should it consider setting a different, more favourable, contract profit rate for UK-based suppliers as opposed to overseas suppliers? I hasten to say that there is no scope for that under the provisions of clause 17, but if there were, it would clearly put us in breach of state aid rules. It is not possible for members of the European Union to offer higher prices to their own suppliers than to suppliers from other member states. Our non-European partners, such as the United States, which has been mentioned several times in the Committee, would also be likely to be somewhat taken aback by such an approach. There is a place for an industrial policy, and, as I have said, that place is within the MOD and not, in our view, within the SSRO.

I recognise the role that the Government have to play in promoting UK defence suppliers. That is why we have the measures contained in the "National Security Through Technology" White Paper, and why we are supporting the defence growth partnership. However, I do not consider that the amendment will support that role, and I ask the hon. Member for Plymouth, Moor View, to withdraw it.

Alison Seabeck: I thank the Minister. He has highlighted in detail the importance of single-source procurement to the UK, particularly on larger contracts, and my hon. Friend the Member for North Durham has flagged up the importance of the smaller ones.

The issue of retrospectivity came up, and it will rear its head later. We need to ensure that we are not using the proverbial sledgehammer to crack a nut. Although saving £200 million is certainly not to be sniffed at, as we consider this part of the Bill we need to hear a little more about the wider benefits, which we would expect to be on a greater scale.

The Minister gave a very good definition of value of money. I am still not entirely certain that "good" is necessarily needed in front of that phrase, but in a sense that is neither here nor there. My hon. Friend the Member for North Durham raised some important issues about the role of the Secretary of State and his power—or lack of it—over decisions on pricing and contracts. That situation could put the Secretary of State in quite a difficult position. I am sure that the Public Accounts Committee will want to scrutinise those decisions. There is a risk, which probably needs to be avoided, of the Department constantly rushing to judicial review in order to have a back-stop and be able to say that it has done everything it conceivably could. That is a worry. We will come back to that issue, however, and on that basis, I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Clause 13 ordered to stand part of the Bill.

Schedule 4

SINGLE SOURCE REGULATIONS OFFICE

Alison Seabeck: I beg to move amendment 46, in schedule 4, page 39, line 17, after 'Secretary of State', insert

'and ratified by the House of Commons Defence Select Committee'.

The Chair: With this it will be convenient to discuss amendment 47, in schedule 4, page 39, line 34, at end add—

'(4) Sections 170, 171, 173, 174, subsections (1) to (4) and (7) of section 175, 176 and 177 of the Companies Act 2006 shall apply to the executive members of the SSRO as if they were directors of a company according to the provisions of that Act.'.

Alison Seabeck: Our amendments are designed to ensure tighter scrutiny of appointments to the single source regulations office. They would give Parliament an overview of appointments and would place clear duties on those sitting on the board. I accept that amendment 47 may well be deemed impractical or possibly inappropriate; our intention is to seek an assurance from the Minister that there are some very clear duties and responsibilities to which people on the board, who are tasked with the protection of significant sums of public money, should have regard.

I heard the Minister's response to an earlier question; as he said then, it could be that some of the issues we will raise will be covered by the contract that is put out when appointments are sought. However, our issue with the schedule is clear: under paragraph 1(1)(a), the Secretary of State appoints non-executive members to the board of the SSRO. The non-executive members then appoint the executive members, but only with the consent of the Secretary of State, as my hon. Friend the Member for North Durham argued earlier. It therefore seems that the Secretary of State potentially has complete control over the procedure. Giving the appropriate Select Committee an opportunity to vet proposed appointments, such as the appointment of the chairman, would mitigate some of the specific concerns about what appears to be the Secretary of State's complete control over the personnel on an apparently independent body.

My hon. Friend the Member for North Durham mentioned conflicts of interest. That is another reason why oversight by the appropriate Select Committee might be a good thing, despite the Minister's assurances that all those issues will be clearly dealt with during the contracting process.

Initially, it was far from clear whether industry would have any representation on the board. To be fair, there has been some movement on that matter on the part of the Department, following outside pressure and pressure from witnesses during the evidence sessions. I am sure that the Minister will explain fully what is currently intended, but my belief is that there will now be industry representation on the board.

Although these details may well be in the contracts, paragraph 3(3) does not outline how much notice the non-executive directors must give when resigning. The schedule does not say whether there will be a review in the case of a suspension from the SSRO. It is also not clear whether board members can be reappointed after the six-year period of service, or indeed after being dismissed. We are unsure whether the pay levels of the SSRO board will be made public and what the constraints will be regarding the pay scale. There has been no indication of the number of employees, what the wage budget is likely to be and whether the single source regulations office will be able to break the Prime Minister's wage rule.

What size of team is envisaged? I appreciate that that is in part a matter for the SSRO, but assumptions about the likely size and therefore cost of the new organisation would have been made by the MOD when considering its impact assessment. There is clearly an envelope in which it has to work. I assume that it will be subject to the usual degree of scrutiny, and that the Secretary of State will be the answering authority for any parliamentary questions.

Paragraph 8 of the schedule states that the SSRO may make arrangements for persons to provide professional services to it, or be seconded to it. I assume that that is a standard provision, but in what circumstances would this be necessary? Again, I assume this will all fall within the budget envelope, and that there will be no additional money for those external appointments. Paragraph 9 amends the Superannuation Act 1972 to include the SSRO. Given past history, what does the Minister expect to be the annual demand from the Minister for the Civil Service under this paragraph? Paragraph 11 relates to committees, yet is completely devoid of detail. What was the thinking behind this paragraph and what will be the purpose of those committees? Will members be seconded or recruited externally? Will they involve MOD staff, or even military staff? Will there be a cap on the remuneration and allowances paid to these people? Could this, like Topsy, grow and simply be an excuse for additional bureaucracy?

The governance framework for the SSRO contains a relatively limited measure to ensure the independence of the SSRO. We feel quite strongly that there needs to be some further oversight. It also provides for only minimal oversight of the SSRO's functions by the Comptroller and Auditor General, although we welcome that oversight. Can the Minister explain why there does not appear to be a more robust governance framework along the lines of that applying to directors of UK companies? We have cited the Companies Act 2006 as an example of where this has been done.

