Public Bill Committee

DEFENCE REFORM BILL

WRITTEN EVIDENCE

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

PBC (Bill 084) 2013 - 2014

Distributed by TSO (The Stationery Office) and available from:

Online
www.tsoshop.co.uk

Mail, Telephone, Fax & E-mail
TSO
PO Box 29, Norwich NR3 1GN
Telephone orders/General enquiries: 0870 600 5522
Order through the Parliamentary Hotline *Lo-call* 0845 7 023474
Fax orders: 0870 600 5533
E-mail: customer.services@tso.co.uk
Textphone: 0870 240 3701

TSO@Blackwell and other Accredited Agents

The Houses of Parliament Shop
12 Bridge Street, Parliament Square
London SW1A 2JX
Telephone orders: 020 7219 3890
General enquiries: 020 7219 3890
Fax orders: 020 7219 3866
Email: shop@parliament.uk
Internet:
http://www.shop.parliament.uk

32810

Contents

Written evidence

Written evidence from the Defence Police Federation (DR 01)

The Ministry of Defence Police

1. The Ministry of Defence Police (MDP) performs a vital service in protecting Ministry of Defence (MOD) assets and the wider general public from terrorist threats by providing general policing. It is primarily responsible for delivering police, investigative and guarding services to MOD property and installations, personnel and their families.

2. The MDP is a unique and specialised national civilian police service, focused on the defence community, providing it with the same service as any of Britain's local police forces, as well as armed and unarmed security at key defence sites, and the protection of Britain's nuclear deterrent and Critical National Infrastructure.

3. The MDP is the MOD's own dedicated civil Police Force of approximately 2,600 officers—all with constabulary powers—and in the region of some 250 civilian staff. It operates in two functional (Nuclear & Territorial) Divisions, serving MOD establishments and units throughout the United Kingdom and is headquartered in Wethersfield in Essex.

4. The MDP provides defensive armed policing—with all our officers trained and authorised to carry firearms, as well as less lethal options, outside the wire and has full constabulary powers within its areas of responsibility.

5. The Defence Police Federation is the staff association of the MDP. It was founded in 1971 after the amalgamation of the representative bodies of the police forces for each branch of the Armed Forces, from which the MDP was formed.

The key functions of the Ministry of Defence Police

6. The Statement of Requirement relating to the MDP identifies a number of key outputs:

- armed guarding and counter terrorist activities;
- protection of defence personnel and property and uniformed general policing;
- criminal investigations and fraud;
- international policing and training;
- the largest number of specialist search dogs of all UK police forces;
- protection of the UK's nuclear assets, both at bases and in road conveys; and
- special capabilities, such as the largest marine support unit of any of the police forces in the UK.

Views on the Defence Reform Bill

7. The Defence Reform Bill directly affects the MDP, with Clause 5 introduced to ensure that the MDP can continue to exercise jurisdiction on premises used by a potential GoCo contractor for the provision of defence procurement services—including any vehicles, vessels or aircraft and any new site utilised by the contractor for these purposes. The clause is also intended to allow the MDP to investigate criminal offences, including fraud, which relate to the provision of defence procurement services—this includes criminal offences which concern contracts between the contractor and third party contractors.

Financial risks/fraud and loss

8. The DPF has a number of specific concerns about the potential operation of a GoCo, which we have outlined below—we hope that the Committee will be able to examine these issues during its consideration of the Bill.

9. It is a well acknowledged fact that Defence Equipment and Support needs significant improvements in the way it functions, but we are concerned about whether the proposed arrangements for a GoCo will adequately address the problems identified with how defence acquisition works at the moment. For example, will it address the incentives which lead personnel to add costs to procurement projects once they have been approved, allowing the cost of procurement projects to spiral out of control? Without this, it is difficult to see how the GoCo arrangements could save significant amounts of money.

10. One of our key concerns relates to how the financial risks arising from procurement will be distributed, given that the GoCo would have shareholders and aim to make a profit. If the GoCo loses money, will it be responsible for these losses, or will they be passed onto the MOD? Clarity on these arrangements is vital if the MOD is to make genuine savings through this model. The explanatory notes to the Bill suggest that while the Secretary of State will remain responsible for defence procurement, it may be necessary for the contractor to exercise a discretion of the Secretary of State in respect of procurement functions.

11. Concerns about accountability have been raised by other stakeholders—notably RUSI, who have also raised questions about ministerial and parliamentary oversight, the financial risks involved, and how the risks

will be assessed. ADS, the defence and aerospace trade group, has also raised concerns about how financial risk will be divided between the MOD and the GoCo.

12. We would also be keen to understand the assurance and monitoring process for the GoCo in further detail; the DPF has previously expressed concerns about the assurance processes operating within the MOD. The MOD's current methods of accounting for equipment and resources is wholly unfit for purpose and the level of loss within the Department masks a greater problem of theft than the MOD is prepared to admit. Problems have been identified with accounting and storage process, and many thefts are written off as losses—this is not only inefficient, it also puts large amounts of taxpayers' money at risk.

13. Our concern that is that this lack of accountability could be further increased by the move to a GoCo structure, with ministers able to distance themselves from problems. We would welcome further clarity on the monitoring and assurance processes which will be put in place.

14. In addition to this, we believe that MDP officers (principally those within Criminal Investigation Department) could be used more proactively and effectively to reduce the levels of loss/theft suffered by the MOD. Instead, the MOD has moved to significantly reduce the role of the MDP CID in investigating fraud and loss. The MOD has also decided to only investigate crime above a certain financial value—ignoring crimes such as fraud on travel expenses which are smaller individually but together cost a significant amount of money per year. In addition, these smaller-scale crimes tend to be simpler to investigate and take less time to complete—meaning there are greater opportunities for recovering money, including through asset forfeiture.

15. There has been some discussion of setting up an MOD wide counter fraud and loss team, but progress on this has stalled and it would be useful to find out further information about future plans for this.

16. With significant amounts of public money being spent by the GoCo, it is vital that a proper assurance process is in place, and that it is clear who will ultimately be held responsible for fraud and loss. This is particularly important since Clause 3 of the Bill states that the MOD will be liable for any claims made against a current or former contractor.

Other concerns

17. It would also be helpful to have more detail on Clause 2, which sets out provisions for the Secretary of State to provide financial assistance to the contractor—as so far detail has not been provided on the circumstances where such financial assistance may be offered.

18. There needs to be consideration of how security will be provided to sites operated by the GoCo to ensure that this does not lead to unnecessary costs—as an example, QinetiQ makes use of security from the MDP to fulfil license requirements—but adds a 5% mark up when this is billed back to the MOD.

19. We understand that services relating to naval bases and defence munitions sites will inititally be out of the scope of the GoCo, but given the strategic importance of these sites we would be keen to gain clarify on this in the future.

Conclusion

20. The Bill will directly affect the Ministry of Defence Police given its responsibility for providing security for defence establishments, assets and personnel; in addition to investigating incidents and offences pertaining to the Ministry of Defence. As such, officers of the MDP should continue to exercise their current levels of jurisdiction under a GoCo model.

21. A GoCo must address current issues of procurement within DE&S, in particular those of incentives leading to personnel adding costs to procurement projects, thereby causing overall cost to increase exponentially. Failure to address this issue will significantly limit a GoCo's ability to deliver savings.

22. The issue of whether it is the private sector partner or the MOD that shoulders financial risk under a GoCo model must be clarified and this will require a reconciliation of the MOD's desire to achieve savings with a private sector contractor's presumed interest in generating profit.

23. There must similarly be greater clarity as to the accountability of a GoCo and the nature of ministerial and parliamentary oversight.

24. There must be clarity over the GoCo's assurance processes, given that the processes employed by DE&S are unfit for purpose, resulting in significant losses to the MOD and potentially masking a larger issue of theft from the Department.

25. The MDP CID should be used more effectively and proactively than at present to minimise the loss and theft of assets under a GoCo model. This includes a greater emphasis on the investigation of smaller scale thefts and frauds as opposed to a focus on 'prestige' offences in the form of large-scale complex frauds. Addressing these smaller incidents could result in the recovery of significant assets for the MOD.

26. There must be clarity on the responsibility of the secretary of state to potentially provide financial assistance to a private sector contractor within a GoCo model.

August 2013

Written evidence from the Federation of Small Businesses (DR 02)

With around 200,000 members, the Federation of Small Businesses (FSB) is the UK's leading business organisation representing the interests of the self-employed and those who run their own business. Small businesses make up 99.3% of all businesses in the UK, and make a huge contribution to the UK economy. They contribute 51% of the GDP and employ 58% of the private sector workforce.

We welcome the Defence Reform Bill and the measures it contains to support and encourage businesses to employ a member of the reserve forces. The FSB has long recognised the potential value and benefits that members of the reserve forces can bring to a business. We have had a positive relationship with SaBRE for a number of years now and work together to give effective advice and support to small businesses employing Reservists. We think that this support can be continuously built on and improved. It is particularly important that the MoD appreciates the views of small and micro businesses and how the proposed changes to the reserve forces may impact on them.

The research findings in this submission are based on a snap poll made available to the FSB 'Voice of Small Business' Survey Panel during December 2012 and January 2013. 6,352 panel members were invited to take part in the poll designed and hosted by Research by Design. The fieldwork took place between Monday 17 December 2012 and Thursday 3 January 2013. One reminder email was sent to non-respondents and 1,836 responses were received representing a 29% response rate.

The main findings from the poll showed that:

— Almost 40% (38%) of small businesses would consider employing a Reservist in the future and 7% currently or have previously employed a Reservist

— Of those who would consider employing a Reservist and those who currently or have previously employed a Reservist, there are mixed views with regard to the likely impact on businesses of the proposed changes to increase the commitment of reserve forces; two in five believe the proposed changes will negatively impact on their business, whereas 43% claim there will be no impact

— Approximately half of small businesses (48%) said that they would ideally require two to three months notice if one of their employees were to be mobilised to minimise the impact on their business

— There are a number of areas where businesses could be incentivised to take on a Reservist. Businesses would appreciate a financial incentive (39%), help in finding replacement staff (30%) and flexibility in training schedules (21%)

— FSB members are particularly keen on any Government support specifically targeting the needs of small and micro businesses rather than big business; it's clear for example that most small businesses (89%) have not heard of MoD employer awareness events

— Businesses believe that potential employees should always be clear and upfront and inform the business if they are Reservists (95%)

Our interest in the Bill very much focuses on Part 3.

Call out of members of reserve forces

The FSB has had concerns regarding the intention of the Bill to extend the call-out powers in the 1996 Act so that members of the reserve forces may be called out for any purpose for which regular forces may be used. On average FSB members employ approximately 7 employees, so if one is a member of the reserve forces and called out, instantly a significant proportion of the workforce becomes absent. There are mixed views from the small business community with regard to the likely impact on businesses of the proposed changes to increase the commitment of reserve forces; two in five of those open to employing Reservists believe the proposed changes will negatively impact on their business and reasons for this focus upon the difficulties in planning and arranging suitable cover for the extended training periods or deployments, whereas 43% claim there will be no impact.

Payments to employers of members of the reserve forces

Given the potential disruption to a business if a member of staff is called out, financial incentives are important to businesses looking to take on a member of the reserve forces with 39% citing this. We welcome proposals in the legislation to compensate employers a maximum of £500 per month and note that this should cover some of the cost of replacing an employee who has been mobilised. Whether £500 will be sufficient remains to be seen.

Other factors that have an impact on a business's ability to plan for the future are also extremely important to members and so we would ask that in addition to payment for employers, employers are also given help in finding replacement staff (30% consider this important) and that training schedules are flexible (considered by 21% a key incentive). In addition approximately half of members have asked for two to three months notice if one of their staff is going to be deployed. The commitment to making deployment more predictable, giving employers more notice and telling them about training should help small firms plan cover for the employee that will be away. There is no doubt that for the smallest businesses this will be a challenge.

FSB members are also particularly keen on any Government support specifically targeting the needs of small and micro businesses rather than big business and it is clear for example that awareness of MoD employer

awareness events is very low and that this could be improved. It is striking that we have such a low level of engagement between small businesses and our forces today, as evidenced by nearly nine in ten, (89%) of members, stating they had never heard of the awareness events that are held around the country from time to time. The FSB is happy to offer to help the MoD to publicise these events to our member firms, across the country via our national and local social media channels and weekly e-newsletter.

Unfair dismissal of reserve forces: no qualifying period of employment

Employment regulations often pose a challenge for small and micro businesses that naturally have a less formal approach to running their business since they lack the resources of a larger counter-part. Small and micro businesses are generally amongst the best employers and in general employees are happiest working for smaller firms. However, small and micro businesses can also be put off from taking on staff if it will be overly burdensome for them. Views on whether small and micro businesses would consider employing a member of the reserve forces were positive with almost 40% of small businesses saying they would consider employing a Reservist in the future and 7% stating that they currently or have previously employed a Reservist.

Even though we see the rationale to consider legislating in order that unfair dismissal qualifying periods of employment should not apply if the dismissal is connected with the employees membership of the reserve forces, we would not want to see further changes to employment regulation in relation to reserve forces as this could add to a business's uncertainty about taking on a member of the reserve forces.

