



House of Commons  
Defence Committee

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# **Gambling on 'Efficiency': Defence Acquisition and Procurement**

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**First Report of Session 2017–19**





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*Report, together with formal minutes relating  
to the report*

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## The Defence Committee

The Defence Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Ministry of Defence and its associated public bodies.

### Current membership

[Rt Hon Dr Julian Lewis MP](#) (*Conservative, New Forest East*) (Chair)

[Leo Docherty MP](#) (*Conservative, Aldershot*)

[Martin Docherty-Hughes MP](#) (*Scottish National Party, West Dunbartonshire*)

[Rt Hon Mark Francois MP](#) (*Conservative, Rayleigh and Wickford*)

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### Powers

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

### Publication

Committee reports are published on the Committee's website at [www.parliament.uk/defcom](http://www.parliament.uk/defcom) and in print by Order of the House.

Evidence relating to this report is published on the [inquiry page](#) of the Committee's website.

### Committee staff

Mark Etherton (Clerk), Dr Adam Evans (Second Clerk), Martin Chong, David Nicholas, Eleanor Scarnell, and Ian Thomson (Committee Specialists), Sarah Williams (Senior Committee Assistant), and Carolyn Bowes and Arvind Gunnoo (Committee Assistants).

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# Contents

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<b>Summary</b>	<b>3</b>
<b>1 Introduction</b>	<b>4</b>
Terms of reference	5
The inquiry	5
<b>2 Reforming defence acquisition</b>	<b>6</b>
A long-running sore? Problems with defence acquisition and procurement	6
Transforming Acquisition and Procurement	7
The role of Defence Equipment and Support (DE&S)	7
The transformation programme	8
Match fit? The front line commands and DE&S	9
<b>3 The Defence Equipment Plan</b>	<b>13</b>
A thermostat on the equipment budget? The SDSR and Equipment Plans	13
The SDSR 2015 and the 2016 Equipment Plan	14
The SDSR and the 2016 Equipment Plan: a reheated equipment programme?	15
Conclusion	20
<b>4 The Single Source Regulations Office</b>	<b>22</b>
The Yellow Book and the Currie review	22
The SSRO	23
The SSRO: an effective regulator?	23
Guaranteeing the independence of the SSRO	30
The role of the Chief Executive	30
<b>5 Acquisition and a Defence Industrial Strategy</b>	<b>33</b>
Defence industrial policy and an industrial strategy	33
What should underpin a new defence industrial policy?	34
Defining value for money	34
Procurement, the UK's skills and industrial base, and sovereign capability	35
Investing in research and development	37
<b>Conclusions and recommendations</b>	<b>39</b>
<b>Formal Minutes</b>	<b>43</b>
<b>Witnesses</b>	<b>44</b>
<b>Published written evidence</b>	<b>45</b>
<b>List of Reports from the Committee during the current Parliament</b>	<b>46</b>



## Summary

In the Strategic Defence and Security Review (SDSR) 2015, and as further detailed by the Equipment Plan 2016, the Government pledged to spend £178 billion over the next ten years on defence equipment and support, including eight Type 26 Global Combat ships, new mechanised infantry vehicles and nine new Boeing P-8A Maritime Patrol aircraft. Delivering these commitments will inevitably rely on an effective and reliable acquisition process.

Since 2010, the MoD has been undertaking a programme of changes to defence acquisition and procurement. Our report examines the extent to which these changes, which include the devolution of responsibilities to the front line commands, a transformation programme within DE&S and the creation of a Single Source Regulations Office (SSRO) as a statutory regulator for single source contracts, have been successful. In particular, our report expresses concerns that:

- While there is much talk of reform and transformation of defence acquisition and procurement, an explanation is required of the criteria for assessing such progress and a timetable is needed for the achievement of clearly specified goals.
- The affordability of the equipment plan rests on £7.3 billion of theoretical 'efficiency savings', in addition to the realisation of £7.1 billion of previously announced savings, but it is extremely doubtful that the MoD can generate efficiencies on the scale required to deliver the equipment plan or detail how it would proceed to do so;
- Though the SSRO has helped the MoD to realise some savings for the taxpayer, its limited scope and powers and the lack of clarity regarding its relationship with the MoD, all serve to restrict the SSRO's ability to be an effective regulator. We recommend that the SSRO be given the ability to inspect all single source contracts, save for exceptional circumstances.