Finally, to end on a more positive note, paragraph 13(5) states that the Secretary of State must lay reports before Parliament. Clearly we welcome that provision, as we do the application of the Freedom of Information Act.

Mr Jones: As my hon. Friend said, schedule 4 and the amendments to it outline the operation of the SSRO. She raised an important point about its independence from the Secretary of State. I understand what Lord Currie was trying to achieve in having some independent scrutiny of these single-source contracts. If the Secretary of State can appoint the chair and at least two other members and remove members, there will be a sword of Damocles hanging over the board's head. To ensure true independence and greater parliamentary scrutiny, having the Select Committee on Defence look at the appointment of the chair would be a welcome move.

Another problem, which we touched on in our previous sitting, is disputes between the SSRO and the Secretary of State. Ultimately, the Secretary of State has the

[Mr Kevan Jones]

power to remove this individual from the body. I am not suggesting for a moment that the present Secretary of State or the Minister would use that power if there were a disagreement, but clearly there is power in the schedule to do that.

That goes back to a point I made earlier: as politicians we endlessly look for people who are completely independent of any influences in life, and I have not yet met one. I think we sometimes use the word "independent" too liberally to suggest that if we could find such an individual they would somehow be devoid of any influence from anyone or anything they have done in life. Unless they were produced in a laboratory, I doubt whether such a person exists.

10.15 am

Those are important points and I welcome the annual report to Parliament, which will allow parliamentary scrutiny of the body's work. Does the Minister think it relevant to have a debate on that report? Some reports just sit in the Library gathering dust, but it is important to debate the annual report in Parliament, either in Westminster Hall, where some reports are debated now, or on the Floor of the House, so that there is proper scrutiny of the body's deliberations.

The Minister said that £5 million has been spent so far on work to set up the body. That is mission creep in terms of who will control its costs. We could get to the point when it deems that it needs to increase its role or work load and before we know it, as with many quangos, we will end up with an organisation that was not intended. What influence will the Secretary of State or taxpayers have to limit its costs and to know not only that it is carrying out its work efficiently but is not wasting money?

Another issue is the directors. We have touched on conflict of interest, and the Minister said that details will be set out. I assume that someone who sits on the board of a relevant defence company, for example, could not sit on the board of this organisation, but what would be the position of someone who had previously held directorships or had influence in companies sitting on the board?

Alison Seabeck: In a sense, there is a challenge with industry representation on the board. If we want people from the industry with experience of the Ministry of Defence, there is a real risk of conflict of interest, yet the board would be weakened without some such experience.

Mr Jones: My hon. Friend makes an interesting point, and the question is what sort of individuals would be deemed fit to serve on the organisation? Should it be a body or committee of accountants, for example? I shudder at the thought, but the members will need a sound financial background, and to have some standing in defence because of the complexities of contracts—not just how they are framed, but how equipment is delivered to our servicemen and women.

Freedom of information is another issue that will be important. It is referred to in schedule 4 and I would like the Minister to comment on it. I accept that financial information on individual contracts will, rightly, not come under the provision. We cannot ask people to make that information public, but what else is covered under part VI of schedule 1 to the Freedom of Information Act 2000? For example, would the actions of the committee, its costs and other information not directly related to contracts be covered? To achieve transparency, which I know the Minister wants, as much transparency as possible in the operation of the body will be important, without straining the important point about individual contracts, which would not be right.

I am still not convinced about the body—possibly because I will never be convinced that we can ever have a truly independent organisation. The Minister needs to explain more about how disputes with the Secretary of State will be resolved. He referred to going down to the courts, but I think that that would be an unfortunate situation. My innate feeling is that we should stop the lawyers getting involved with anything, because it is not the taxpayer or the individual who gains but the lawyers—no disrespect to anyone in the room who is a lawyer. What could be a welcome move on the part of Lord Currie to ensure that we have true transparency and good value for money, not only for the taxpayer but for our armed forces, could mean that we end up in the courts, which would not help the relationship between Government and industry, nor would it be good value for the taxpayer.

My hon. Friend the Member for Plymouth, Moor View touched on single-source contracts, which are a concern for industry. The Minister outlined the fact that there are large contracts, some of which were entered into over many years. Is it the intention of the SSRO and the Secretary of State either to look at those contracts in terms of value for money or to renegotiate them? The Minister referred the other day to a contract that he said had been renegotiated, but clarified that it was actually a renegotiation due to a break clause in the contract. Does the Secretary of State intend that the body should look at all the contracts with the aim of renegotiating them? If that is the case, it will cause disquiet among some organisations, which have invested time and their shareholders' money in new facilities that will produce equipment under the contracts.

We need clarity about the Secretary of State's intentions for existing contracts. Without such clarity, we will enter a new field. Let us be honest: single-source contracts are good in that they ensure proper investment in defence manufacturing, and that the equipment our armed forces need is produced on time and on budget. If people are more or less told that they can have a single-source contract, but at any time during the lifetime of that contract a body can come along and renegotiate it to get "good value for money"—I am still not clear about the definition and whether it will be the definition of the SSRO or the Secretary of State—it will be difficult for companies that enter into such contracts. A company will have entered into the contract and invested huge sums of money. In the previous sitting, I raised the example of the BAE Systems munitions plant at Washington in my constituency. It is a brand new facility that has been built with investment from the company because of the 15-year contract that it has with the MOD for munitions. That is clearly a result of the fact that the contract will run for those 15 years at a certain price.

In its deliberations on value for money, will the SSRO take exports into account? Companies such as the one I have just mentioned that have single-source contracts with the MOD put themselves in a position whereby they can look for export opportunities. One of the big selling points, certainly if one goes to Sweden, is that if the MOD is a customer, many export customers ask: "Who is actually using this equipment?" If the reply is that the MOD is not using it, they would ask why. The Swedes certainly take a view that to secure exports it is important to demonstrate that the Swedish armed forces are using the contracts. Will that be taken into consideration with regard to value for money—not just the contract, but the contribution to UK plc?