An overwhelming majority of 95% of businesses surveyed said that potential employees should always be clear and upfront and inform the business if they are Reservists, so that they can be supported.

The Employers Charter that is now in place should make a positive contribution.

Further support for businesses employing a member of the reserve forces

The FSB believes the Defence Reform Bill could go further in introducing measures to encourage small and micro businesses to employ a member of the reserve forces, and indeed regular members of the Armed Forces when they have completed their service.

Undoubtedly members of the reserve forces have strong skill sets which will be useful to a diverse range of businesses. Given this, the FSB suggests that in certain sectors where particular skills are essential, there is a 'central pool' of labour that could fill vacancies for any employer. Secondly there could be a far better way of 'matching' regulars (and possibly those Reservists) who wanted to find a job, with employers who had vacancies—in essence an MoD-led 'matching service' which could operate online but also at Job Centre Plus branches, Armed Forces Recruitment centres, and Territorial Army (TA) centres.

Further issues for clarification

There are also some fairly fundamental questions around detailed support—in particular when a Reservist returns to their civilian role, and any apparent medical condition becomes apparent at a later date. This will inevitably lead to questions around liability, issues over sickness absence and possibly finding another replacement to cover what in essence is not a further deployment, but a further absence of their employee for a longer period than anticipated. It raises important questions under current employment legislation.

Concerns have also been voiced if TA centres are to be amalgamated as the large majority of Reservists engage because their TA centres are local, and they have colleagues or friends serving as well. If extended travelling which is remote from where they live is to happen either to their local centre, or to training grounds, then this could raise further issues. The extension of training though from 35–40 days unless a business operated shift patterns over the weekends, should not cause the majority of employers any problem.

Finally, although the accredited military training that Reservists will receive should help develop highly valued skills that can be easily transferred to their civilian roles, the accreditation process will need to be understood and meaningful to employers. At the moment, businesses do not know what Reservists will be accredited to and what areas the training will be in.

Conclusion

Although there is appetite amongst small businesses to employ members of the reserve forces it is clear that without government aids small businesses find employing a Reservist an administrative, financial and resourcing challenge. This coupled with the fact that many small businesses are of the view proposed changes will have a negative impact on their business means that Government support to specifically target small and micro businesses would be welcome. Financial incentives are the preferred means of encouraging small businesses to employ Reservists, but other measures such as help with finding replacement staff and adequate notice of when staff would be mobilised would also be useful. It is also extremely important to small businesses that potential employees tell them if they are members of the reserve forces. Finally, it is clear through our survey work that more should be done to engage small and micro businesses with MoD employer awareness events.

August 2013

Written evidence from Prospect (DR 03)

Introduction

1. Prospect is an independent trade union representing 120,000 professional, managerial, technical and scientific staff across the private and public sectors. Our members work in a range of jobs in a variety of different areas including in agriculture, defence, energy, environment, telecommunications, heritage and scientific research.

2. Within the defence sector, Prospect has approximately 13,000 members split evenly between the MOD and defence contractors. The MOD contingent includes over 2,000 members in Defence Equipment and Support (DE&S) with the remainder working in other technical and specialist roles in direct support of the armed forces, from the Defence Infrastructure Organisation through military training and education, to research and analysis in Dstl and Defence Intelligence. Private sector companies where Prospect has a significant membership include QinetiQ, AWE, BAE Systems, Babcock and Serco. Many of our relationships with these companies formed when MOD functions have been contracted-out or privatised over the last 30 years. As such, Prospect has extensive experience of the move of Civil Service functions to the private sector.

3. The Defence Reform Bill contains provisions which are likely to have a significant impact on the majority of Prospect members employed in the Defence Sector. We welcome the opportunity to contribute evidence to the committee. The views in this memorandum reflect Prospect policy as well as the comments and views of elected officials and members on their reaction to the government's proposals.

4. The key points and issues for clarification raised are summarised in the section below. Detailed comments are provided in later sections.

Summary of key points and issues for clarification

5. The government is right to seek to modernise defence procurement. The MOD summarises the challenges thus:

> *... identified three "root causes" of underperformance; an over-heated Equipment Programme; an unstable interface between those parts of the MOD which request acquisition and support services and the Defence Equipment & Support organisation (DE&S) which delivers them; and a lack of business capability (processes, tools and skills), including management freedoms.*[1]

The key question for Prospect is: how do the changes enabled by the Defence Reform Bill 'fix' these problems? The Impact Assessment goes on to acknowledge that Defence Transformation has already started to address some of these issues, but suggests that the DE&S GOCO is required to correct "Poor specification by the Armed Forces, a lack of understanding of cost drivers, poor initial cost estimation and insufficient project control by the DE&S".

6. Repeated statements by both CDM and the Secretary of State have made it clear that the principal driver for the DE&S GOCO being the preferred option is the need to remove the staff from the Civil Service and, as such from direct control of the Cabinet Office and the Treasury; in other words, the 'freedom' to recruit, reward and release staff. Prospect certainly shares one of the three declared objectives of the Materiel Strategy: "a DE&S with engaged and motivated staff with the behaviours, accountabilities, skills and processes required to do the job."[1] Indeed, we have been trying to highlight the impact of the long-term erosion of technical and specialist capability (the loss of the 'intelligent customer') for years, but have been ignored. However, we are at a loss to understand why (other than dogma) the government refuses to allow DE&S to reform its own HR policies and processes and why, therefore, such a huge change as the creation of a GOCO—with all the risks that entails—is required.

Any projected savings that favour the GOCO over DE&S+ have to be a lot more than marginal if these risks are going to be acceptable

7. In fact, Prospect would argue that DE&S is simply the most high-value and visible example of the loss of capability to do this sort of work across the Civil Service. This is a result of the failure of successive government's both to recognise the specialist skills required in the Civil Service and to understand how those skills need to be developed, nurtured and rewarded. 'Fixing' DE&S will not fix rail franchising and it will not fix IT procurement.

8. We challenge the notion that GOCO is the solution to these problems. It might be *a* solution, but there are better solutions. The only obstacle to reform within the Civil Service appears to be government policy on the pay and conditions and personnel management of civil servants. We agree that these policies are not sensitive to the particular requirements of a highly complex and specialist business as defence procurement. But, shouldn't that fact inform a change in government policy?

9. If the Treasury and Cabinet Office view is that DE&S staff must be subject to the 'vanilla' management applied to the rest of the civil servants, then the government has to quantify the additional costs and risks

[1] Evidence Base, *Defence Reform Bill Impact Assessment*, MOD, July 2013

presented by the GOCO option. This is a huge and potentially very expensive change for what appears to be an easily-realised prize.

10. In short, Prospect believes the GOCO solution will not work. Not withstanding the juicy carrots being dangled in front of them, our members believe that their activities should be conducted by the MOD for Defence, not outside of the MOD for profit.

11. If GOCO is to happen, Prospect seeks some key reassurances:

— Renewal of the enabling agreement between industry, the MOD and the unions on the handling of staff transfers to industrial partners. This will help secure an orderly change.

— No two-tier workforce: if enhanced terms and conditions are introduced for new GOCO employees, then staff who have transferred-in should benefit from those changes.

— The New Deal arrangements being designed for the PCSPS should be applied, ensuring that staff take membership of the PCSPS with them into the GOCO and all new employees of the GOCO become members of that scheme.

12. Prospect is broadly neutral on the proposals relating to Single Source Contracts, but we do have significant experience of regulated industries (including representation of the staff in most Regulators) which raises a number of questions about the MOD's plans. Fundamentally, it is difficult to see where the MOD will draw this and other intelligent customer communities from when it has contracted-out much of its technical and commercial expertise.

13. The SSRO should be tasked with some responsibility for using defence procurement to sustain the industrial skills base and ensuring that key capabilities required in the long-term are not lost.

Part 1: Defence Procurement

Scope of the GOCO

14. The Defence Secretary's statement on the Bill suggested that the GOCO will assume responsibility for the current DE&S's procurement functions alone—approximately half the present staff. The plans for equipment support are less clear and, therefore, the objectives and implications of the Bill are unclear. Through Life Capability Management (TLCM) envisaged a 'cradle to grave' approach to defence acquisition: a single contract for the design, manufacture, support and disposal of equipment, with, in its purest form, the contract specifying the availability of a military capability rather than specific numbers of particular bits of kit. As with so many change initiatives in the MOD, TLCM was not allowed to prove itself (and was not evaluated) before being overtaken by The Next Big Thing.

15. But support accounts for a growing proportion of equipment spending. As RUSI observed recently:

> *The MoD is also likely to be asked to look at its growing expenditure on equipment support (which now accounts for a third of the resource budget) as a possible source for savings. While the total defence budget is due to fall in real terms by 7.8% between 2012/13 and 2014/15, planned equipment support spending is due to rise by 5.6%. These numbers suggest that equipment support spending has been relatively unaffected by the rationalisations and reductions set in motion by the SDSR.*[2]

16. It appears that support activities will variously be transferred to the Front Line Commands (HMNaval Bases), privatised (DSG), contracted-out (LSC), or a combination of these. Is this the end for TLCM? How will the Bill address the cost inflation RUSI has identified? Cost inflation that is arguably a product of the extensive privatisation and contractorisation of support activities over the last 30 years. And this has levied the additional cost of a loss of technical capability within the MOD, with the loss of its nursery for the development of engineering managers and project managers with direct industrial experience.

Employment in the GOCO

17. Prospect seeks some key reassurances:

— Renewal of the enabling agreement between industry, the MOD and the unions on the handling of staff transfers to industrial partners. This will help secure an orderly change.

— No two-tier workforce: if enhanced terms and conditions are introduced for new GOCO employees, then staff who have transferred-in should benefit from those changes, including career development opportunities.

— The New Deal arrangements being designed for the PCSPS should be applied, ensuring that staff take membership of the PCSPS with them into the GOCO and all new employees of the GOCO should have the option to become members of that scheme.

18. In addition to the normal procedures to comply with TUPE, there is a tripartite agreement—the *Code of practice for staff transfers in MOD Contracts*—between MOD, the unions and industry. This was signed by a Minister for the department and by the CBI and the Defence Manufacturers Association for industry. Prospect

[2] RUSI Briefing Paper *Mid-Term Blues? Defence and the 2013 Spending Review*, February 2013 Malcolm Chalmers

believes this agreement should be renewed, amended as necessary to ensure that it is fit for the purpose envisaged by the Bill.

19. The MOD's Impact Assessment says:

> *It is envisaged that the GOCO partner (in relation to the Operating Company) would seek to benefit from greater HR freedoms and flexibilities to change culture and behaviours in DE&S, subject to compliance with employment legislation* ***and any restrictions imposed by the GOCO contract****.*

What would these restrictions be? We suspect that the dead hand of the Treasury might continue to restrain the GOCO.

20. We could provide the Committee with extensive evidence on the problems created for DE&S by its inability to recruit, develop and reward specialist staff properly. We have submitted evidence on this issue to both the Defence Committee and the PAC in the past. Suffice to say: there is growing evidence of severe shortages in key specialist areas, resulting in major capability gaps. The costs of the neglect of specialist skills in the MOD are all too apparent: safety incidents (Nimrod XV230), engineering disasters (Astute) and increased costs (the explosion in FATS spend).

21. The Impact Assessment continues:

> *It is envisaged that:*
>
> *The Contracting Entity would have the freedom (in relation to the Operating Company) to set its own talent management strategy (recruitment, retention, reward and release of staff) and could introduce changes to the contractual employment terms of transferred civilian staff (through the normal course of business) subject to consulting employees and their representatives in line with employment law; and,*
>
> *The Contracting Entity would be free to provide new recruits to the Operating Company with a different employment contract. The Contracting Entity would also have the freedom (within certain constraints) to manage the terms and conditions of its employees in the Operating Company to deliver the required outputs.*

This seems to herald the creation of a two-tier workforce: the bulk of the DE&S staff on legacy terms and conditions, failing to benefit from the release from Treasury control, while external recruits to the GOCO are brought in on higher pay and lucrative bonus schemes. Prospect requires reassurance on this—ideally through provisions in the Bill. DE&S is already seeking to recruit staff externally through the use of financial incentives (known as Higher Starting Pay, or HSP) leapfrogging existing staff who have been subject to pay restraint over recent years. Internal candidates successful in applying for posts advertised with HSP are deemed ineligible to benefit from the enhanced pay. This is having a catastrophic impact on morale within DE&S.