Our report also explores the way in which acquisition concerns should be dealt with in a revised defence industrial policy and a new industrial strategy. We recommend that a new defence industrial policy should be underpinned by the following:

- A broader definition of 'value for money' that incorporates the positive impact of major defence projects on local economies, skills and employment levels by adopting new Government procurement guidelines so that 'local value' can be taken into account;
- An emphasis on the importance of a regular drumbeat of activity [i.e. a sustained production line of defence manufacturing in the UK] to sustaining a successful and high-skilled workforce and to maintain the UK's sovereign defence manufacturing capabilities; and
- Increased investment in research and development, with a commitment by the Government to spend at least 2% of the MoD's budget on science and technology.

# 1 Introduction

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1. Each year since 2012, the Ministry of Defence (MoD) has published a Defence Equipment Plan (the Plan) which sets out how the MoD will deliver and support the equipment the UK Armed Forces require over the next 10 years. The equipment requirements of the MoD are based on its assessments of current and future threats, as set out in regular Strategic Defence and Security Reviews (SDSR).

2. The SDSR 2015 made a commitment to increase the equipment budget by at least 1% in real terms every year between 2015 and 2020 and to continue to meet the NATO target to spend 20% of the defence budget on researching, developing and procuring new equipment. In total, the MoD will spend at least £178 billion over 10 years from 2015 on defence equipment and equipment support.<sup>1</sup> How the MoD manages the procurement process will determine the extent to which it can deliver the equipment plan.

3. As the SDSR 2015 highlights, the Government has undertaken a number of reforms in recent years to improve the acquisition and procurement process.<sup>2</sup> These changes have included:

- The creation of a new operating model for defence acquisition within the MoD, following the recommendations of the Levene Review in 2011 that responsibility for managing equipment and support budgets should be delegated to the front line commands, under the respective Service Chiefs;
- The establishment of Defence Equipment and Support (DE&S) as a bespoke trading entity (BTE), operating at arms-length from the MoD; and
- The creation of the Single Source Regulations Office (SSRO), as an independent statutory regulator of the UK government's procurement of 'single source', or non-competitive, military goods, works and services.<sup>3</sup>

4. The importance of successfully implementing these reforms in delivering the equipment required by our Armed Forces should not be underestimated. As the National Audit Office's (NAO) report, *Reforming defence acquisition*, noted in 2015, the MoD "has long wrestled with problems in defence acquisition", resulting in a multi-billion pound gap in the defence budget in 2010.<sup>4</sup>

5. Our Report first considers the longstanding problems in defence procurement and the steps taken by the Government to reform it. It then assesses the affordability of the SDSR 2015 and the 2016 Plan. We also consider the relationship between the Single Service Regulations Office (SSRO), MoD and industry, and whether the SSRO has sufficient powers and independence to be an effective regulator. The Report finishes with an assessment of the Government's broader defence strategy and its implications for acquisition and the UK's science and technology base.