Mr Dunne: This is one of the key sections of today's debate on establishing the SSRO. Schedule 4 sets out how it is envisaged that the SSRO will operate. I will endeavour to address most of the questions that have been put to me, but first I shall set out a bit of context.

As the hon. Member for Plymouth, Moor View has said, the industry has expressed concerns about the independence and impartiality of the SSRO on a number of occasions—for example, in ADS's written evidence to the Committee in September, and in the evidence from the CBI that we received last week. I would like to use the debate on schedule 4 to assure the Committee that we are committed to ensuring that the SSRO will be both independent and impartial, whether or not any of its members have been brought up in a laboratory—the hon. Member for North Durham suggested that that would be the only way it could be independent or impartial.

The credibility of the new single-source framework rests on that independence and impartiality. For example, the SSRO can act as an independent adjudicator in the event of disputes between the parties, and it is the appeal body to which the industry can refer if we apply a civil penalty to it. Perhaps even more significantly, it makes an annual recommendation on the profit rate, and recommends changes to the framework as part of the quinquennial review process.

Alison Seabeck: I apologise for intervening on the Minister so early, but will he set out the percentage of contracts that he feels are likely to be challenged, based on current experience? That relates to the point he just made about how often he feels the SSRO's mediation and decision-making process will be put into action.

Mr Dunne: The hon. Lady is asking me to use my crystal ball, which is of course difficult. I have given some indication of the extent of the challenge under the current regime with single-source contracts. We are hopeful that the new regime will start off with a clean sheet of paper. It will apply only to new contracts that are placed under the single-source regime.

To answer the question posed by the hon. Member for North Durham, the SSRO will look at existing contracts only if they have been renegotiated with the agreement of the counter-parties. The intention is that new contracts will be placed under the new regime, where the profit formula has been worked out in accordance with the requirements for the SSRO. The purpose is partly to encourage a more harmonious relationship between the Ministry of Defence and its suppliers, and I hope that fewer disputes will arise.

Mr Jones: Will it be for the SSRO or the Secretary of State to determine which contracts are renegotiated?

Mr Dunne: The decision about whether to look at an existing contract will be taken by the Ministry of Defence. If it decides to reconsider an existing single- source contract, it would need to renegotiate it with the supplier, and the SSRO regime will apply only when that contract is replaced with a renegotiated—in other words, a new—contract.

10.30 am

Mr Jones: Is it therefore the Secretary of State's intention to look at existing contracts? I accept that the Minister is saying it will happen only with a company's agreement, but does not the Secretary of State have the whip hand in the sense of being able to threaten a company or to imply that if there is no renegotiation, due consideration of its later work with the MOD might be put in jeopardy?

Mr Dunne: Mr Brady, you will recall that we discussed at length last week the extent to which we are seeking to renegotiate contracts. I have tried to reassure the hon. Member for North Durham, who in this instance is representing industry concerns, that we are not using the introduction of a new single-source regime as a means to renegotiate contracts. That came up last week in the context of the GoCo, and the hon. Gentleman is now raising it in the context of single-source procurement. Changing the regime for single-source procurement is not the driver for renegotiating contracts with industry. All I am saying is that, if we renegotiated a single-source contract with an industry, the contract would fall within the new regime, provided the SSRO has been set up.

Mr Jones: Does the Minister therefore agree that basically, what the former Secretary of State for Defence, the right hon. Member for North Somerset (Dr Fox), said at the time of the strategic defence and security review—when he made great play of saying that he would renegotiate all existing contracts—is history?

Mr Dunne: I again refer the hon. Gentleman to our discussion last week, when I made it clear that certain large contracts and private finance initiative contracts—I referred to those two types of contract—are being reviewed case by case to seek to improve value for money for the taxpayer. That will not be affected by the Bill, other than that, if fresh single-source contracts are signed or amendments are made to existing ones, then, by agreement with the supplier, they will come under the single-source regime.

Mr Jones: I agree with the Minister that it is sensible and quite right that contracts, if they have a break clause, come up for renegotiation or change, should be renegotiated, but that is very different from the language used in the early days of the coalition Government, which concerned the industry by giving the impression that a host of existing and long-term contracts were up for renegotiation, irrespective of whether there were break clauses or changes.

Mr Dunne: As I have indicated several times—I will repeat this a final time—the Department is looking and will continue to look at very large contracts and at PFI ones. I have now said that so many times that it would test the Committee's patience if I said it again.

To revert to amendment 46, we were discussing whether the SSRO can be seen as independent. It is worth considering the consequences of its not being seen as independent, because its being perceived as partial would cause great difficulties in the relationship between the Ministry and our suppliers. If the perception was that it was too biased towards the Government, suppliers could decide that they no longer wished to invest in the sector. Our suppliers could be driven to leave the industry, or at least the sector in the UK. If the perception was the other way around—that it was too biased towards industry—we would seek to change the framework entirely, or we would exempt our contracts from it, thus losing the protections we are trying to establish in the Bill. Neither outcome serves either the MOD or our single-source suppliers.

It is the need for independence and impartiality that has led us to want to set up the SSRO in the first place. The current framework requires consensus to change. As we discussed in response to the intervention by my hon. Friend the Member for Rugby, what that has meant is that for 45 years, any change that one side felt would put them at a disadvantage was blocked. That is the principal reason why the old system has remained frozen in time for so long. Consensus does not serve either party.

One alternative—a statutory framework determined entirely by the MOD—would always be resisted by industry. There would also be a risk that, over time, the framework would become steadily more one-sided, and industry would be driven out of the sector. So that option will not do either. What we need is an independent body, which is what the Single Source Regulations Office will provide.

On looking at some of the Bill's provisions, the industry had some concerns that the SSRO will not be independent. It pointed to the fact that the chair and other non-executive members are appointed by the Secretary of State—a point raised by the hon. Member for Plymouth, Moor View—and that the Secretary of State can repeal part 2, including the SSRO. It considers that that will give the Secretary of State considerable leverage over the SSRO.