Prospect wants to see the Bill outlaw the creation of a two-tier workforce in the GOCO

22. One of the unspoken drivers for the GOCO is the desire to remove military officers from procurement decisions. It is an open secret that military staff in leadership positions in DE&S are in post for too short a time to build expertise, that specifications are changed with the arrival of their replacement and that they owe their loyalty (and career prospects) to their Service, not to DE&S. The Defence Secretary suggested in the second reading of the Bill that military staff would be seconded to the GOCO to represent the customer (ie the Front Line Commands) and there is no doubt that this knowledge of operational requirements would still be vital. However, it is less than clear that this intention is shared. The MOD Impact Assessment says:

> *Military staff drawn from all three Armed Forces provide military skills, knowledge and experience to support the delivery of Defence acquisition in the current DE&S organisation. We envisage that this would continue under the GOCO operating model. The placement of military personnel in the Operating Company means they would not be employees of the Contracting Entity or the Operating Company.*

The role of military officers in the GOCO needs to be clarified

23. Reassurances on these issues would be welcome. But we return to our fundamental question: if the case for GOCO is built principally on the need to employ the right people properly, why can't that be done within the Civil Service? The MOD has not exploited the pay flexibilities that do exist; it has not advocated the need for a different employment framework for specialists sufficiently strongly and the result has been the imposition of dysfunctional systems.

Assessment of the GOCO option

24. In recent years, numerous steps have already been taken to address the MOD's problems: most recently with Defence Transformation. DE&S's performance is arguably much-improved in the last five years. But he most recent changes have not had time to prove themselves. How will the potential impact of the GOCO option be assessed *ceteris paribus*?

25. The GOCO decision is to be determined through assessment against an in-house benchmark: DE&S+. It is not clear whether the team developing DE&S+ are being given the same level of resources and support as the other bidders have at their disposal. Of greater concern is a statement in the MOD's *Explanatory Notes* to the Bill; under the heading *Financial effects*, paragraph 166 says:

> *If the Part 1 arrangements are made, they are expected to deliver a net benefit of £934m over 10 years. The new arrangements will be established in stages and steady state is expected by 2024/2025. Should the public-sector comparator (DE&S+) option be chosen, savings are estimated to be a third lower.*

It is not clear where this assessment comes from and we urge the Committee to seek further information on this. The forecast returns from any reform should be robust and significant enough to justify the risks.

26. The GOCO will present new costs: most obviously the margin charged by the consortium. And it presents new risks: an extra layer of decision-making, the need for an extremely complex contract and the replacement of political control with commercial control. Is the possibly marginal improvement to be gained by GOCO worth the additional costs and risks? Is a one-year pilot enough to test the change?

Part 2: Single Source Contracts

27. The creation of the Single Source Regulations Office represents a significant increase in the oversight of non-commercial contracts in the defence sector, which is expected to deliver a net benefit of £1,712m over 20 years, with steady state benefits of circa £190m per year.

28. Prospect accepts that the 'Yellow Book' procedures need to reflect the industrial landscape of the industry. However, it is important to note that the guidance has been periodically updated by the Review Board for Government Contracts. The decision to create a new regulatory body appears to be driven by the government's determination to increase transparency and to share gains and losses accrued through these contracts. The failings in the current process are rooted in the lack of requirement on contractors to supply the MOD with sufficient information on the pricing of contracts, which results in poor oversight by MOD of contract price outcomes.

29. While there may be benefits in creating an independent regulatory body to scrutinise contracts and ensure that value for money is being obtained from non-commercial contracts; there is clearly a concern that the creation of the SSRO causes a degree of uncertainty for defence contractors. A possible result of the increased scrutiny of the pricing of contracts and company overheads by the SSRO may inadvertently cause job losses, as contractors trim budgets to comply with stricter transparency rules. Increased scrutiny may reduce profits on existing contracts and a stricter application of the rules may create perverse incentives on contractors to reduce efficiencies on future contracts to stay within an agreed price. There is also an additional cost on contractors from the part funding of the SSRO by contractors. While the formula set out in the bill that determines the profits rate, based on the approach developed by the Review Board for Government Contracts, seems to be reasonable, the process of transition may still have a significant impact on some contracts as contractors adjust to the tighter regulatory framework. As a result, Prospect is not convinced that the projected savings will be achieved in practice. The move towards greater regulation of non commercial contracts is likely to cause a behavioural change by employers. This outcome may be desirable from a value for money perspective, but may not generate any additional income for defence contracting.

30. An important element of the contract price is the payment of labour costs. These costs are uncertain and will be subject to the prevailing labour market conditions. Under Clause 20, the SSRO can issue guidance on allowable costs that are "appropriate" and "reasonable". Labour market costs can vary considerably over the course of a long-term contract. Pay bargaining takes account of a number of different factors including affordability, employee development, adjustments to take account of the cost of living, addressing changes in the composition of the workforce and the emergence of skills shortages. In our view the pay budget is best negotiated through collective bargaining arrangements between the contractor and the appropriate recognised trade unions. It would be inappropriate for the SSRO to provide guidance on pay bargaining and attempt to micro-manage pay arrangements within the defence industry.

31. Prospect is concerned that the regulator will not be able to make an informed judgement about the industrial skills needed within the sector. The requirement under Clause 24 to ensure that there is not double counting of overheads by contractors, including industrial skills, would require a high degree of knowledge of the skills needed within the defence sector. At present there is a significant gap in this kind of knowledge of skill needs, both across industry and within the MOD, of the skills needed within the defence sector. This particular clause may deter contractors from investing in the skills needed where these costs are accounted for across a number of different contracts. There needs to be greater clarity about what overhead costs are allowable for skills development and how these will be audited by the SSRO.

32. Without a detailed breakdown of the SSRO it is not possible to judge whether the regulatory body will be sufficient for the sector. The skills needed of those working for the SSRO will be similar to those working for DE&S and the private sector. These skills are highly valuable and so pay rates will have to set at a level that are sufficient to attract those with the skills needed for these highly specialised roles. This will need to include

appropriate competencies in the technical and engineering expertise required to make suitable assessments of defence contracts.

September 2013

Written evidence from ADS (DR 04)

The UK Defence Industry employs over 300,000 people—directly and through the supply chain. The UK is the second largest defence exporter in the world and is highly skilled, with 59% of workers holding a university degree or equivalent. It is research intensive, investing 8% of annual sales revenue in research and development.

Overview of Key Issues

Industry recognises that reform of defence acquisition and the Reserve Forces is necessary. Defence reform has four objectives—to ensure that our Armed Forces have the equipment and support they need; that the taxpayer receives value for money; that suppliers receive a fair return allowing them to invest for the future; and that there is predictability for industry.

UK industry supports reform of single source contract pricing and reporting, but the provisions in Part 2 (Single Source Contracts) present significant concerns. ADS's submission therefore focuses principally on Part 2 of the Bill.

Part 1—Defence procurement:

- There is **inadequate protection for suppliers' IP and commercially sensitive information (Clauses 7 and 8)**. IP is critical to the success of the UK Defence Industry and the Bill must consider proper safeguards or risk a loss of business confidence.
- MOD should **communicate the metrics it intends to use to assess the GOCO and DE&S+ options** even if it chooses not to define them in legislation.

Single Source Contracts:

- **The lack of political independence in the SSRO** (Single Source Regulations Office) **(Clauses 13 and 39; Schedule 4)**. The Bill appears to allow the customer (MOD) to control the regulator (SSRO). The checks and balances in the Pharmaceutical Price Regulation Scheme (PPRS) could be used as a basis for developing similar arrangements tailored to defence requirements.
- **Subsection 7 of Clause 14** allows the Secretary of State to exempt any Qualifying Defence Contract from the new regulations. Industry recognises that there will be occasions when it will be necessary to exempt a contract. However, **the circumstances and criteria when an exemption can be granted should be defined in a transparent manner.** Failure to do so may place UK suppliers at a disadvantage in the international market place.
- The new regulations will **create uncertainty over contract price (Clauses 18, 20, 21 and 23)** with possible adverse consequences for shareholder value, boardroom confidence to invest and the international perception of the UK as a good place to do business.
- **A failure to maintain the comparability principle**, which links the profit allowance on single source contracts to the average profit earned by a reference group of companies listed on the London Stock Exchange, **in Clauses 17 and 18** may undermine suppliers' willingness to participate in single source procurement and invest in the UK.
- The regulations may place a **heavy burden on subcontractors and SMEs (Clauses 27 to 29)** and ADS would ask that the scope of application of the regulations is defined.
- ADS supports the restrictions on disclosure of information in **Clause 37 and Schedule 5**, but protection of suppliers' information could be strengthened by amending Schedule 5 to include an **additional criminal offence of failure to protect suppliers' information. There should be a requirement for the MOD and SSRO procedures for protecting suppliers' information to be subject to audit by an independent third party to demonstrate their efficacy, replicating the responsibilities of a Data Controller under the Data Protection Act.**

Reserve Forces:

- **Clause 43, Subsection 4**, which extends the circumstances under which the Reserve Forces can be deployed, will place a **greater burden on employers, particularly SMEs employing Reservists** with unique skill-sets. Greater clarity is required on what appeals process will be put in place to protect employers.

PART 1—DEFENCE PROCUREMENT

1. *Inadequate protection of suppliers' IP and commercially sensitive information (Clauses 7 and 8; Schedule 2)*

1.1. A willingness to invest in the R&D creates "hard IP". This, in addition to "soft IP" (eg unique business models), are factors that explain the UK Defence Industry's global success. Elements within the consortia bidding for the GOCO contract will at times inevitably compete, both in the UK and abroad, with companies not bidding for the contract. **The Bill must provide safeguards to ensure UK industry IP is protected. Sanctions should be put in place to deter IP infringement, deliberate or otherwise.**

1.2. Clauses 7 (Restrictions on disclosure or use of information) and 8 (Intellectual property rights) secure the Secretary of State new legal rights to disclose IP and commercially sensitive information currently held by MOD. This will include private and commercially sensitive information to which MOD has been given access outside of a contractual obligation in circumstances where the owner has had a reasonable expectation that MOD would hold it in confidence and not disclose it to a third party.

1.3. Clause 7 gives effect to Schedule 2, which allows the Secretary of State to disregard confidentiality obligations under any defence procurement contract where it is "necessary or expedient" under Clause 1, which sets out the arrangements for providing defence procurement services. Clause 8 allows MOD to disregard the rights of owners of work protected by copyright or database rights. Disclosures are not required to be under conditions of confidentiality.

1.4. **Clauses 7 and 8 take rights away from the disclosing party or copyright owner without any right to objection and without compensation.**

1.5. **ADS has serious concerns about the proposed provisions in Clauses 7 and 8. We recommend that, in the case of copyright, the existing Crown user rights under the IPR DEFCONS should be preserved.[3] Clauses 7 & 8 should therefore be removed from the Bill.**

1.6. Clause 37 in Part 2 of the Bill gives effect to Schedule 5, which creates a criminal offence of disclosing protected information. Part One does not include a corresponding provision.

1.7. A lack of sufficient safeguards may undermine MOD's ability to be an intelligent customer. Industry trusts MOD and is willing to give it access to its IP and commercially sensitive information. Without stringent safeguards, that confidence will be lost and companies may become unwilling to share their information with MOD. The consequence would be a more transactional relationship between MOD and industry.

1.8. **Part 1 should provide stronger safeguards to protect suppliers' IP and private and commercially sensitive information. A new clause should be introduced in Part 1 to provide for a criminal offence of failure to protect, or prevent the unauthorised use of, suppliers' protected information.**

2. *Communicating the metrics used to assess the performance of GOCO/DE&S+ (no applicable Clause)*

2.1. ADS recognises that the detail defining the function and purpose of the proposed GOCO will be contained in secondary legislation.

2.2. MOD may not wish to enshrine in legislation the criteria by which the success of the new contracting entity will be assessed. **However, MOD should communicate the metrics to both industry and Parliament.** ADS suggests that metrics might include: value for money; a reduction in the length and cost of bidding processes; greater stability in the funding and direction of the equipment budget; and increased staff skills and expertise.

2.3. Given that the GOCO will be awarded a contract of up to nine years, it is not clear how the contracting entity will be incentivised to take longer-term considerations into account. MOD should clarify the balance it seeks between short-term priorities (eg reducing the cost of the bidding process) and longer-term ones (eg maintaining critical capabilities).

PART 2—SINGLE SOURCE CONTRACTS

3. *A lack of political independence in the SSRO (Single Source Regulations Office) (Clauses 13 and 39; Schedule 4)*

3.1. The Bill gives the Secretary of State significant power over the SSRO, which risks a perverse situation in which the customer (MOD) holds substantial influence over the regulator (SSRO). The Secretary of State will appoint the Chair of the SSRO (Schedule 4, Subsection 1) and can remove any board member from office on certain grounds (Schedule 4, Subsection 4). Clause 39 gives the Secretary of State broad powers to repeal the new single source contract regulations and abolish the SSRO.

3.2. The checks and balances within the Pharmaceutical Pricing Regulation Scheme (PPRS) could be used as a model for developing a set of similar arrangements. For example, the PPRS states that parties must attempt

[3] Current MOD IPR policy follows Government policy. For contracts funded by MOD, ownership of IP arising from the contract is owned by the developer; however, MOD takes rights to use the IP itself or have it used by others for the purpose of government contracts free of charge. This allows the IP to be exploited more readily. DEFCON is the term used for MOD defence conditions. DEFCONs are standard form conditions of contract which are referred to in MOD invitations to tender and purchase contracts.

to resolve differences by negotiation before initiating the dispute resolution process; whilst an industry body is involved in the selection and appointment of the chairman of the panel established to adjudicate on disputes.