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1 HM Government, National Security Strategy and Strategic Defence and Security Review 2015, Cm 9161, November 2015, p.75

2 HM Government, National Security Strategy and Strategic Defence and Security Review 2015, Cm 9161, November 2015, pp.75–6

3 The SSRO was established under the Defence Reform Act 2014 and subsequent regulations.

4 National Audit Office, *Reforming defence acquisition*, Report by the Comptroller and Auditor General, HC 946, Session 2014–15, 26 February 2015, p.5

## Terms of reference

6. On 19 September 2016, the previous Defence Committee launched an inquiry into the MoD's defence acquisition and procurement policy. Its call for evidence asked for submissions which addressed the following questions:

- How well is defence acquisition reform—a major Departmental initiative—working?
- What issues, risks and uncertainties exist within the Equipment Plan?
- Do we need a new Defence Industrial Strategy?
- Post-Levene, can the front line commands meet their obligations for resource management and requirements setting?
- How are acquisition competencies being developed and assured?
- Does the emerging acquisition system offer value for money?
- What are the implications of leaving the EU for the viability of the UK-based defence industry?
- How are the SSRO and the single-source procurement regime contributing to UK defence?
- How effective is the application of science and technology and research and development within the defence environment?

## The inquiry

7. The previous Committee held four oral evidence sessions with contributions from academics, industry leaders, trades unions, the SSRO, officials from the Ministry of Defence and the Minister for Defence Procurement, Harriett Baldwin MP. They also visited BAE Maritime—Submarines in Barrow and Airbus in Seville, to understand how the Government's acquisition and procurement policy impacts on defence contractors. As part of these visits, they held meetings with senior figures from BAE and Airbus and at Barrow with trade union representatives. While our predecessors had hoped to report earlier in 2017, the calling of the early General Election delayed proceedings. Since that election, we chose to return to this inquiry and have asked additional procurement-related questions to the Ministry of Defence in the course of our inquiry into F-35 procurement and during a one-off evidence session with the then Secretary of State for Defence, the Rt Hon Sir Michael Fallon MP. We intend to report separately on F-35 procurement in due course.

8. We are grateful to all of our witnesses and our predecessor Committee's witnesses for their oral and written evidence and to BAE and Airbus for facilitating the previous Committee's visits.

## 2 Reforming defence acquisition

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### A long-running sore? Problems with defence acquisition and procurement

9. In 2013, our then predecessors noted that “over the years, defence acquisition has presented intractable problems, as the cost of programmes increased and they were delayed”.<sup>5</sup> Indeed, the failures of defence acquisition policy has been a regular feature of Defence Committee and Public Accounts Committee Reports over several Parliaments. In 2004, the Defence Committee reported that “on almost all counts”, the MoD’s Smart Acquisition strategy—which was launched in 1998—had failed to deliver its objectives of procuring equipment “faster, cheaper, better”, with costs increases for the top 20 defence equipment projects totalling £3.1 billion in 2002–03.<sup>6</sup> Five years later, the Committee highlighted the failure of DE&S to control delays on equipment projects and concluded that “almost half of the 20 largest projects” experienced in-service date slippage in 2007–08.<sup>7</sup>

10. The MoD has tried periodically to reform defence procurement. In 2008, the then Secretary of State for Defence, the Rt Hon John Hutton MP, asked Bernard Gray, a former Special Adviser at the Ministry of Defence, to conduct a review of defence acquisition. According to Gray’s report, published in 2009, MoD projects overran on average by 80% and cost more than 40% more than estimated.<sup>8</sup> By 2010, the situation had reached the level where the gap between the Defence programme and the MoD’s budget was believed to be “substantially in excess of £38 billion”.<sup>9</sup> In 2010, Lord Levene was asked to head an independent review into the structure and management of the MoD. His report recommended a ‘new operating model’ for how the MoD should operate, as described in paragraphs 12–13 of this report.<sup>10</sup>

11. In its 2013 White Paper *Better Defence Acquisition: Improving How We Procure and Support Defence Equipment*, the MoD identified three root-causes of the problems experienced in defence procurement:

- i) an overheated equipment programme (i.e., one which is too ambitious in terms of the money available);
- ii) an unstable interface between the parts of the MoD which request equipment and support services, and DE&S which delivers them; and

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5 House of Commons Defence Committee, Defence Acquisition, Seventh Report of Session 2012–13, HC 9, para.7

6 House of Commons Defence Committee, Defence Procurement, Sixth Report of Session 2003–04, HC 572-I, p.3, paras. 12, 19 and 149