However, there are reasons for both provisions, and they do not stem from a desire to exert influence over the SSRO. We looked at the different models for arm's length bodies. We wanted to give the SSRO as much freedom as possible, including the ability to recruit its own staff. We did not want the SSRO to be a servant or agent of the Crown. Those requirements have led to its being designated as a non-departmental Government body.

Considerable attention has been given to such bodies over the past few years. One of this Government's aims, as the hon. Member for North Durham rightly pointed out, has been to reduce their number. In this case, the SSRO will replace an existing non-departmental Government body—the Review Board for Government Contracts, which, through no fault of its own, has not had the power to amend the current framework.

However, there is a substantial set of guidance regarding such bodies. For example, they must be allocated to a Department, which, given the functions of the SSRO, in this case clearly has to be the MOD. The Secretary of State of that Department must appoint the chair and non-executives of that body, in accordance with that cross-Government guidance.

The independence of the chair and the other board members is essential, so I hope the Committee will bear with me if I now describe the recruitment process in some detail. That should help to address the concerns that have been raised. To ensure that the appointment will result in a suitable, independent and unbiased person, we will be running the recruitment process in full accordance with the guidelines of the Office of the Commissioner for Public Appointments. All the posts will be publicly advertised, with public selection criteria. The recruitment panel for the chair will be headed by a public appointments assessor, who has already been chosen for us by the Office of the Commissioner for Public Appointments. They will review and clear the advertisements, the selection criteria and the recruitment strategy.

Also on the recruitment panel will be an independent person suggested by the Office of the Commissioner for Public Appointments and approved by the public appointments assessor. There will be two others on the panel—one MOD official and another person suggested by industry. Industry has suggested Paul Everitt, chief executive officer of Aerospace Defence Security, one of the trade bodies for the defence sector; Mr Everitt gave evidence to the Committee last month. Of the four members of the interview panel, only one will be from the Government.

Once the interview panel has selected one or more suitable candidates, they will be reviewed by the Secretary of State. Anyone may apply, and we have encouraged industry to seek out and inform possible candidates. We want the best person for the job. The same recruitment panel, with the addition of the newly appointed chairman, will be used to select the other non-executive directors. There are additional requirements on suitable candidates. They must not have recently come from the Ministry of Defence or a defence supplier. Together they must represent a balance of private and public sector experience—for example, legal, regulatory and private sector acquisition.

Alison Seabeck: Could the Minister specify what he means by recently?

Mr Dunne: It will be for the panel to determine what it regards as a recent appointment. Clearly, for people of certain seniority, the two-year rule—the OCPA rule—would apply, but it may not apply to individuals who have served in a less senior post.

Once the non-executives have been appointed, the board will then have responsibility for appointing the chief executive officer and the chief operating officer. The chief executive will become the chief accounting officer for the SSRO and, together, the board will then appoint what staff they need.

Alison Seabeck: While the Minister is on his feet, now is the time to ask small questions. Is a job specification available for new board members and for any of the other posts?

Mr Dunne: Indeed, there is a draft job specification available. It will be published as and when the selection process begins. It will be readily available to hon. Members.

Mr Jones: Will the same rules apply to the chief operating officer and other members of staff if they have not been recently employed by the Ministry of Defence or industry?

Mr Dunne: As I have just said, it will be up to the board, which will be comprised entirely of non-execs, to decide the criteria for members of staff and for the first two executive appointments. The chief executive and the chief operating officer will obviously then join the board. One would assume that it will wish to ensure it has sufficient understanding of the industry, and has individuals who perhaps have been on both sides of the negotiations. It would be unreasonable for us to fetter the criteria the board will choose when determining who should work for it.

Mr Jones: I do not disagree with that. We obviously do not want someone in this role who has spent his life producing potatoes or in the Milk Marketing Board. However, the chief operating officer will have quite a lot of influence in the organisation. For them to be seen to be independent, is it not important that they have not recently been in industry or in the MOD?

Mr Dunne: I would caution the hon. Gentleman on casting aspersions about potato growers. As we speak, potatoes are being dug out of the fields on my farm. I am not a candidate for the directorship of the SSRO, I hasten to add.

I hear what the hon. Gentleman says. It is important that we introduce rules on appointment, but it is most important that the board be able to form its own view as to who should work for it and to ensure that those individuals are fully compliant with conflict of interest and public appointments rules, which I was about to discuss.

Mr Jones: I accept what the Minister has said, but should we not at least give guidance to the board to ensure that the rules governing appointments are taken into account when appointing the chief officer? It will be important for the organisation's credibility that not only board members but the chief operating officer and others be seen to be as independent as possible, with no connection with the MOD or industry.

Mr Dunne: I share the hon. Gentleman's concern. It is important that it be seen to be independent, but it is also important that both industry and the MOD have confidence that the organisation has the relevant skills within it to do its job properly. The board will have to be cognisant of the public appointments rules, which are pretty clear on those matters.

10.45 am

I hope I am demonstrating to the Committee that the appointment process is rigorous. I am confident that the result will be an independent SSRO board, notwithstanding its lack of presence in a laboratory. I do not think it necessary to require the chair and other non-executive members to be ratified by the House of Commons Defence Committee. Such ratification is not the norm for public appointments, and it takes place only for very specific reasons. The SSRO will not be regulating Government, nor will it be required to protect public rights and interests pertaining to decisions of Government. Those are the circumstances that would typically require parliamentary pre-appointment scrutiny.

The SSRO is, for the most part, free to determine its own procedures, including making committees. The exceptions to that are where its procedures are laid out in the Bill; and the requirement for it to run a full public consultation in support of the quinquennial review, which I will return to later and which will be included in the framework document between the MOD and the SSRO. We are sharing the draft framework document with industry, and we have set up a specific working group with our top 10 single-source suppliers on the set-up of the SSRO, sharing the proposed organisational structure and recruitment strategy with them.

The ability to dissolve the SSRO would arise only if we repealed the whole of part 2. We have no intention to do that, and we would be likely to do so only if we were going to replace it with an alternative single-source regime. It is sensible to include in legislation the ability to repeal it. If we were to do so, we would want to dissolve the SSRO at the same time.