3.3. Industry will fund up to 50% of the running costs of the SSRO through deductions from the price payable under single source contracts without having a say over the body's outputs. The amount of funding will be determined each year by the Secretary of State on the advice of the SSRO and taken from payments made to contractors (see step 4 of the contract profit rate under Clause 17).

3.4. The cost of the current Yellow Book arrangements is approximately £270k per annum. The expected annual cost of the SSRO is £4m. **MOD should communicate the value of this significant increase.**

3.5. Past precedent demonstrates that the cost of non-departmental public bodies (NDPB) tends to increase over time. **ADS recommends that Clause 19, which sets out the process for determining the SSRO funding adjustment, is amended to ensure that the SSRO gives due consideration to how the burden of potential cost growth of the SSRO should be shared to ensure that overall profit margins are not adversely affected.**

3.6. **Schedule 4 requires amendment to enhance the impartiality and independence of the SSRO by:**

3.6.1. Ensuring that Industry is represented on the SSRO Board by allowing for a proportion of the Board's members to be nominated by an industry body in accordance with the procedures laid down by the Office for the Commissioner for Public Appointments, as in the case of the Technology Strategy Board and the Advisory, Conciliation and Arbitration Service.

3.6.2. Giving Parliament and/or an appropriate select committee an opportunity to scrutinise appointments of executive and non-executive members of the SSRO.

3.6.3. Ensuring that industry's contribution to the SSRO running costs reflects up to 50% of the cost of reviewing the profit formula periodically, creating and amending the Single Source Cost Standards, Single Source Contract Regulations and calculating the baseline profit rate annually.

3.6.4. Requiring that SSRO committees have a majority of members who are not members or employees of the SSRO.

3.7. The regulations made under Part 2 should also be subject to external consultation. **The Bill should be amended to ensure that, before making any regulations, the Secretary of State consults an industry body and any other bodies and persons he thinks fit; and has regard for the consultation responses by laying a report of the results and his conclusions before Parliament.**

3.8. **The SSRO should also be obliged to consult externally when it undertakes its periodical review of Part 2 of the Bill and the accompanying regulations and require the Secretary of State to have regard for the consultation responses by laying a report of the results and his conclusions before Parliament.**

4. *Defining the circumstances in which the Secretary of State may exempt a Qualifying Defence Contract/Sub Contract from the regulations (Subsection 7 of Clause 14)*

4.1. **It is of great concern to industry that the Bill does not state whether the regulations will apply universally, ie to overseas as well as UK suppliers.** Subsection 7 of Clause 14 allows the Secretary of State to exempt any single source contract from the new regulations. Industry recognises that there will be occasions when it is necessary to exempt a contract from the regulations. However, the circumstances in which an exemption can be granted and the criteria against which an application for an exemption is assessed should be clearly defined. Failure to include these measures may create an unlevel playing field in which it will be easier for overseas suppliers to obtain an exemption. UK companies may subsequently be disadvantaged.

4.2. Exempting overseas suppliers from the stringent monitoring and compliance regulations provided for in Clauses 23 to 26 and Clauses 30 to 33 respectively places an additional cost burden on UK suppliers and their supply chains, putting them at a competitive disadvantage in international markets. Overseas suppliers may fare better under the new regime than UK counterparts because their contracts are more likely to be exempt from the regulations. Single source contracts awarded as follow-on contracts to those placed as a result of competition are particular concerns (eg spares, support and Through Life Support contracts).

4.3. ADS notes that the Secretary of State may delegate his decision-making powers on exemptions to the new operating entity, which could have consequences for the accountability of decisions.

4.4. **The Bill must define the circumstances when a Qualifying Defence Contract/Sub Contract can be exempted from the regulations and the exemption process must be transparent.**

5. *Improving predictability over contract prices and profit (Clauses 18, 20, 21 and 23)*

5.1. Directors require a high degree of predictability over cost, price, and contract risks and obligations when approving tenders, authorising their submission and accepting contracts. They must be certain that the price will ensure a fair and reasonable return to shareholders for the risks taken.

5.2. The Bill may undermine predictability by allowing the SSRO to adjust the final price of a contract and monitor and adjust contract prices through a new reporting regime which gives MOD a general audit right and

places a responsibility on suppliers to demonstrate that a cost is "appropriate, attributable and reasonable". The uncertainty may have unintended consequences for shareholder value, group decisions on where to invest, and the perception in the wider market place that the UK is a good place to invest.

5.3. The sense of ambiguity is heightened by the absence of any obligation for MOD to respond, accept or approve cost and pricing data provided to it within a specific timescale.

5.4. **The legislation should contain an obligation for MOD and contractor to disclose to each other all facts likely to affect the agreed price of a contract. It should also require that the disclosures must be made at or before the price for the contract or amendment was agreed, and in sufficient time to allow the other party to assess and evaluate the information disclosed.**

5.5. As it stands, the logical end-point of the new regime will be for a supplier to refer its own contract to the SSRO at the start of a contract in order to gain greater confidence over price and profit. **MOD should make clear the purpose of the proposed new operating model and explain what assessment it has made of potential unintended behavioural consequences of the new regime.**

5.6. The final Bill must recognise the restrictions on publicly-listed companies and their subsidiaries when providing certain information under Stock Exchange regulations. **Clause 25 should be amended to read that "single source contract regulations *must* disapply a requirement [of the Bill]…to the extent that compliance with the requirement would…contravene a relevant restriction."** This would make mandatory the disapplication of the regulations when compliance with the requirement would breach legislation or private law.

5.7. **Boardroom predictability over price needs to be enhanced by amending the Bill to:**

5.7.1. Define the specific types of information that will be covered by the new regime.

5.7.2. Limit the number of times, and the timeframe in which, MOD can challenge a contract price.

5.7.3. Define how a cost will be determined to be 'appropriate, attributable and reasonable'.

5.7.4. Define the grounds on which a challenge to a contract price may be made.

5.8. Clause 21 states that the regulations may provide for adjustments to the total price, without stating a purpose or criteria for those adjustments. This creates uncertainty for the supplier on the total price of a contract. **The Clause should be amended to define the purpose for regulations on final price adjustment of qualifying defence contracts.**

5.9. Clarity over contract price could be improved by restricting the timeframe in which a contractor may be asked to show that the criteria for an allowable cost has been met in relation to a particular cost. As drafted, the Bill enables the Secretary of State to ask the contractor at any time to demonstrate that a cost is an allowable cost. **Given that the purpose of the Bill concerns the pricing of certain contracts, the period during which a request may be made should be limited to the period before a price is agreed or before overhead rates are agreed (Clause 20, Subsection 4).**

6. *Improving business confidence by setting the basis on which profit is determined (Clauses 17 and 18)*

6.1. The current Government Profit Formula and Associate Arrangement determines the Baseline Profit Allowance (BPA) and equates to the average profit earned by companies listed on the London Stock Exchange. In practice, the profit allowance on UK single source contracts is broadly similar to the profit earned for performing similar work in other countries such as the US, Canada and France.

6.2. The Bill does not define how profit allowance will be determined. Yet profitability is an important consideration when a board decides whether to bid for a contract. The consequent impact on profitability may undermine boardroom confidence in bidding for contracts.

6.3. Large defence contractors operate globally. An adverse change in profit earned from UK single source contracts in comparison to overseas contracts may undermine willingness to invest in the UK. The final profit formula should avoid encouraging suppliers to construct complex contract structures that have the net effect of offshoring the delivery of UK single source contracts.

6.4. **ADS recommends that Clause 17 be amended to enshrine the comparability principle and tie the BPA calculation to profit earned by wider UK industry.**

7. *Fair application of the regulations to subcontractors and SMEs (Clauses 27 to 29)*

7.1. SMEs are a vital part of the UK Defence Industry. Their flexibility and innovation provide great value to the Armed Forces and to the primes which they supply. ADS supports MOD's efforts to ensure that SMEs have more opportunities to become suppliers.

7.2. A significant proportion of MOD contracts are non-competitive: in 2011/12, 63% of the total number of new MOD contracts (4,598) were single source; 40% of the total value of MOD contracts were single source.

In 2011/12, 285 companies were paid £50m or less by MOD; 87 companies were paid over £50m.[4] A significant volume of contracts were therefore of relatively low value.

7.3. Primes may encounter significant practical difficulties in applying the new single source contract regime to their own suppliers. It is possible to envisage a situation in which a single source subcontractor, for whom defence work represents a small part of their business, declines a contract due to the onerous nature of the new regime. This has the potential to cause disproportionate disruption in supply chains and MOD programmes.

7.4. The burden placed on companies by the new regime may also act as a barrier to entry for SMEs seeking to enter the UK defence supply chain or as a disincentive to remaining in the market.

7.5. The current drafting of Clauses 27 and 28 suggests that the regime is likely to apply to all single source subcontracts. **The Bill should be amended so that the regime only applies to subcontracts of a significant value (for example, above £50m) providing goods, services or works directly for a qualifying defence contract.**

8. *Improving the protection of suppliers' commercially sensitive and confidential information (Clause 37; Schedule 5)*

8.1. IP and sensitive commercial information is critical to business success. Information received by MOD and the Single Source Regulations Office (SSRO) must be treated with care and appropriate penalties must be in place.

8.2. The increased totality of information to which MOD and the SSRO will have access under the new regime will be more sensitive than that disclosed previously to MOD. The detail, volume and regular reporting of information will have an aggregating effect making it 'super-sensitive'.

8.3. ADS supports Clause 37 and Schedule 5, which create a criminal offence of unauthorised release of protected information.

8.4. The Bill requires a deliberate act before unauthorised disclosure of information becomes a criminal offence. Greater assurances are required to demonstrate that commercially sensitive information received by MOD under the new regime will be held securely. **Schedule 5 should be amended to include a criminal offence of failing to protect suppliers' information, which would mirror the provisions in the Data Protection Act 1998.**

8.5. **The Bill requires amendment to ensure that the internal procedures of MOD and the SSRO for protecting information from unauthorised disclosure are subject to external third part audit, replicating the responsibilities of the Date Controller under the Data Protection Act 1998.**

8.6. Further work is required to define the categories of information that will be protected by the provisions of the Bill, as this is currently unclear.

Part 3—Reserve Forces

9. *Supporting employers of Reservists by improving the transparency of the deployment and appeals processes (Clause 43)*

9.1. From primes to SMEs, the UK Defence Industry has a close relationship with the Armed Forces including the Reserves. Industry recognises the increased future role of Reserves and supports the principles of the provisions in the Bill.

9.2. **Clause 43, Subsection 4** places a greater burden on employers of Reserve Force members by allowing Reservists to be deployed for any purpose for which Regular Forces may be used. **Subsection 6** extends the maximum duration of service for members of the Reserve Forces.

9.3. Increased demands on the Reserve Forces may impact SMEs employing Reservists with unique skill-sets. Reservists are most likely to be mobilised for deployment during times of conflict, at a time that is by its very nature busiest for the UK Defence Industry. A paradox therefore exists whereby defence SMEs may lose valuable employees in times of conflict when they must step up production. Greater clarity is required as to what steps will be taken to support SMEs in these circumstances and what appeals process will be put in place to protect employers. A mechanism is required to enable a compromise agreement to be reached on the restricted availability of certain Reservists in key SME jobs. The existing appeals process may prevent flexible arrangements.

10. *Sponsored Reserves*

10.1. The Bill does not mention Sponsored Reserves. ADS would support an explanation of what implications Part 3 of the Bill has for the role of Sponsored Reserves within the Reserve Forces. The Defence Reform Bill is an opportunity to provide a link between the Reserve Force and the Whole Force Concept designed to provide more integrated and efficient provision of defence capability.

[4] Figures sourced from DASA Defence Statistics 2012.

About ADS

ADS is the trade organisation advancing the UK Aerospace, Defence, Security and Space industries. Farnborough International Limited (FIL), which runs the Farnborough International Airshow, is a wholly-owned subsidiary. ADS has offices in England, Scotland, Northern Ireland, France, and India. ADS comprises over 900 member companies within the industries it represents, of which over 850 are small and medium enterprises (SMEs). Together with its regional partners, ADS represents over 2,600 companies across the UK supply chain.

August 2013

Written evidence from The Public and Commercial Services Union (DR 05)

Defence Procurement and Single Source Contracts

1. The Public and Commercial Services Union (PCS) is one of the largest trade unions in the UK, with over 260,000 members. We are organised throughout the civil service and government agencies, making us the UK's largest civil service trade union. We also organise widely in the private sector, usually in areas that have been privatised.

2. PCS represents around 12,000 members working in the Ministry of Defence and those employed in the wider defence sector. Our submission focuses specifically on the GoCo and Single Source proposals. We would be happy to provide the Bill Committee with further written or oral evidence on request.

Introduction

1. The government is proposing the creation of a new Government Owned Contractor Operated (GoCo) entity to replace Defence Equipment and Support (DE&S).