7 House of Commons Defence Committee, Defence Equipment 2009, Third Report of Session 2008–09, HC 107, para.50

8 [Review of Acquisition for the Secretary of State for Defence: An Independent Report by Bernard Gray](#), October 2009, p.7

9 House of Commons Defence Committee, [The Strategic Defence and Security Review and the National Security Strategy](#), Sixth Report of Session 2010–12, HC 761, para.203

10 [Defence Reform: An independent report into the structure and management of the Ministry of Defence](#), June 2011

- iii) a lack of business capability (processes, tools and skills), including management freedoms.<sup>11</sup>

Failures to date have made reforming defence acquisition an increasingly pressing departmental priority for the MoD.

## Transforming Acquisition and Procurement

12. Since 2010, the MoD has also been engaged in a transformation of the way in which procurement takes place, a process rooted in the Gray and Levene reports.<sup>12</sup> The NAO's Report *Reforming defence acquisition*, published in 2015, identified three strands to the Department's strategy for reforming defence acquisition, with the MoD seeking to:

- develop an affordable equipment plan, in the form of the Department's ten-year Equipment Plan;
- strengthen the roles and responsibilities of head office, DE&S and the commands, through a new operating model in line with Lord Levene's 2011 review; and
- improve DE&S's skills and capabilities through the Department's materiel strategy.<sup>13</sup>

13. As part of this new operating model, responsibility for equipment and support has been devolved to the individual Service Commands.<sup>14</sup> The MoD stated that this delegation of responsibility to the heads of the Armed Forces included, "the resources and decision rights to shape, own and be held accountable for the military equipment capability that our Armed Forces require".<sup>15</sup> **At least where 'big ticket' equipment items are concerned, such as the F-35 and the carriers, it is questionable to what extent real responsibility resides with the individual Service Chiefs, rather than remaining under central MoD control. Under such circumstances, the Service Chiefs risk taking the blame for equipment acquisition delays and cost overruns primarily caused by Ministerial or MoD miscalculation.**

## The role of Defence Equipment and Support (DE&S)

14. Single service procurement is supported by DE&S, established in 2007, following the merger of the Defence Procurement Agency and the Defence Logistics Organisation. DE&S currently employs 12,500 civil servants and military personnel, and is responsible for:

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11 HM Government, [Better Defence Acquisition: Improving How We Procure and Support Defence Equipment](#), June 2013, Cm 8626, p.4

12 [Review of Acquisition for the Secretary of State for Defence: An independent report by Bernard Gray, 2009](#); [Defence Reform: An independent report into the structure and management of the Ministry of Defence](#), June 2011. For a discussion of the Gray and Levene reports and the Coalition Government's approach to Defence acquisition reform, see: House of Commons Defence Committee, [Defence Acquisition](#), Seventh Report of Session 2012–13, HC 9

13 National Audit Office, *Reforming defence acquisition*, Report by the Comptroller and Auditor General, HC 946, Session 2014–15, 26 February 2015, p.6

14 [Review of Acquisition for the Secretary of State for Defence: An independent report by Bernard Gray, 2009](#), p.13; [Defence Reform: An independent report into the structure and management of the Ministry of Defence](#), June 2011, pp.17–18

15 ACQ0017

- the procurement and support of ships, submarines, aircraft, vehicles, weapons and supporting services;
- general requirements including food, clothing, medical supplies and temporary accommodation;
- inventory management;
- British Forces Post Office; and
- the Submarine Dismantling Project.<sup>16</sup>

15. The materiel strategy initiated by the MoD during the 2010–15 Coalition Government sought to “give DE&S greater management freedoms to introduce private sector practices, skills and tools”, to provide more formalised and rigorous relationships between DE&S, the commands and head office and to “improve DE&S’s efficiency and deliver the Equipment Plan for less”.<sup>17</sup>