That all points to the considerable efforts we have made to ensure that the SSRO will be independent. The Secretary of State's ability to appoint the chair and dissolve the SSRO will not determine the independence and impartiality of the SSRO; those are powers that cross-Government guidance requires us to introduce. The statutory aims of the SSRO—to balance the interests of value for money and a fair and reasonable price; the recruitment process for the chair and board, which I have just explained in some detail; the nature of the SSRO's functions, which are set out in the Bill; and its freedom to determine its own processes and recruit its own staff—will all help to demonstrate its independence. Like all public bodies, the SSRO is subject to checks and balances, such as the Competition and Markets Authority and the National Audit Office. Its chief executive officer will be an accounting officer, and the SSRO chair can be brought before a parliamentary Committee at any time.

I hope that reassures the Committee of our commitment to an impartial and independent SSRO, and I ask the hon. Member for Plymouth, Moor View to withdraw amendment 46. I will respond to those of her questions that I have not covered after I have addressed amendment 47.

Amendment 47 also stems from a concern about the impartiality of the SSRO. It is designed to apply the governance regime placed on company directors, which is set out in the Companies Act 2006, to the executive members of the SSRO. The sections of the 2006 Act mentioned in the amendment cover the duties to act within powers, to exercise independent judgment and to exercise reasonable care, skill and diligence. They also include the duties to avoid conflicts of interests, not to accept benefits from third parties and to declare interests in proposed transactions or arrangements. Taken together, those requirements are a summary of what would be considered good governance in a company director.

The SSRO, however, will be an executive non-departmental public body and not a company incorporated under the Companies Act. We have a framework to which board members of public bodies must adhere, which is designed to address the different functions and responsibilities of public bodies: the Cabinet Office "Code of Conduct for Board Members of Public Bodies". The code of conduct sets out that board members must act with selflessness, integrity, objectivity, accountability, openness and honesty. It places restrictions on how public money can be used and limits political activity. It also requires board members to

"ensure that no conflict arises, or could reasonably be perceived to arise, between your public duties and your private interests—financial or otherwise".

The requirement for a board member to follow that guidance will be set out in the framework document between the MOD and the SSRO, so it is not necessary to include it in statute.

The Government periodically amend their guidance, and we will update the framework document accordingly. The SSRO will also have a requirement to publish a code of conduct for both executive and non-executive members. Again, that will be set out in the framework document. We will also share the draft framework document with our top 10 single-source suppliers to reassure them that all these protections will be in place. As an executive non-departmental public body, the SSRO will be reviewed every three years. That review will be overseen by the public bodies reform team, which has responsibility for reviewing arm's length bodies across Government.

The triennial review has two principal aims: to provide a robust challenge to the continuing existence of the SSRO, both in terms of its functions and form; and to review the control and governance arrangements in place to ensure that the SSRO is complying with recognised principles of good corporate governance. In addition, the Government Department sponsoring a non-departmental public body is required to ensure that a suitable governance regime is in place in the body and that it is adhered to at all times.

The Companies Act duties that the amendment would place on members of the SSRO are simply not necessary. Those duties, and others that relate to public office, are already in place for members of public bodies and have been for many years. We want the SSRO board members to adhere to the standards of public office. I hope the hon. Lady recognises that the status of officers of a public body will provide the reassurance she seeks.

The hon. Lady asked about the notice period for non-executive directors. I read last night the draft appointment proposals and observed that a notice period was not included. I have suggested that we include a notice period of one month. The hon. Lady is on the button and we think alike on those matters. Non-executive directors can be re-appointed but they will be subject to the same guidance rules across Government on re-appointment. Cabinet Office guidelines generally limit appointments to two terms or 10 years, and we would expect to follow those guidelines. They will be initially appointed for a three-year term.

The hon. Lady also asked whether conflict of interest provisions were envisaged in individual contracts for director or chairman. The answer is yes; I can reassure her that there will be. Again, we will follow Cabinet Office guidance on the code of conduct for board members, and that covers conflict of interest provisions.

The hon. Lady also asked whether pay levels will be made public. I can confirm that the adverts will indicate the pay level that applies. Although we have not yet made this public, I can confirm that we have followed Cabinet Office guidance for the approval of senior pay and have set the chair's remuneration package below the defined threshold that applies to all civil service appointments and appointments to public sector bodies, which are subject to ministerial approval. We have also undertaken a benchmarking exercise, to ensure that the proposed remuneration package is consistent with other executive non-departmental public bodies of similar remit, size and overall expenditure.

The proposed remuneration of the SSRO chair is up to £550 per day. The advert indicates that the person would be expected to contribute up to three days a week. On a pro rata basis for a three-day week that works out at approximately £84,000. The expectation for other non-executive directors is that they would be paid at a rate of £500 a day. Their contribution will be determined in discussion with the chair on how many days a week they will be expected to contribute.

The hon. Lady also asked about the number of employees and the pay scales for the team. Again, all that will be determined by the board once it is constituted, but our working assumption is that there will probably be up to 35 members of staff and, as we have already identified, we expect the total cost to be some £4 million a year, which will be shared in due course between the MOD and industry. The hon. Lady also asked about the cost of recruitment, which is part of the costs for the first period to March 2017 that will be entirely absorbed by the MOD. She further asked whether the annual uplift in pensions will be taken into account. That will apply to the extent to which there are increases in civil service pension contributions and benefits.

The hon. Lady asked about the committee structure. Schedule 4 envisages a permissive structure to encourage the board to set up committees as it sees fit. For a committee to be quorate, we have identified that there should be a minimum of three people and that one individual should be from outside the SSRO. At this point, we do not have any restriction in the Bill on who can be a member of a committee, which gives the board the flexibility to include military personnel or members of the MOD if appropriate, but we are not being prescriptive either way.

The hon. Member for North Durham asked whether the SSRO's annual report will be debated in the House. That matter is way over my pay grade and is for the Leader of the House to determine. Of course, hon. Members may be interested in the subject and I am sure the hon. Gentleman will be at the forefront of those appealing to the Backbench Business Committee for regular such debates. I look forward to reminding him of that, should he omit to do so.