2. The government believe this will improve the delivery of the equipment programme: "by introducing systems and ways of working that provide staff with the best access to the necessary skills, processes and tools to enable them to do their jobs better, driving value for money in equipment projects." (White Paper Better Defence Acquisition page 5)

3. PCS believes that existing DE&S staff already have the vast majority of skills to deliver world-class procurement and that the risks of moving to a GoCo are too high. This paper demonstrates why the work must remain in the civil service and how to retain, recruit and incentivise DE&S staff.

Background

4. The GoCo concept originally emerged from a review by Bernard Gray. However the then defence secretary, Bob Ainsworth, rejected this, stating: "we are not convinced that such a change would ultimately lead to better outcomes for the armed forces or defence generally."

5. Bernard Gray was then appointed head of DE&S in January 2011, resurrecting his GoCo proposal.

Learning Lessons

6. We will not be the first western country to try using the private sector for defence procurement.

7. In 2009, the US Department of Defense (DoD) announced the cancellation of the US Army's Future Combat System (FCS) contract and directed the Army to takeover the FCS contract. The FCS programme was initially undertaken by a US Lead System Integrator (LSI's).

8. These are contractors, or teams of contractors, hired by the US government to: "execute a large, complex, defense-related acquisition program, particularly a so-called 'system of systems' (SOS) acquisition program. LSIs can have broad responsibility for executing their programs, and may perform some or all of the following functions: requirements generation; technology development; source selection; construction or modification work; procurement of systems or components from, and management of, supplier firms; testing; validation; and administration." In other words, broadly what the UK government are looking for from a GoCo.

9. The LSI for the FCS program was a partnership between Boeing and Science Applications International Corporation (SAIC). This experienced multiple problems, among them cost and schedule overruns, and were the subject of multiple Congressional oversight hearings before the contract was rescinded in 2009,

10. The US DoD turned to the LSI concept for FCS because at that point they lacked the in-house technical and project-management expertise needed to undertake complex procurement projects. One of the primary reasons for this lack of in-house expertise was the downsizing of the DoD acquisition workforce. (In comparison, UK DASA stats show that DE&S civilian numbers have shrunk from 16,150 on 1 April 2010 to 12,550 on 1 April 2013—a 22.3% loss of experienced procurement staff in just three years).

11. The US DoD also subsequently believed that they had insufficient visibility into programme and overall system performance. In the US LSI arrangement, the US government had a contractual relationship with the LSI prime contractor, not with any subcontractors that report to the prime contractor. A lack of transparency in

this area made it more difficult for the US government to adequately manage and conduct effective oversight of their acquisition programme. It is also believed that this lack of transparency increased the risk of cost overruns, schedule slippage, poor product quality, and inadequate system performance.

12. Mirroring the problems we have with British military tour lengths, the DoD were concerned about the three-year rotation cycle of most US senior military officers when using an LSI meaning that their ability to make independent assessments of programmes being carried out by LSI's had been reduced.

13. The US government also had major concerns that LSI arrangements would create conflicts of interest for an LSI in areas such as determining system requirements and soliciting, evaluating, and hiring contractors. They were concerned that an LSI might tailor system requirements to fit the LSI's own products, or that in selecting another contractor, the LSI might favour one of its own subsidiaries (or a favored supplier firm) over other potential suppliers. This would lead to an increase in the government's costs or reduce technical innovation, particularly if a more innovative solution offered by another firm would compete with a core business line of the LSI.

14. The US believes it would be extremely difficult for an outside company to successfully challenge an incumbent LSI that has managed a programme for several years. The incumbent's greater knowledge of the program and the potential disruptions to the program that might be caused by switching to a new LSI would likely pose a barrier to another contractor's ability to take over the contract. This could make it difficult for the government to terminate such a contract and as a result, the government of the day will have very little leverage to re-compete the contract.

15. These problems are likely to be magnified in a GoCo. With an initial contract length of nine years, the MoD has done no risk analysis on the ability of other contractors to be able to rebid in 2023. Without this risk analysis there is a huge fear the winning contractor will be able to hold the MoD to ransom in years to come.

16. US media reports estimate it cost up to $1.5 billion to close down the ill-fated FCS programme. Probably most important is the fact that the US Congress has banned it from ever happening again. PCS believes the UK government must learn from this.

17. In the House of Commons debate on GoCo on 10 June 2013, defence secretary, Phillip Hammond stated: "The United States, contrary to some media reporting, is relaxed about this process. It recognises that there will be some technical issues that we need to resolve, but I am glad to be able to tell him that the Chief of Defence Materiel received this morning, by coincidence, a letter from his counterpart, the Under-Secretary for defence procurement, in the Pentagon confirming that the United States is confident that it will be possible to make these arrangements work. We have set up a joint working group to work through the issues that will need to be addressed before a decision is made."

18. This however seems to contradict statements made by other senior US defence procurement officials. Melinda Morgan, a spokeswoman for Frank Kendall, the department's top acquisition official, recently told Defense News magazine: "We do have some concerns over an option that would put contractors in roles normally filled by government employees — and the effects this would have on ongoing and future co-operation."

19. PCS believes we need to learn from the US LSI debacle and stop the GoCo process now. At the very least, the government should ensure that this working group conducts a transparent review of the failed US attempt at privatising defence procurement.

Potential conflicts of interest

20. One of the key recommendations of the Haddon Cave report into the loss of Nimrod aircraft XV230 was that, to avoid a conflict of interest, those responsible for the regulation of safety should be independent of those responsible for delivering output. A GoCo would compromise this position because each of the bidding consortia already have a multitude of defence contracts between them.

21. MoD has stated that: "From the outset, bidders have been required to declare any perceived, potential or actual conflicts of interest, together with proposals for how they would manage them. The MoD has the right to exclude potential bidders if new conflicts of interest arise during the process." To ensure transparency, we would ask that this information be placed in the library of the House.

22. PCS also wishes to understand how any winning GoCo bidder will deal with existing contracts, many of who will be with industry competitors.

23. PCS is also unsure how the GoCo will deal with classified information and intellectual property belonging both to the UK and to our overseas allies.

Risks in defence procurement

24. Defence procurement is a high risk proposition: it is technically risky; the military requirement keeps changing and budgets are constantly being squeezed to meet short term needs. Changes in Governments and defence reviews also bring uncertainty.

25. The MoD has already (in the impact assessment) agreed that the highest risk to the GoCo option is that: "international partners do not accept the proposed changes at all, or that the limitations put upon the scope of the GOCO through negotiation with our international partners mean that the GOCO no longer offers value for money." MoD has said they are talking with our international partners, but we have seen no outcome.

26. UK military forces have been involved in numerous conflicts, many at very short notice such as the Falklands crisis in 1982. We have seen nothing to demonstrate that a GoCo would absorb such additional costs attributed to such short notice requirements and not seek to renegotiate additional remuneration at a time of conflict.

27. At present, DE&S and the government bear all of the defence acquisition risk. However a GoCo will price risk into their bid and will charge the department every time senior military personnel or ministers decide to change requirements.

28. The operational and financial risks of delays and over-runs will remain with the government, compromising any benefit from a private sector partner.

GoCo accountability

29. It is not clear how and to whom a GoCo will be held accountable. Civil servants operate within a constitutional framework, enforced through a series of safeguards ranging from the civil service code to various parliamentary audits and inspections.

30. The NAO, Parliamentary committees and Parliament itself have limited authority to call companies to account and the electorate's democratic control is thereby neutered. Instead there is managerial control and accountability to shareholders and to the wider markets, despite the reality that the ultimate responsibility and risk continues to rest with the Government.

31. PCS further understands that, as the GoCo will now be acting as an agent on behalf of the MoD, there will be less transparency as to how and with whom the GoCo contracts.

32. PCS is also yet to understand who will own any value for money savings and any profits generated by the GoCo.

Future DE&S staffing issues

33. PCS's primary role is to protect and promote the interests of its members, including their job security. We are therefore concerned by references to redundancy, for example in the Impact assessment, signed by Philip Dunne on 2 July 2013, which says: "Recurring costs include the introduction of new IT/MIS, upskilling and redundancy costs and fees." To date PCS has been unable to ascertain the extent of any proposed redundancies.

34. PCS does not believe there is any justification for job losses in DE&S as a result of GoCo or DE&S+. In the Aug 2013 issue of Desider (DE&S in-house magazine), defence secretary, Philip Hammond states; "The gradual erosion of skills and capability in the organisation over recent years cannot be allowed to continue if we are to ensure the MoD's ability to deliver equipment to the front line." PCS agrees with this statement and seeks assurances that there will be no redundancies and instead investment in the development and training of all staff.

35. Any GoCo bidder needs to restore staff morale and incentivise the workforce, who have seen their pay frozen and increasing attacks on their terms and conditions. The investment appraisal hints at a two-tier workforce, stating that: "The Contracting Entity would be free to provide new recruits to the Operating Company with a different employment contract." With morale already at rock bottom, creating a two-tier workforce will make the chances of a GoCo succeeding even slimmer.

36. The perceived problems of recruitment and retention are symptoms of civil service pay restraint, which can be solved by removing the constraints on pay, terms and conditions.

Questions over the assertions on tax

37. The White paper, quite correctly, states numerous times that one of the aims of the GoCo is to get better value for money for the taxpayer.

38. However, in response to a question where the winning bidder would pay tax from Angus Robertson of the SNP in the House of Commons debate on Defence Reform on 10 June 2013 , the defence Secretary, Phillip Hammond stated: "the entity with which we contract will be UK-registered and domiciled, and will pay its tax in the UK."

39. It is clear, from the bidding consortia, that any GoCo entity will in reality be American owned. If, as PCS believes, the winning consortium cannot be forced to pay all of the tax liabilities in the UK, this will skew the cost/benefit analysis of the GoCo proposals as the award of a substantial contract to a foreign owned entity could see significant tax losses to the UK exchequer and taxpayer.

GoCo and the military

40. PCS is concerned that very little has been said regarding the relationship between any winning GoCo consortia and the UK armed forces. Contracting for military availability is completely different to contracting for anything else, either in the public or private sector.

41. A major underlying factor in the problems with defence procurement has been identified as the issue of the 'revolving door' approach of military tours where military personnel come and go at regular intervals. The lack of coherence and consistency that comes from these short tours does, as the MoD has seen during the years, lead to multiple changing of requirements and this subsequently adds time and costs to any given procurement project. Moving to four-year, rather than two-year terms from the rank of colonel upwards, as has been proposed will help, but instead of tinkering round the edges, PCS believes the MoD must come up with much more robust sustainability and succession planning to resolve these issues for future generations.

GoCo and lobbying

42. Unfortunately, in recent years we have seen a very rapid rise in the numbers of ex military personnel and ex MoD civilian staff, usually from the senior ranks of both, who have left the department and in a very short period re-appeared employed either by defence contractors or setting up on their own in a defence related business.

43. Whilst there have been instances of wrongdoing, these are (hopefully) relatively few. PCS is looking for assurances that during the GoCo tender process and evaluation (should the decision be to proceed with GoCo) that no ex military or ex MoD personnel will be involved in these processes on behalf of bidding companies or consortia.

44. These waters have already been muddied by the appointment by Bechtel of Richard Freer, described as one of the prime thinkers behind the previous Strategic Defence and Security review.

Ethical and moral contracting

45. The government should lead the rest of the country by example when they are letting public sector contracts. It is therefore disappointing that two of the bidding consortiums have chequered histories. In the US, CH2M Hill paid an $18.5 million (£12.2m) fine for fraud on government contracts and Bechtel paid a $458m (£301m) fine for shoddy work—leading to a death—on a public contract.

46. When the CH2M Hill fine was announced the US Department of Justice said: "This sort of systemic fraud is an appalling abuse of the trust we place in our contractors." Does the MoD now really wish to deal with such companies and run even more risk if the department is brought into disrepute.

Single source proposals

47. PCS would always wish to ensure the best outcome for the front line and the taxpayer, we welcome the second part of the bill in relation to tightening how we contract using single source procurement. However we do wish to know how this will work if we go down the GoCo route.

48. At present, approximately 45% of the UK's defence procurement is done through single source. Have the companies who we use for single source contracts been asked if they will find it acceptable that another private company, and in all likelihood, a defence industry competitor will have access to not only details of the goods and services they provide to the MoD, but the prices they charge?

49. PCS believes the vast majority, if not all of these companies will be extremely unhappy to see industry competitors having access to this sort of information. We believe there may be downright refusals to share this information. If this happens, what plans have the government and the MoD taken to overcome this and ensure that we are still able to contract with these companies?

Conclusion

50. At present, PCS is opposed to the introduction of a GoCo, as we believe the government will be better served ensuring DE&S is properly resourced and properly staffed. Moving to a GoCo will in our opinion cost the taxpayer more money and adds too much risk in delivering capability to the front line.

51. If the government's argument is that because government departments such as the MoD are not very good at negotiating and managing contracts with the private sector, it seems perverse that the self same government is going to negotiate a contract with industry to undertake the task on their behalf. PCS believes investment in existing and future civil servants will deliver the world-class procurement support our armed forces need and deserve.