16. In 2014, DE&S became a Bespoke Trading Entity (BTE), operating at arms-length from the MoD.<sup>18</sup> DE&S also began a three year transformation programme to ensure that it was “match fit” by 2017.<sup>19</sup> The MoD has defined “match-fit” as:

- equipped to deliver its promises and on the right track to becoming a leader in defence acquisition and in-service support;
- able to deploy its people functionally and flexibly to task;
- using standardised ways of working to help staff to maximise their time and minimise wasted effort;
- supported by a pay and performance system that rewards good performance; and
- developing a Management Information system underpinned by the principle of input once and use many times.<sup>20</sup>

### ***The transformation programme***

17. The transformation programme is based on three key aims:

- i) People Model: “We will have new approaches to people management to improve skill levels, motivation and performance”;
- ii) Balanced Matrix: “We will deploy our people functionally and flexibly to task according to their skill set and availability”; and

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16 [About us - Defence Equipment and Support](#)

17 National Audit Office, Reforming defence acquisition, Report by the Comptroller and Auditor General, HC 946, Session 2014–15, 26 February 2015, p.6

18 See: Newson, N. and S. Tudor, Defence Reform Bill, LLN 2013/038, 6 December 2013; Brooke-Holland, L. Defence Equipment and Support (DE&S), House of Commons Library Standard Note, SN06903, 3 June 2014

19 Brooke-Holland, L. Defence Equipment and Support (DE&S), House of Commons Library Standard Note, SN06903, 3 June 2014.

20 Ministry of Defence and DE&S, Defence Equipment and Support - Corporate Plan 2016–2019, p.16

- iii) Process and Control Framework: “We will have standardised our ways of working so that people focus on the value they add and cut down on wasted effort”.<sup>21</sup>

DE&S claim that this transformation programme will “secure significant gains” both for itself and for its key stakeholders. These claimed benefits include “simplified, standardised and more efficient ways of working”, “better equipment and support for the Armed Forces”, a “more structured approach to decision making” with “greater confidence in DE&S’s ability to support the Armed Forces when needed” and “more power to drive value from industry and deliver cost-savings for the customer and tax payer”.<sup>22</sup>

18. The MoD negotiated new freedoms with the Treasury for DE&S to retain, reward and manage DE&S staff. These include:

- the freedom to manage all aspects of its workforce as necessary to meet its business needs;
- a pay strategy that is treated as separate from the rest of the MoD;
- freedom to pay 25 members of staff more than the senior salary cap set by HM Treasury, without further agreement; and
- exemption from Cabinet Office controls relating to strategic supplier management, advertising, marketing and communications, external recruitment, redundancy and compensation, civil service learning, commercial models and consultancy.<sup>23</sup>

DE&S claim that these freedoms will help the organisation to strengthen both its capability and development into a “world-class programme management organisation”, by allowing it to adopt industry best practice and manage its resources “as efficiently and effectively as possible”.<sup>24</sup>

## Match fit? The front line commands and DE&S

19. In his most recent annual report, Lord Levene suggested that the MoD had “succeeded in transforming the work and achievements of the Department in a number of the most critical areas of business and operations”.<sup>25</sup> On the progress made by the front line commands in implementing the responsibilities devolved to them, Levene found that they had all “embraced, to varying degrees, the changes that are required and are embarked on a journey to develop the skills and expertise required”.<sup>26</sup> On their role as intelligent

21 Ministry of Defence and DE&S, Defence Equipment and Support - Corporate Plan 2016–2019, p.29

22 Ministry of Defence and DE&S, Defence Equipment and Support - Corporate Plan 2016–2019, p.30

23 Ministry of Defence and DE&S, Defence Equipment and Support - Annual Report and Accounts 2015–16, HC 754, p.10

24 Ministry of Defence and DE&S, Defence Equipment and Support - Annual Report and Accounts 2015–16, HC 754, pp.10–11

25 In his 2011 report on Defence Reform, Lord Levene recommended that each year for three years following the publication of his report he produce an independent review of the progress that the MoD had made on implementing his recommendations. Following these three reports, Lord Levene produced an additional report in January 2016.