Mr Jones: When the Minister is on the Back Benches, which he inevitably will be some day, he could perhaps join me in doing so.

Mr Dunne: I am again being asked to look into my crystal ball to foresee who will be in office after the next election. I am quietly confident—although certainly not about my own position—that the hon. Gentleman will be better placed to appeal to the Backbench Business Committee than me.

The hon. Gentleman asked for transparency concerning the operations of the SSRO. As is clear from the schedule, there will be an obligation to publish an annual report, which will be subject to audit by the Comptroller and Auditor General and will provide such transparency.

We discussed at some length the hon. Gentleman's comment about retrospectivity and I do not intend to go over that again, but he also asked whether exports will need to be taken into account by the SSRO. That comes back to the same point. Such policy will be determined by the MOD, as it is not appropriate for policy to be part of the SSRO's remit.

Mr Jones: Could the Minister touch on the point I made about freedom of information?

Mr Dunne: I will get back to the hon. Gentleman on how the Freedom of Information Act will apply. We have already made it apparent that contracts will be publicly available in redacted form to remove commercial sensitivity, as happens now. I think the hon. Gentleman is asking whether the activities of the SSRO will be subject to the Freedom of Information Act, and I will write to him to confirm that.

With those comments, I ask the hon. Member for Plymouth, Moor View to withdraw the amendment.

Alison Seabeck: The debate on this schedule has been quite productive and I thank the Minister for his contributions.

Regarding a debate in the House, although this issue is above the Minister's pay grade, the budget is significant and I would expect such a discussion to happen in future.

11 am

My hon. Friend the Member for North Durham reinforced the point that the Opposition have concerns about the potential for cost creep, and the Minister suggested that he did not necessarily think that that was likely. Again, we will keep an eye on that. I am grateful to the Minister for his assurances on independence. While I accept that he does not have a crystal ball, one assumes that when he and his officials looked at making an estimate of staffing levels and budget, a view was taken on the demand for the SSRO to adjudicate. I am not altogether sure that we are much wiser about industry's likely use of the SSRO. Although I accept that it was not the driving intention, questions will still arise about the potential for renegotiating contracts.

The point that my hon. Friend the Member for North Durham made about guidance being offered to non-executive directors on and around the appointment process has good sense behind it. Clearly, if the Secretary of State has the ability to veto all these things, it makes sense for non-execs to get some guidance about what in particular the Secretary of State might be looking for. I fully understand that there is a tension there, but given that the Secretary of State has the ultimate power of veto, it would make sense if the non-execs knew what sort of playing field they were on.

Mr Dunne: I am not sure if the hon. Lady means to suggest that the Secretary of State will veto individual decisions of the SSRO, because that is not the power. It is merely the residual power required by Government guidance, which was applied when her party was last in government. There has to be somebody with the power both to appoint and dismiss the SSRO in the event of it becoming redundant.

Alison Seabeck: I fully accept that. My point is about whether there is any potential for guidance to go from the Secretary of State to the non-execs prior to the appointment process, so that they have some indication of what is important to the Secretary of State. They could go off and appoint somebody entirely inappropriate, and potentially he could then withdraw his support.

Mr Dunne: I think I can help the hon. Lady in two ways. There will be the advertisement for the role, which will include a job description. Secondly, there will be the framework agreement between the Ministry of Defence and the SSRO, which will set out the expectations of the Ministry of Defence and how the SSRO will conduct itself. That is subject to discussion with industry, and probably will not be available to the chairman of the SSRO in its final form, because they, too, may wish to contribute to it, but that will help the hon. Lady on the issue of appointments to the board; they will be cognisant of the contents of that document.

Alison Seabeck: I thank the Minister for that intervention. On that basis, I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Schedule 4 agreed to.

Clause 14

Regulations relating to qualifying defence contracts

Alison Seabeck: I beg to move amendment 31, in clause 14, page 9, line 30, at end insert—

'(1A) Before making any regulations under this Part, the Secretary of State must consult with the industry body and those persons as he thinks fit and must have regard to the results of the consultation.'.

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

Amendment 32, in clause 14, page 10, line 2, leave out 'and' and insert—

(aa) the contract is not made under the terms of a framework agreement that was concluded before the relevant date, where that agreement determines the basis for pricing contracts placed under it, unless the Secretary of State and the primary contractor agree that the contract is to be a qualifying defence contract,

(ab) the invitation to tender for the contract work identifies the prospective contract as a contract to which this subsection applies, and'.

Amendment 33, in clause 14, page 10, line 21, at end insert

'so long as that direction does not place suppliers in one country at a disadvantage compared to those in other countries.'.

[The Chair]

Amendment 41, in clause 27, page 19, line 43, at end add

'so long as that direction does not place suppliers in one country at a disadvantage compared to those in other countries.'.

Amendment 45, in clause 41, page 27, line 15, at end insert—

'"industry body" means any body which appears to the Secretary of State appropriate to represent manufacturers and suppliers;

"manufacture" includes assembly, install and service and "manufacturer" means any person who manufactures goods for defence purposes;

"supplier" means any person who supplies goods, works or services for defence purposes.'.

Clause stand part.

Alison Seabeck: I hope that in his response the Minister will start by explaining why the impact assessment in this regard is a little contradictory, and explain for the benefit of the Committee why the Government have felt it necessary to go down the statutory route. We touched on this in the debate on clause 13. Page 16 of the impact assessment states that

"Government intervention is necessary as industry are unlikely to comply with recommendations that are not statutory",

yet the document later states:

"Although there have been areas of difference, defence suppliers have"—

yes, have—

"accepted the need for change."

As a starting point, it would be helpful if the Minister could set out the evidence on which he based his decision to regulate in the Bill. Some of that was addressed in the opening two clauses, but specifically, where is his evidence that industry is unlikely to comply with non-statutory recommendations? I am playing devil's advocate but, none the less, I would like the Minister to make a statement on that.