52. We will leave the last word to the pioneer of the DE&S GoCo proposals, Bernard Gray, who we believe in his interview with Civil Service World in July 2013 said, "If we save £20,000 on somebody's salary, and it costs us £200m in a failed project, is that really good value for money?"

53. The answer is clearly no. PCS believes the correct answer is to properly and fully reward and incentivise public sector workers to do what is clearly now and must remain a public sector function.

September 2013

Written evidence from the CBI (DR 06)

CBI evidence to the Defence Reform Bill Committee

1. The CBI is the UK's leading business organisation, speaking for some 240,000 businesses that together employ around a third of the private sector workforce. With offices across the UK as well as representation in Brussels, Washington, Beijing and Delhi the CBI communicates the British business voice around the world.

2. The CBI welcomes the opportunity to provide evidence to MPs to inform legislative scrutiny of the Defence Reform Bill. The CBI's membership includes businesses operating across the UK defence sector, from major contractors to small and medium-sized businesses in the supply chain.

Changes to defence procurement must not undermine the economic contribution of the UK defence sector and supply chain

3. CBI members support efforts to balance the defence budget while maintaining effective military capability, and believe that defence procurement reform has a crucial role to play in ensuring that the Armed Forces receive the equipment, support and technology they need at a value both the Government and taxpayers can afford.

4. At the same time, the UK defence sector is a truly world-class industry, supporting over 300,000 jobs in the supply chain and generating £8.8bn worth of exports for the UK economy in 2012. Therefore, the sector has the potential to make a significant contribution to securing private sector growth in the UK and supporting the Government's wider efforts to rebalance the economy towards investment and trade.

5. It is crucial, therefore, that the legislation proposed in the Defence Reform Bill is carefully considered to avoid changes that might bring unpredictability and uncertainty for industry, particularly for SMEs, and which could have unintended consequences for suppliers in the UK defence market and their contribution to jobs and growth.

6. At present, CBI members are concerned that the Government's proposed changes to defence procurement do not provide this certainty to businesses operating in the UK defence sector, and could undermine future commercial planning and investment decisions. The legislation should also include sufficient protection of commercially-sensitive information and intellectual property, as well as ensuring that suppliers receive a fair return for the risk they accept in defence contracts.

The Government should adopt a collaborative approach to defence procurement reform

7. The CBI believes the Government must commit to adopting a collaborative approach when introducing the proposed reforms to defence procurement, engaging in detailed dialogue with industry to ensure that the changes are implemented in a way that delivers improved efficiency and value for money, whilst eradicating costly delays and changes to programme specifications.

8. CBI members support the objectives of the Ministry of Defence's (MoD) Transforming Defence Programme, so the interface with industry can be made more transparent, efficient and cost-effective. The Government is right to examine options for reforming the Defence Equipment and Support organisation (DE&S), as there is a clear need to inject greater financial and commercial skills into the management of major defence procurement projects, and partnering with the private sector could help to eradicate delays and deliver improved efficiency and value for money.

9. CBI members have identified some key metrics against which the reforms to DE&S should be assessed. These include:

- better value for money in defence procurement projects
- a reduction in the length and cost of bidding with simplified processes for bidders
- improved commercial skills and expertise which enable the MoD to become a more intelligent customer
- minimal disruption to planned defence procurements during the transition to the new DE&S operating model
- greater stability and visibility in the direction and funding of the defence equipment budget

10. The CBI takes an agnostic view as to the model for DE&S that is best placed to deliver these outcomes. However, our members consider it important that the Government consults closely with businesses operating across the UK defence industry to properly explain how the Government Owned Contractor Operated (GoCo) will work in practice and the benefits it will deliver for both the MoD and industry. This will enable businesses

to make more informed judgements of the cost-effectiveness of the GoCo and its likely impact on their commercial operations in the UK.

11. At present, however, it is difficult for businesses to assess the viability and practicality of the GoCo operating model, particularly as there is a lack of information in the Bill with regards to the criteria against which the GoCo will be judged, and the Bill's own impact assessment recognises there are substantial uncertainties over the level of costs and benefits associated with the GoCo model.

12. In addition, there is no mention in the legislation of the public sector comparator ('DE&S+'), which creates further uncertainty within industry and prevents suppliers from analysing whether the DE&S+ model is a viable and cost-effective alternative to the GoCo.

13. Similarly, there is a lack of certainty for potential bidders as to whether the Government will proceed with the GoCo option following the competitive process, with bid consortia being asked to produce complex and costly bids with some probability that no contract will be awarded at the end of the process.

14. Irrespective of the DE&S operated model that is pursued, it is crucial that the Government ensures there are appropriate safeguards in place to protect suppliers' intellectual property and commercially-sensitive information.

There are a number of outstanding concerns within industry that need to be addressed to achieve consensus on the new framework for single source defence acquisition

15. As one of the parties to the existing Yellow Book arrangements, the CBI supported Lord Currie's Independent Review of the pricing regulations governing single source defence contracts. The CBI responded to the Government's consultation in January 2012, highlighting a number of issues which required further consultation with industry in order to achieve mutual agreement on the transition to a new single source framework.

16. We have consistently argued there are clear advantages in the Government achieving consensus with industry on reforms to single source defence acquisition rather than imposing changes through legislation. That is why the CBI welcomed the Government's commitment to engage in further discussions with 'top ten' single source suppliers, following the conclusion of the formal consultation period, through the creation of a sub-group of the Defence Suppliers Forum.

17. While progress has been made in many areas, there remains a need for further dialogue between the MoD and industry to achieve a robust and workable single source framework, which delivers on the objective to drive greater efficiency and value for money from non-competitive defence contracting, whilst ensuring a fair balance between risk and reward for suppliers.

18. Indeed, CBI members have a number of concerns about the Government's proposals which should be carefully considered and addressed through the legislative process in order to achieve consensus on the new framework. Firstly, it is crucial that the Single Source Regulations Office (SSRO), the new Non-Departmental Public Body (NDPB) being established to govern the new regime, is viewed as truly independent and impartial by industry. As such, we believe there is a case for reconsidering the powers the legislation hands to the Secretary of State (eg over abolishing the SSRO, appointment of the chair, removal of board members, etc.), so that industry has assurances that the SSRO is free from political influence over its governance and processes.

19. The CBI also believes the Government should enshrine within the legislation a commitment to equal composition of the SSRO Board, to which both Government and industry are able to nominate suitable representatives, and allow for Board nominations to be scrutinised by Parliament through an appropriate select committee.

20. The introduction of the new single source framework must also avoid unintended consequences for UK defence suppliers and the vitality and strength of their supply chains. At present, there is a risk that UK suppliers could be placed at a competitive disadvantage should overseas suppliers not be subject to the new regime. Over time, this could result in suppliers choosing to leave the UK market with significant negative consequences for jobs and growth. To avoid this, the Government must commit to ensuring there is a level playing field with both domestic and overseas suppliers under the jurisdiction of the new regulations governing UK single source contracts.

21. In addition, there is a lack of clarity in the Bill about how the new pricing regulations and reporting requirements will apply to SMEs, with CBI members concerned that the new regime might act as an additional burden and barrier to entry for smaller suppliers. The CBI believes fuller analysis is required of the impact of the regulations on SMEs, in order to sustain a diverse and competitive defence supply chain in the UK which promotes quality, innovation and value for money.

22. Similarly, the legislation should also include further provisions on confidentiality and the safeguarding of commercially-sensitive information which suppliers submit to the SSRO. In particular, there is a case for extending the criminal offence provision to include failure to protect against unauthorised disclosure of suppliers' information. Industry also needs a clearer understanding of the potential interaction between the SSRO and the GoCo so that steps can be taken to avoid duplication and to mitigate unnecessary bureaucracy.

23. Finally, when introducing the new statutory framework, the Government should look to avoid changes which might result in a more adversarial approach to pricing and contract negotiations with industry regarding UK single source contracts. CBI members have concerns that the proposed new regime risks undermining the collaborative approach between Government and industry that has been a hallmark of the Yellow Book's voluntary arrangements.

24. For example, the legislation permits the MoD to challenge a contract price at any time up to two years after contract award, which would cause uncertainty for suppliers and potentially undermine shareholder value and willingness to invest in the UK. To alleviate industry's concerns, the legislation should clearly define the grounds on which a challenge can be made, and limit the number of times and overall timeframe within which the MoD can appeal to the SSRO to challenge a contract price.

The CBI welcomed the recent Future Forces White Paper, which addressed the majority of employers' concerns on the Government's proposals to reform the Reserves

25. CBI members recognise the importance of national security and the crucial role of the Armed Forces, and the CBI signed the Armed Forces Corporate Covenant at its launch in June in support of the Forces community.

26. Reservists play an important role in preserving our military capability, particularly in specialist fields. Businesses also recognise the positive contribution that Reservists make in the workplace with skills they develop and strengthen whilst serving in the Armed Forces.

27. With regards to the specific changes the Government is looking to introduce, the CBI had some initial concerns with aspects of the Future Reserves 2020 green paper, especially the possible introduction of 'discrimination' type legislation. Our response to the green paper argued these proposals went against the partnership approach that is needed between employers and the Armed Forces to make the reforms work, and CBI members were particularly concerned that it could strain working relationships between employers and Reservists.

28. Similarly, we also argued more could be done to ensure that employers had as much notice as possible of mobilisation and training, alongside clearer and consistent communication to employers, targeted financial assistance, and accreditation of skills and training for the workplace.

29. These concerns were largely addressed in the Future Forces White Paper published in July 2013, which the CBI welcomed. Our members support the partnership approach that is now being adopted, and the fact that the Ministry of Defence listened to the concerns from within the business community around taking a purely legalistic approach. We are especially pleased that the revised proposals include additional financial support for small businesses and a single contact point for large employers.

September 2013

Written evidence from the Army Rumour Service website (DR 07)

BETTER DEFENCE ACQUISITION CM8626, DEFENCE REFORM BILL 2013/14

Executive Summary

1. This document covers discussions that have taken place on the Army Rumour Service website regarding the proposed improvements to Defence Acquisition in the 2013/14 Defence Reform Bill.

2. The major concerns and issues that have been raised by our users can be summarised as follows:

(a) A concern that the national interest will suffer.

(b) Scepticism that a private company will be able to reduce costs given the requirement to make a profit.

(c) A belief that a decision has already been made to choose the GOCO model.

(d) The suggestion that the DE&S performance is caused by issues within the Department

National Interest

3. There is widespread concern that both the presented options and the current list of bidders will not support the UK national interest. It would appear that both the remaining bidders are US owned companies without a track record in this area. There are also question marks over ownership of intellectual property and possible conflicts of interest

4. Typical quotes include:

User: Goatman

HMG is now running a competition between two US-majority owned bid teams for its indigenous Defence R&D and arms procurement. At what point in this depressing exercise will the NAO mutter that British national interest has been poorly served?

User: meridian

How are you going to control and manage intellectual property if the winning organisation has similar interests to those bidding for future MoD contracts. We saw how there were problems with the SAR PFI, it is so easy for a small part of the machine to be corrupted but even the merest whiff of it will bring the whole house of cards down

User: Without Commitment

Finally with the withdrawal of KBR this will only leave 2 consortia, both American led I believe, bidding for DE&S. Is it REALLY such a good idea to leave the equipping and support of the Armed Forces in the hands of a foreign nation? How many existing Contracts with DE&S do these Consortia members have and are they not then excluding themselves from bidding?

User: bobthebuilder

Another angle on the debate; with KBR out of the competition, is this a procurement going wrong? Surely it is not in the MoD's interests to be down to two bidders at this stage. Neither of the players have much of a track record of delivering UK defence projects or of major TUPE transitions. Where are the big British players in the engineering services sector (Babcock, Interserve etc etc)? Why did KBR pull out? They have been lobbying for this for a long time, have a globally renowned partnering culture and are one of the best (if not the best) performing defence contractors. If they can't make a case for bidding this, can anyone make it work?

Profit & Costs

5. Any commercial organisation will need to make a profit from the funding lines that are currently used to buy military equipment. It is widely believed that DE&S is already poor at achieving value for money contracts and many users highlighted that the GOCO option may just replicate this in the procurement organisation.

User: Fatcivvy

Given that the Defence Equipment budget is finite; then surely any profit margins, etc for the privatised company whoever it may be, will have to be taken out of the budget which means in turn, that there will be less money to spend on the actual equipment.

User: Without Commitment

And finally, how can it possibly be cheaper to employ another 300 'Management Staff ' for the Co that's going to run DE&S and then get the Government to pay a 20–25% Overhead and profit charge on top of all the costs? I make that a massive increase in running costs. The Civil servants/military don't charge overheads or profit on their costs currently.

User: bobthebuilder

My issue with a GOCO is that it won't be subject to market discipline; it won't have to deliver a dividend to shareholders and it won't have a share price to maintain or push up. It won't, therefore, deliver the best of industry.

User: AlMiles

The very first thing that will happen is that the Contractor Operator will bring in its very best commercial staff and whole fleets of lawyers to stitch up the MOD something rotten, and ensure it gets absolutely minted whatever happens. There'll be no alternative, no true competition, unless MOD is going to set up a rival procurement agency with another contractor or piggy-back on another country's.