26 Defence Reform - Fourth Annual Report dated 11 January 2016, p.6

customers of DE&S, Levene reported that “the building blocks are in place”, with the “key challenges being the provision of timely and accurate management information and the pace of transformation within DE&S”.<sup>27</sup>

20. Industry appears to be supportive of the Gray and Levene reforms. Paul Everitt, the Chief Executive of the ADS group, for example, stated that these reforms were “substantial” and that “there is no doubt [ ... ] that the direction is absolutely right”. According to Mr Everitt, the delegation of responsibility to the front line commands and a more transactional and business like relationship with DE&S created “the right kind of tensions for ensuring responsibility and a focus on delivery”.<sup>28</sup> However, he also stressed that while the direction of travel was correct, the “substantive” nature of the reforms meant that it would take “considerable time” for them to be fully implemented.<sup>29</sup> Bob Keen, Head of Government Relations at BAE Systems (BAE), agreed:

The basic principles of delegating responsibilities so that the armed services are more clearly responsible for their own budgets and for making decisions about their capability seems to me a sound one.<sup>30</sup>

21. Mr Keen went on to say that BAE’s recent experience of working with DE&S on the Successor programme, the carrier programme and the Type 26 Global Combat Ship had demonstrated that “lessons have been learned from previous experience”.<sup>31</sup> As with Mr Everitt, Mr Keen stressed that while the reforms represented progress, the “journey” was not over.<sup>32</sup>

22. Safran Helicopter Engines UK Ltd, which manufactures and supports products such as landing gear, aircraft, helicopter and missile gas turbines, oil pumps and electrical power systems for platforms such as the Merlin and Apache helicopters and Eurofighter Typhoon, also welcomed the progress made by the MoD in reforming acquisition. However, it drew attention to the challenges of full implementation of the programme, and highlighted the “scale of behaviour change required” for DE&S to deliver on its objectives, a point also made by ADS in its written evidence.<sup>33</sup> In addition, Safran claimed that the “procurement timelines considered as ‘standard’ within DE&S still appear to be excessive”.<sup>34</sup>

23. The overall direction of reform was also welcomed by techUK, a body representing the 900 technology companies in the UK; but techUK was concerned that the “gigantic task” of implementation was “occurring too slowly”. It said that “much work is still to be done to create more efficient and collaborative procurement and acquisition systems”.<sup>35</sup>

24. Concerns about the pace of reform were raised by the trade union Prospect, which questioned the ability of DE&S to be “match fit” and deliver its transformation programme on time.<sup>36</sup> The union claimed that DE&S continued to suffer from skills shortages, with “significant numbers of ongoing vacancies and little evidence of an improvement in the

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27 Defence Reform - Fourth Annual Report dated 11 January 2016, p.6

28 Q8

29 Q8

30 Q9

31 Q9

32 Q9

33 ACQ0012; ACQ0015

34 ACQ0012

35 ACQ0016

36 ACQ0009

effectiveness of the recruitment processes".<sup>37</sup> Furthermore, its evidence pointed to the difficulties facing DE&S in being match fit at a time when headcount had been cut as part of overall reductions in the civil service. This concern was also raised by Professor Andrew Dorman, of King's College, London, in his evidence.<sup>38</sup>

25. Further scepticism about the benefits of the transformation programme was expressed by Professor Trevor Taylor, Professorial Research Fellow in Defence Management at RUSI. While Professor Taylor noted that DE&S was "improving steadily as an organisation", he believed that it would not "make a big deal of difference to how acquisition works", emphasizing rather the importance of requirements and the emphasis placed on through-life costs to tackling the problems of affordability and overruns.<sup>39</sup>