If the Minister intends to press on with expanding the regulatory framework, we feel there is a need to enhance the degree of transparency, or at least to tease out whether that is required, and to ensure that a sound base is built on wide consultation on changes to regulations that the Secretary of State may wish to make, hence amendment 31, which would effectively insist that the Secretary of State consulted with industry and relevant parties prior to making regulations in relation to this part. The Minister made a strong case for not doing that when we considered a similar amendment earlier, but again, I would like him to restate his intention.

Obviously, we are moving into some technical areas, and to avoid Committee members' eyes starting to glaze over as we approach the areas of formula and contract law, I will start with what I hope are relatively straightforward questions to the Minister on the definition of qualifying defence contracts.

My understanding is that a qualifying defence contract is one in which the Secretary of State is a party, but a QDC could in theory also be part of an unbroken chain of single-source procurement that starts with a single-source contract with the MOD. Will the Minister enlighten the Committee—I am not sure I know the answer to this—as to what happens if a QDC is established but, because of outside circumstances, the chain is broken in some way and the contract ceases to be a QDC? That scenario is hypothetical, but could it happen? If it does, what action would the SSRO take?

On the size limitation on someone becoming party to a QDC, the bar is being set at having one current contract at around the £5 million level. Is there any risk that the MOD might need a contract that falls in every other way within the remit of the SSRO but that is for less than £5 million—a small project of enormous importance? I am sure the Minister's officials have scoped this out well, but will the Minister confirm that it is extremely unlikely that the scenario I have set out will occur? If that is the case, could standard MOD conditions—defence contracts—sweep up such a contract if it is missing some of the elements of a QDC? I also note that there is an opt-in option for contracts previously let that may come in under the £5 million cut-off point. How many existing contracts could potentially opt in and become a QDC?

Defence suppliers, as the Minister would expect, have serious concerns on the pricing regime and on the way in which the regulations will be applied, and the amendments reflect their concern. The Minister, in response to similar amendments proposed to part 1, made it clear that consultation before the production of regulations can at times be onerous and, because of the degree to which industry interrelates with Government, such further consultation on a statutory basis is not necessary. I have heard anecdotally that some companies that will fall within the remit of the SSRO have a dedicated Minister within Government. Is that correct? Do Babcock and BAE Systems have dedicated Ministers outside the MOD? If so, what exactly is the role of those Ministers? Is it to seek the views of companies on issues such as this?

Clauses 14(2)(b) and (c) determine to which contracts the pricing mechanisms under clauses 15 to 21 apply. Paragraphs (b) and (c) prescribe that secondary legislation will determine a de minimis value below which the pricing mechanisms will not apply, and categories of contracts to which the pricing mechanisms will also not apply. The threshold value for the purposes of regulation 3(1)(b) is £5 million, and for the purposes of regulations 5(2)(c) and 5(3)(c) is £25 million. That gives the Government a significant margin of discretion and appears to provide no guarantee that important contracts will be caught by the provisions. Will the Minister offer reassurance on that?

I would welcome a further attempt by the Minister to explain the reasons for the thresholds. He had a go at that in the witness sessions, and he was reasonably clear, but I would welcome further clarification. He stated, as do the regulations, that there is a far higher threshold for subcontracts—£25 million—than for prime contracts, which have a threshold of £5 million. We need clarification because he said that the threshold is different for prime contractors because they,

"almost by definition, are in the single-source regime anyway, and are of a scale and substance whereby clients with information requests will not be overly burdensome because they will be doing it anyway."—[*Official Report, Defence Reform Public Bill Committee,* 5 September 2013; c. 103, Q216.]

Is he certain that what is proposed will not be seen as burdensome to some smaller and medium-sized enterprises? At what level were they consulted on where the cut-off points should be?

Will the Minister say why the exclusions listed in the regulations and specific to this part of the clause include intelligence activities? I assume that is to do with the covert nature of that work and the fact that those involved do not want to publicise what they are buying or being equipped with, but some clarification would be welcome.

The regulations as they apply to clause 14(3) and clause 27(3)(c) talk about the effect inflation or deflation may have on the value of allowable costs likely to be included in the contract price. What measurement will be used to calculate that impact?

I now come to the rationale for amendment 32. Will the Minister explain why the MOD believes it is reasonable to identify its intention of letting a QDC at the time pricing is initiated, rather than at the time of the award, which is how the clause appears to be drafted? Suppliers are saying very loudly, and perhaps understandably, that the terms of the contract need to be set out clearly at the time of entering the contract negotiations and no later than the time of pricing. For the benefit of the Committee, will the Minister set out the history of the internal discussions behind the clause? Will he tell us whether there is any precedent for this approach in Government contracting?

Suppliers feel that, if a potential contract is a QDC, the supplier can decide whether to participate in contract formation under the terms implied by law. At the moment, they clearly feel at a disadvantage. That may well be the aim of the clause, and if that is the case, perhaps the Minister can say so. Is this one of the areas where the change from the "Yellow Book" arrangements is most marked? Does the Bill offer suppliers the clarity they need regarding the problems envisaged if a contract is placed under a pre-existing framework agreement? They clearly believe the pricing process for that agreement will be prejudiced if the contract is classed as a QDC simply because it was entered into after the single-source regulations come into force.

On clause 14(6), the process for determining competitiveness is guided by the regulations. Again, I am sure there is a logical explanation for the provisions, so could the Minister give us it in due course? Will he explain why, where a contract notice has been published, as outlined in regulation 4(a)(i), and the contractor was not aware of a lack of other bidders, as under regulation 4(c), that would be considered a competitive process? Surely, even if the competition was made public and the contractor was unaware of a lack of other bidders, the mere fact that only one firm had bid would make this an uncompetitive process, therefore qualifying the contract as a single-source contract? I know the regulations outline that, in bidding for the contract, the contractor would have assumed some competition and therefore made a competitive bid, but how can that be proved by the SSRO or the contractor?

11.15 am

Under clause 14(7), the Secretary of State has a very broad power to redefine the scope of the pricing provisions. It is not strictly a Henry VIII clause, but its effect could be similar. We need clarification from the Minister that it will apply across the piece, and not just to UK suppliers. The Secretary of State appears to be able to limit the circumstances in which a contract that meets the criteria for a QDC can be declared not to be a QDC. Is there the potential for that to be seen as discriminatory, and as favouring overseas suppliers, to whom it can be disapplied? I would welcome the Minister's response on that. We tabled amendment 33 to seek assurance that the clause will not disadvantage suppliers from one country—Britain. The amendment also relates to clause 27, because there is a read-across. Will the Minister provide examples of when Secretary of State might decide that a contract does not qualify? That would help to inform the Committee.