Decision Already Made

6. It is widely believed that the GOCO option has already been chosen and the DE&S+ option is not being seriously examined.

User: Without Commitment

Regarding the "privatisation" of the part of part of the MoD responsible for purchasing items for the Armed Forces, the DE&S, it will be catastrophic. Bernard 'GOCO' Grey is widely regarded as already having made his mind up, but is still trying to formulate the right question to justify the unjustifiable

User: OldSnowy

I would guess that we'll find the "DE&S+" option being used purely as a benchmark against which to 'aim' the GOCO version. In other words, there is a presumption (and that certainly seems true for the Top Men involved) that GOCO is happening, and that's that. I would bet my house, family and car on GOCO being the preferred option. That's not to say it's a bad thing—there are problems in the procurement system, of that there's no doubt, but to say that this will be a fair test of two options is, I fear, just not going to be true.

DE&S Performance

7. Many users questioned whether DE&S performance was actually as poor as people thought. Especially when considered within the context of the existing regime that included political interference, military tour lengths bringing disruption and the lack of decision making authority at appropriate levels.

User: Without Commitment

The suggestion that "privatisation" will remove constraints, said constraints having been put upon the DE&S by the politicians themselves leads to another question "why not simply remove our own constraints rather than privatise?"

User: dcpw

Keep politicians out of the final decision loop, there is nothing more demoralising than producing a technically superior offer and seeing it put into 2nd place because one of the other bidders will build a factory in a deprived area that has a dearth of technically minded people to work in it.

User: HE117

When will people realise that procurement is not a game for amateurs that you post about every three years.

User: jim30

The Military manning system sees tours at Abbey Wood as being something to be endured for 2 years and then avoided like the plague. People do not, in the main, join HM Forces to do requirements management or procurement. The culture of revolving doors, where new people have to reinvent the wheel for the OJAR tick in the box doesn't help either. While you replace your workforce on a regular basis, wiping out uniformed corporate memory of a project and watch as different people in different layers react in different ways, things will go wrong.

User: bobthebuilder

The lack of accountability is staggering; those SO1 grade CS you refer to have virtually no executive authority; decisions are raised upwards and subject to endless review by board who have little competency on the project. The whole thing is sclerotic, decisions are taken too high and too late.

User: BrunoNoMedals

I can point to some genuinely outstanding staff members in my own team, balanced out by one bloke for whom Restoring Efficiency wouldn't even come close. From the GOCO perspective I can see why there would be benefit in thinning out the chaff, but it does feel like a bit of a cop out when the government suggests it can't manage to arrange its personnel management that effectively.

About The Army Rumour Service

8. The Army Rumour Service website (arrse.co.uk) was founded in early 2002 and is the United Kingdom's most popular military community website. It has 85,000 registered users and is routinely visited by in excess of 500,000 unique visitors per month

---

Written evidence by Professor K G Hambleton, I J Holder and Professor D L I Kirkpatrick (DR 08)

THE UTILITY OF A GOCO FOR DEFENCE ACQUISITION

Authors

1. The authors (all now retired) have had long and varied careers in the MoD. They created and managed the MoD's designated centre of excellence for acquisition education and research, and were the principal authors of the only comprehensive UK textbook on defence equipment acquisition, Conquering Complexity.

Introduction

2. The Defence Reform Bill seeks to improve the MoD's management of defence acquisition, of single-source contracting, and of Reserve forces. This submission addresses only the future of defence acquisition, for which the MoD's policy is presented in 'Better Defence Acquisition—improving how we procure and support defence equipment' published as Cm 8626.

3. Cm 8626 identifies the three principal problems of defence acquisition as:

(a) An overheated programme of acquisition projects

(b) An unstable interface between the MoD and its acquisition organisation

(c) Scarcity of knowledge and skills in the acquisition organisation

4. Cm8626 suggests that, subject to the satisfactory conclusion of on-going studies, these problems can best be solved by transforming the MoD's present acquisition organisation—Defence Equipment and Support (DE&S) based at Abbey Wood near Bristol—into a Government owned Contractor operated (GoCo) entity. Cm 8626 has correctly identified three of the principal problems (there are at least seven others) but it is unclear whether a GoCo would solve them more effectively than a thorough intramural reform.

Overheated programme

5. In 2009 the National Audit Office revealed a gap of at least £36bn between the MoD's scheduled programme of defence acquisition projects over the following decade and its likely budgets for that period. Soon afterwards the Gray Report estimated that this 'overheated' acquisition programme, which annually demanded frenetic re-scoping and rescheduling of projects, caused delays which wasted up to £2bn per year. It is generally accepted that this overheating had arisen because of a long-standing 'conspiracy of optimism' between Service customers and industrial contractors who had both underestimated the likely costs of their cherished projects (often with the collusion of Ministers eager to associate themselves with ambitious and newsworthy projects), and because the MoD's acquisition organisations (DE&S and its predecessors) had generally been insufficiently influential to resist that conspiracy.

6. A second important source of overheating, particularly affecting large and protracted acquisition projects, was the tendency of the Service customers to revise their requirements. Sometimes such revisions arose from the MoD's rational response to developments in the threat or in the relevant technologies, and sometimes they arose from the imaginative zeal of staff officers eager to get the very best equipment for their Service. Almost all of these revisions, however they arose, tended to increase project costs. The GoCo would presumably seek to minimise such cost increases by accepting only those requirement revisions which are well considered and have been justified by rigorous cost-effectiveness analysis, even if its rejection of other revisions provoked unpopularity with the customer Service. In principle the scrutiny of potential revisions should be the responsibility of the MoD.

7. Only the UK government can determine the nature and balance of military requirements for national defence. The GoCo's proper role would be to manage the MoD's programme of defence equipment acquisition as economically as possible, but not to determine which projects are included in that programme. The solutions to both optimistic cost estimates and unnecessary programme changes must therefore be found within the framework of UK government, and must include the power to restrain the optimistic enthusiasms of Service staffs and their contractors.

8. In particular, the Minister responsible for equipment acquisition must insist on having an independent forecast of a project's cost and timescale, as well as forecasts from the customer Service and industry, before its budget is approved. In principle this forecast could be produced within the MoD by a unit directly responsible to the Minister, but in practice its staff would find it difficult to resist institutional influences (and thereby imperil their future careers) if their forecasts were unpopular with senior officers and officials. It would be more appropriate to establish a truly independent cost forecasting unit within the Cabinet Office or within the National Audit Office to validate the cost forecasts produced by the MoD (and by other government departments prone to launch ambitious projects). During analysis of a new defence project in the US, for example, the cost forecasts produced by the customer Service and by its contractor are validated twice by comparison with forecasts from the Office of the Secretary of Defense and from the Congressional Budget Office.

MoD/GoCo Interface

9. In any complex system or organisation the interfaces between the component parts are as important as the entities themselves and require detailed attention and firm management if the whole system is to operate successfully. At present on any defence project there is a single major contractual interface between the MoD and its chosen prime contractor (although there are also many internal interfaces within the MoD and many contractual interfaces between the prime and its subcontractors). Interposing another private contractor as a GoCo in the acquisition process would create an additional major contractual interface which would have to be regulated effectively.

10. The contractual interfaces between a GoCo and the defence industrial companies which manufacture and support equipment would be relatively straightforward. They would replicate the existing interfaces between the MoD and industry and would no doubt have similar conflicts of interest. However, the new interface between the MoD and a GoCo is by no means as simple, as it will involve the transfer of responsibility and resources (finance and possibly staff) compounded by the acrimonious issues of liability and recompense should projects not go according to plan, as happens all too often in practice. The three-cornered relationship (MoD, GoCo and industry) will be inherently more complex than the current relationship between the MoD and industry, and will require greater management control. The MoD/GoCo interface will need to be sufficiently flexible in order to accommodate any necessary changes (either in requirement or solution) that may be required during the life of a major project and yet rigid enough to resist additional (desirable but unnecessary) features that appeal to military customer. However there is no fundamental reason why a reformed DE&S, under robust civilian management (with appropriate military, technical and financial advice) should not manage this interface equally successfully.

11. One important aspect of the MoD/GoCo interface involves the conversion of a military "Capability Requirement" made by the MoD into a "Contractual Equipment Specification" suitable for the GoCo to place with the defence industry, either in a competition or with approval to a single source. At present this is done in several stages, by determining which types of equipment are likely to provide the desired capability, choosing between the various technical or separate Service options, and writing the final specification. The responsibility must therefore transfer from the MoD to the GoCo at some stage, but it is important that the MoD should permanently retain the responsibility for defining the final contractual equipment specification which will determine the performance of the equipment delivered.

12. The role of policing this interface and regulating a GoCo would be a challenging task and would require staff with the necessary skills and experience to judge what is best for the defence of the UK. Many other Government Regulatory Bodies have been criticised for failing, the NHS Care Quality Commission being an obvious recent example. The failures seem to have either been due to inadequate expertise or a lack of will power to stand up to a powerful government department or contractor with vested interests in preserving the status quo. The regulatory bodies often appear to be staffed by well-meaning individuals with limited specialist knowledge or by retired experts from within the field, reluctant to criticise their previous colleagues too strongly. Creating a sufficiently strong and capable regulatory body may add to the challenge of implementing the GoCo solution, as the regulatory body will need to be more effective than some of the existing regulators.

Knowledge and skills

13. Command 8626 states that the MoD needs better defence acquisition skills in order to improve the procurement and support of defence equipment. During the 1960s, 70s and 80s the MoD introduced many processes and structural changes intended to improve defence acquisition performance. Despite these changes, acquisition continued to be a difficult challenge for the MoD and the problems and issues of the 1980s meant that a new approach was needed.

14. In the early 1990s, the MoD concluded that it needed people with a particular set of skills, knowledge and behaviours which was specifically tailored to defence acquisition, in order to manage the acquisition of complex defence systems in the 21st century. These ideas led to the creation of the MSc course in Defence Systems Engineering (MDSE) which was delivered from 1991 until 2004 at University College London (UCL). The main subjects of the MDSE were almost identical to the list at paragraph 36 of Cm 8626, with the exception of GoCo management. The MDSE provided the MoD with graduates who had the ability to understand complex defence systems, resolve interface and system issues and manage industrial suppliers; they were thus better able to manage projects to meet their agreed performance, cost and timescale targets.

15. Conquering Complexity summarises the content of the MDSE and presents the view that project management combined with a holistic systems engineering approach, supported by rigorous analysis, provides the key skill-set for defence acquisition. Leadership is an important attribute and is necessary to set and plan for strategic goals, but defence acquisition involves a plethora of risks, issues and problems across a wide range of subjects (technical, commercial, financial, people, defence etc.) and the most important skill is managing the numerous issues to achieve the best balance of performance, cost and time. Paragraphs 25 and 36 of Cm 8626 rightly place the emphasis on project management rather than leadership.

16. Unfortunately, the MDSE graduates were too few (and several years from senior management positions) to revolutionise the competence and culture of DE&S, which remained generally deficient in the knowledge and skills which its role required. The transfer of the DE&S workforce to a GoCo would not alter this situation, even if the GoCo paid higher salaries to attract and retain talented personnel, because very few individuals in the UK workforce have the particular combination of knowledge and skills required for defence acquisition. The GoCo would need to make a substantial investment in MDSE-style training and education in order to improve the capabilities of its personnel. The MoD could, if it chose, augment its staff's knowledge and skills by rediscovering its 1991 commitment to defence acquisition education and training (guided by the experience of MDSE graduates) and by instituting more flexible personnel management with adequate rewards for achievement, while still maintaining the public-service ethos embodied in the Civil Service Code and recognising why the Civil Service was created (essentially to support the policies of the government of the day and to act impartially as a check and balance to avoid commercial issues from distorting, or even corrupting, Government intentions).

Challenges for a GoCo

17. A GoCo for the acquisition of defence equipment, and hence for one vital component of the UK's military capability to provide national security, would be even more complex than privatising Britain's railway system or reforming its NHS. The plan for the GoCo must resolve:

(a) The financial risks, if any, which would be transferred from the MoD and its industrial contractors to the GoCo and which powers would be delegated to the GoCo to enable it to manage these risks.

(b) The conflict between the GoCo's ambitions to streamline bureaucracy with continuing Ministerial oversight and public accountability.

(c) The GoCo's responsibility, if any, for maintaining the UK's defence industrial base and for promoting exports.

(d) The security and protection of intellectual property rights of the many industrial contractors involved in defence projects, particularly if some of the technology originates from foreign governments.

(e) How to sustain fair future competition for subsequent GoCo contracts, by which time the management company which had won the first contract would have the advantage of its accumulated experience.

(f) Whether the MoD Governor responsible for monitoring the GoCo's performance would be able to assign, beyond reasonable doubt, the respective responsibilities of the MoD, the GoCo and its industrial contractors for the failure of any project to meet its targets for performance, cost and timescale.