Could the clause result in some contractors receiving preferential treatment? Does the Minister foresee any potential legal issues emerging from that? Will the Minister make public the reasons for the exemption in subsection (7), or does he feel that commercial sensitivities prevent him doing so? If that is so, I am sure he will appreciate that that could lead to a sense of distrust amongst suppliers. I know that he and his officials work hard to avoid that in their dealings with industry; trust is an important factor.

The Opposition wish to see greater transparency, so amendment 31 inserts a new subsection (1A), which would make the introduction of regulations under part 2 much more visible and subject to consultation. It would be astonishing if the MOD did not consult industry prior to drawing up the regulations that will affect it. However, rather than trusting that the right thing will be done, we suggest that a requirement to consult be put in the Bill. The regulations will be crucial to the way in which major contracts are procured, and we should not forget that they are a significant portion of the overall defence budget. It is therefore not unreasonable for Parliament to be able to scrutinise the process. I am sure that the Minister will say that given the role of the Public Accounts Committee and the Select Committee on Defence, and Back Benchers' ability to ask questions, that base is already covered. However, I would welcome his reassurance on that matter.

Clause 14(8) refers to "defence purposes", which are also mentioned in part 1. Is there any reason why part 1 gives a specific interpretation of defence purposes, but part 2 says that they should be set out in regulations? Is that a drafting error? Would it not be simpler to have the same reference, with a direct read-across? The term "defence purposes" is mentioned throughout the regulations, but I cannot find a definition. It may be that I have missed it. If I have not, can the Bill be redrafted so the same definition applies in parts 1 and 2?

Mr Dunne: This is another important clause. I suspect that our debate on this clause and the two previous clauses will represent the greatest part of our discussions today, because they provide the opportunity to clarify and explain what the provisions seek to do.

The hon. Lady tabled several amendments to clause 14. Amendment 31 would require the Secretary of State to consult with industry before making single-source contract regulations. As the Committee is aware, many aspects of the single-source framework in part 2 will lie in regulations rather than primary legislation, and many of the clauses in part 2 will give the Secretary of State the power to make those regulations. That will allow the regulations to be updated regularly every five years without the need for additional primary legislation. Most of the regulations are the so-called single-source contract regulations, which I recently provided to the Committee

[Mr Dunne]

in draft. The amendment would make it a precondition that before making the regulations the Secretary of State must consult with industry.

I would like to reassure the Committee that we are aware that the new single-source framework represents an important change to our single-source procurement. We have, as a result, been consulting closely with industry for a considerable period, throughout the development of part 2, on both the Bill and the detail of the regulations.

Lord Currie published his report in October 2011. Subsequently, we ran a full public consultation, which was completed in January 2012. In April 2012, we started a defence suppliers forum sub-group with our top 10 single-source suppliers. That includes BAE Systems, Finmeccanica, Rolls-Royce, Babcock, Thales, MBDA, QinetiQ and others. Over the past year and a half, we have met with the sub-group more than a dozen times to share our proposed approach and to understand their concerns. I have personally met them twice since being in post.

Beneath that forum, we have also established four technical working groups on specific matters, such as confidentiality, the SSRO and risk. That is a substantial degree of consultation—more than is typical for introducing new Government policy. It has resulted in our making some important changes to the framework. For example, we introduced a new criminal offence to protect sensitive industry information under the single-source regime. We will continue that consultation for many more months.

We will soon share with industry the draft regulations provided to the Committee last week. I anticipate a considerable number of comments, and I will ensure that industry's concerns are carefully considered before the regulations are finalised.

It is certainly not in our interest to create an unworkable framework. For one thing, we pay for any additional overheads that our suppliers incur, which will be incorporated into the single-source prices, provided that they are fair and reasonable. We also need the capability they provide, and have no desire to make it hard to do business with the MOD. Indeed, it is because of our desire to ensure that the framework is as practical as possible that we have consulted industry to the extent that we have. Industry cannot credibly claim that we have not consulted them before the making of the first regulations.

Alison Seabeck: Clearly, the discussions that the Minister and his officials have had with the defence suppliers forum have helped inform some of the way in which the Bill is worded. How confident is he that those in the supply chain are feeding into the process? Is he confident that they have had discussions on the impact of some of the changes on the supply chain?

Mr Dunne: The discussions have been handled through the defence suppliers forum, but they have also been undertaken with the trade bodies—ADS being at the fore. Other trade associations have also been made aware of our discussions, so there has been plenty of opportunity for them to consult their members, but I cannot answer for any of the trade bodies on the extent to which they have done so. The fact that the regulations have been under consideration since Lord Currie published his report has made it widely known across the defence industry that we are heading in this direction.

Returning to the hon. Lady's amendment, we want the new framework to be kept up to date. We do not want to end up again in the situation that we find ourselves in now, namely with a framework that is 45 years old, clearly out of date and virtually incapable of being revised or improved. That is why we have introduced a statutory duty for the Secretary of State to review the regulations every five years, which is set out in clause 38.

Changes will, of course, be put before Parliament, admittedly through the negative procedure. Considering the technical nature of the regulations, I am sure that the Committee will agree that that procedure is suitable. The Delegated Powers and Regulatory Reform Committee will of course consider the regulations in more detail when the Bill goes to the Lords.

In making any changes, the Secretary of State must have regard to any recommendations made by the SSRO. It is anticipated that as guardians of the new framework, the Secretary of State will follow the recommendations of the SSRO, except where there is a compelling policy reason not to. The SSRO's recommended changes will be publicly available, and any deviation from them will therefore also be public. In making its recommendations, the SSRO will follow a rigorous process. First, it will draw on its experience in monitoring and analysing single-source procurement.

11.25 am

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

Adjourned till this day at Two o'clock.