(g) How to ensure that the criteria used to measure the GoCo's success, and hence to determine its incentive payments or penalties, are closely aligned to the MoD's own priorities regarding any project's performance, cost and timescale, and to ensure that these criteria can be modified to match changes in the MoD's own priorities whenever the UK's armed forces engage in combat.

18. At least some of these problems might be avoided, for example, by sharing the initial responsibility for managing defence acquisition projects between two or more competitive GoCos and by retaining within the MoD the responsibility for those projects in which foreign governments are significantly involved, especially if the GoCo were a foreign company. The liability and risk of introducing leading-edge technology must also be addressed.

Conclusions

19. A man with a hammer in his hand tends to perceive every problem as a nail. A government with an ideological faith in private enterprise may be predisposed to believe that every difficulty in a public-sector organisation can be solved by outsourcing. However this solution does not always work well. Even in other government departments (where the services outsourced are easier to compete, scrutinise and assess) the performance and ethics of some private contractors have been robustly criticised by the Public Accounts Committee.

20. It seems clear that the creation of a GoCo would be largely irrelevant to the three principal problems of UK defence acquisition (overheated programme, unstable interface and a dearth of knowledge and skills) which the MoD itself identified in Cm 8626. In any event, solutions to two of these three principal problems will require specific action by skilled and experienced staff within the MoD in addition to any external GoCo activity. It is the MoD's own responsibility (whether or not a GoCo were created) to formulate an affordable acquisition programme through better forecasting of project costs. It is also the MoD's responsibility to determine the specification for the new equipment it requires and to control judiciously any changes to that specification. Regarding the third problem, the creation of a skilled workforce for defence equipment acquisition would require a long-term commitment to recruitment, training, education, mentoring and retention, either within a GoCo or within a reformed DE&S. In either case, dramatic improvements cannot be achieved in the short term, even by offering increased salaries, which may be necessary but are not in themselves sufficient.

21. It is unclear whether or not the outsourcing of defence acquisition management to a GoCo would yield savings larger than the additional costs of providing an effective regulatory body for the GoCo and of managing an additional contractual interface. However it is obvious that the creation of a defence acquisition GoCo of the proposed scope and scale would be an unprecedented experiment which would have to overcome a daunting array of challenges and potential risks

September 2013

References

1. Hansard, HC Deb, 26 March 1991, vol 188 c397W.

2. Prof K G Hambleton et al, Conquering Complexity – Lessons for Defence Systems Acquisition, TSO, 2005, ISBN 0117730343.

3. Better Defence Acquisition – Improving How We Procure and Support Defence Equipment, Command 8626, June 2013.

4. Prof K G Hambleton, I J Holder & Prof D L I Kirkpatrick, Defence Acquisition – Ten Challenges, 4 Feb 2013, unpublished paper.

5. NAO Major Projects Report, TSO, London, December 2009 para 2.3.

6. B Gray et al, Review of Acquisition for SoS for Defence, MoD October 2009 p283.

7. Warren Chin, British weapons acquisition policy and the Futility of Reform, Ashgate 2004.

Written evidence from Professor Trevor Taylor and Dr John Louth (DR 09)

Royal United Service Institute

We are grateful that the Committee, in addition to our oral evidence, is willing to receive written material from us. We have not sought to address the full gamut of issues associated with the GOCO section of the Defence Reform Bill but have restricted ourselves here to two areas.

1. *The national identity of the GOCO company/participating companies*

We were asked Q.23 if we had concerns about the national ownership of any GOCO lead contractor. We responded that it was the clearance arrangements for (and implicitly national identities of) the staff involved which should provide the main protection for the sensitive information received by the GOCO.

On reflection we would add that the governance arrangements which the US imposes on foreign owned defence companies operating in the US would perhaps be a reasonable model to consider: it would at least provide a clear sense of what another country regards as a satisfactorily arrangement to protect intellectual property.

2. *The US concept of the Inherently Governmental Function*

We assume that the Government is aware of the precise US stance but nonetheless wish to bring some particular wording to the Committee's attention.

President Obama decided that the precise meaning of Inherently Government Functions should be studied and clarified and, as a consequence, after a period of consultation with a preliminary document in 2010, the Office of Federal Procurement Policy issued a definitive Policy Letter in June 2011.[5]

The Letter identified three areas of concern

- Inherently governmental functions
  - 'a function that is so intimately related to the public interest as to mandate performance by public employees': these were words used in the Federal Activities Inventory Reform Act of 1998.
- Functions 'closely associated' with the inherently governmental
  - These were mainly concerned with information provision and advice roles
- Critical functions
  - These were roles and associated capabilities necessary to an agency (ministry) being able effectively to perform and maintain control of its mission and operations

On the Inherently Governmental, the Letter said that 'the term includes functions that require either the exercise of discretion in applying Federal Government authority or the making of value judgments in making decisions for the Federal Government, including .... judgments relating to monetary transactions and entitlements'. In addition, 'an inherently governmental function ... involves, among other things, the interpretation and execution of the laws of the United States so as

(5) to exert ultimate control over the acquisition, use, or disposition of the property, real or personal, tangible or intangible, of the United States, including the collection, control, or disbursement of appropriations and other Federal funds.

The Letter went on to define what this meant in practice and provided an extensive list of examples of functions that fell into the inherently governmental category. We quote:

'15. in Federal procurement activities with respect to prime contracts

(a) determining what supplies or services are to be acquired by the government ....

(b) participating as a voting member on any source selection boards

(c) approving of any contractual documents, including documents defining requirements, incentive plans, and evaluation of criteria;

(d) determining that prices are fair and reasonable;

(e) awarding contracts;

(f) administering contracts (including awarding changes in contract performance or contract quantities, making final determination about a contractor's performance, including award fee determinations or past performance evaluations and taking action based on those evaluations, and accepting or rejecting contractor products and services;

(g) terminating contracts;

[5] Office of Management & Budget: Office of Federal Procurement Policy, Publication of the Office of federal Procurement Policy (OFPP) Policy letter 11-01, Performance of Inherently Governmental and Critical Functions, Federal register, Vol.76, No.176, 12 September 2011, p.56227-56242. See also Office of Management & Budget, Office of Federal Procurement Policy, Publication of the Office of Federal Procurement Policy, letter 11-01, Performance of Inherently Governmental Functions, http://www.willis.com/Documents/Publications/Industries/Government_Contractors/Letter_11-01_Performance_of_Inherently_Governmental_and_Critical_Functions.pdf.

(h) determining whether contract costs are reasonable, allocable and allowable; and

(i) participating as a voting member on performance evaluation boards.'

The 'closely associated' roles with regard to procurement related mainly to areas of information generation and advice. The Letter notes concern that, when contractors are used in these closely associated functions, it could impinge on officials' capability to do inherently governmental work, and so departments are required to take special care when using contractors in such roles. The Department of Defense is singled out as needing particular wariness and 'is further required, to the maximum extent practicable, to minimise reliance on contractors performing functions closely associated with inherently governmental functions'. Moreover, 'when contractors are used in this area, agencies must give special management attention to preventing contractors' expansion into the inherently governmental area'. Other relevant commandments are that: 'Agency managers are required to ensure institutional knowledge is maintained by sufficient personnel with the requisite training, experience and expertise to oversee contractor effort'; and 'Agencies must maintain internal capability to keep control over their core functions'.

September 2013

Written evidence from Philip Dunne MP on behalf of the Ministry of Defence (DR 10)

Thank you once again for allowing me to give evidence to the Defence Reform Bill Committee. I undertook to confirm in writing the numbers of current DE&S posts that are expected to be in the scope of the GOCO. I also undertook to provide a short note on TUPE, which is attached to this letter.

As I am sure you will understand, it is too early to make definitive statements about the precise size and shape of DE&S in the future, and which elements of the organisation, and the programme it manages, may or may not transfer to a GOCO. The numbers that follow are based on current assumptions. To date, our working assumption has been that, with the exception of changes which are happening outside the Materiel Strategy programme, the scope of DE&S should remain the same under a GOCO unless there is a compelling reason to do otherwise. That said some roles that are Department of State functions which DE&S currently carries out on behalf of the whole MOD, such as policy-setting, would remain within the MOD.

Since May 2010, and following the 2010 Strategic Defence and Security Review, we have made considerable reductions in the size of DE&S, decreasing from some 21,500 personnel to the present figure of approximately 16,300. By 2015, this will have reduced still further to approximately 14,500. This figure includes the planned outsourcing of the Logistics, Commodities and Services activity. Also outside the scope of a potential GOCO are the 1,500 people who manage our naval bases. This activity currently sits within DE&S but will be largely transferred to the Royal Navy. A further 2,100 in the Information Systems and Services organisation will be transferred out of DE&S into Joint Forces Command. Finally, we expect that approximately 1,250 of the posts in what will be the "common resource platform" (HR, Finance, Commercial, and Technical specialists) and 350 of the posts involved in Requirements Management and the Finance Military Capability transformation could be retained within the MOD as part of the intelligent customer function.

Of the remaining 9,300 posts, we would expect that some 1,500 would be military personnel. These posts are planned to transfer into the GOCO in two stages, with a first vesting day at the end of FY14/15 followed by a second vesting day at the end of FY 16/17.

I hope that this is helpful, and look forward to sitting as a member of the Committee when we meet again in October.

TUPE—An Explanatory Note

What is TUPE?

"TUPE" is the Transfer of Undertakings (Protection of Employment) Regulations 2006. These regulations implement the EU Acquired Rights Directive (Directive 2001/23EC) which ensure that employees' rights are safeguarded in the event of transfers of undertakings, businesses or parts of undertakings or businesses.

The TUPE regulations protect employees if the business in which they are employed changes hands, or the services which they provide are to be provided by another organisation. Their effect is to transfer employees and any rights, powers, duties and liabilities associated with them from the old employer to the new employer.

This includes any rights specified in their contract of employment; statutory rights; and the right to continuity of employment. It also includes employees' rights to bring a claim against their employer for unfair dismissal, redundancy or discrimination, unpaid wages, bonuses or holidays and personal injury claims. Liabilities arising from such claims also transfer to the new employer.

What does this mean for employees?

TUPE gives employees a legal right to transfer to the new employer on their existing terms and conditions of employment and with all their existing employment rights and liabilities intact (although there are special provisions dealing with old age pensions under occupational pension schemes).

Where the sole or principal reason for a dismissal is the transfer itself, it will automatically be deemed to be unfair. This is also the case where the sole or principal reason for the dismissal is a reason *connected* to the transfer, unless it is for an economical, technical or organisational reason (an "ETO" reason) requiring a change in the workforce (such as an organisational restructuring resulting in a reduced workforce requirement, or a business relocation). This ETO defence is narrow in scope, and it can be difficult for the new employer demonstrate. Even if the employer can rely upon an ETO defence and the dismissal is not automatically unfair, it may still be unfair for other reasons (such as a failure to consult properly in a redundancy situation).

Similarly, the new employer cannot change the terms and conditions of employment of transferred employees if the sole or principal reason for the change is the transfer. This is also the case where the sole or principal reason is *connected* to the transfer, unless there is an ETO reason for the change, usually requiring a change in number of the workforce. This often makes it difficult, if not impossible, for new employers to harmonise terms and conditions of employment of staff immediately after a TUPE transfer.

Status of Trades Unions

Where an independent trade union has been recognised by the outgoing employer in respect of transferring employees, recognition will transfer to the incoming employer to the same extent.

Opting out

Employees can refuse to transfer (or "opt-out") but, depending on the circumstances of the case, employees can lose valuable legal rights, such as the right to redundancy payments, if they do.

Why is TUPE included in the Defence Reform Bill?

The proposed legislation will ensure that the legal protection afforded to employees under the TUPE Regulations applies to MOD employees currently carrying out activities which are within the scope of the proposed GOCO.

This provision is required for the avoidance of doubt as the transfer could be deemed to be a Public Administrative transfer, and as such would be a transfer to which the Regulations would not normally apply.

October 2013

Written evidence submitted by Vice Chief of the Defence Staff, Air Chief Marshal Sir Stuart Peach (DR 11)

During my oral evidence to the Defence Reform Bill Public Bill Committee on 5 September I agreed to provide further written evidence on the practice for appointing senior Royal Navy and Royal Air Force Reservists.

In the Reserve Naval Service and Royal Auxiliary Air force (RAuxAF) we define senior posts as those holding commodore, brigadier or air commodore rank and above (one star).

The Naval Service currently has no reservists at one star or above. For all appointments within the Naval Service at this level, the First Sea Lord chairs the Flag and Senior Officers' Appointments Board. For a reservist appointment at this level the Secretary to the Board would consult across Defence, including the Assistant Chief of Defence Staff (Reserves and Cadets) prior to the Board's deliberations.

The Royal Air Force's Air Ranks Appointments Board, chaired by the Chief of the Air Staff, considers Air Commodore and above appointments. When considering the appointment of the most senior RAuxAF post advice is provided to CAS by the outgoing senior Reservist and the Honorary Inspector General of the RAuxAF.

I would also like to assure the committee that work is ongoing to review whether changes to the above processes are required.

October 2013