26. Professor Taylor also warned that, while the new, post-Gray and post-Levene relationship between DE&S and the front line commands made sense for purchasing products which were already available in the marketplace, it made "little sense at all" for projects requiring significant development effort, or for arranging "sensible in-service support arrangements".<sup>40</sup> According to Professor Taylor, in countries that have achieved "remarkable things for their size in defence procurement", industry, government and the military were seen as being on the same team. Indeed, he noted that the UK's cooperative Team Complex Weapons has delivered on time and to cost a series of weapons "that work well".<sup>41</sup>

27. DefenceSynergia also questioned the arrangement between the front line commands and the DE&S. It asked why the armed services should remain " beholden to an arms-length Defence Equipment & Support (DE&S) organisation for procurement of purely naval warfare, land warfare and air warfare equipment and systems". Instead, it suggested that if the four DE&S divisions (maritime, land, air and Joint) were embedded within their respective commands, each head of Command would have responsibility not only for the budget and resources, but would also assume accountability and the ability to "tune procurement processes in context". As a result, "the Four Service Chiefs would be held accountable for the 'Whole Force' delivery of their tasked Capabilities".<sup>42</sup>

28. The MoD claim that the changes involved in defence acquisition reform "have delivered a step change in performance", and an internal audit conducted in 2015 "provided 'substantial assurance' that the relationships between military customers in the front line commands and DE&S are working".<sup>43</sup> However, the MoD conceded that it still had more to do "to ensure that processes are simplified and that there is sufficient clarity about accountability, authority and responsibility".<sup>44</sup>

29. Since the 2017 General Election there have been a number of high level departures announced in the defence procurement field. Most notably, Tony Douglas, the Chief Executive of DE&S, who will be standing down from his post at the end of 2017, and

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37 ACQ0009  
 38 ACQ0009; Q135  
 39 Q135  
 40 ACQ0014  
 41 ACQ0014  
 42 ACQ0004  
 43 ACQ0017  
 44 ACQ0017

Marcine Waterman, the Chief Executive of the SSRO.<sup>45</sup> Giving evidence to the PAC on 11 October 2017, Stephen Lovegrove, the Permanent Under Secretary at the MoD, was clear that Mr Douglas's resignation was unwelcome news for the Department.<sup>46</sup> According to Mr Lovegrove, Mr Douglas had been a "real force for change" within DE&S and had "provided an enormous amount of positive momentum" for the organisation. Mr Lovegrove suggested that it might be some weeks after Mr Douglas left before a successor could begin work.<sup>47</sup>

**30. It is clear that the MoD has made some progress in implementing the reforms recommended by the Gray and Levene reviews. While the direction of the transformation programme appears to command general support, we note the concerns raised about the pace of reform and, in particular, the ability of DE&S to be truly "match fit" this year. Indeed, the MoD has itself acknowledged that it has more to do in delivering the transformation programme. It is therefore a source of concern that Mr Douglas has announced his departure, after a little more than two years in post, as Chief Executive of DE&S and the Committee is unclear as to the reasons for his departure.**

*31. While DE&S has made some progress to date, it is still too soon to judge whether it has adequately matured as an organisation. We remain sceptical about how this goal can be objectively measured. The MoD should provide us with a list of the criteria which have to be met; details of which aspects of the transformation programme have yet to be completed; and an explanation of how to measure the resultant improvements.*

*32. With a National Security and Defence Capability Review underway and due to report early in 2018, the Department must act swiftly to appoint an interim Chief Executive of DE&S, while a full competition is run for a permanent successor to Tony Douglas. The appointment process should also include a pre-appointment hearing with this Committee.*

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45 Hollinger, P. (15 October 2017). Key resignations add to pressure on MoD ahead of funding cuts, The Financial Times, <https://www.ft.com/content/ac0c0a60-b04d-11e7-beba-5521c713abf4>

46 Public Accounts Committee, Oral evidence: Delivering Carrier Strike, HC 394, Wednesday 11 October 2017, Q1

47 Public Accounts Committee, Oral evidence: Delivering Carrier Strike, HC 394, Wednesday 11 October 2017, Q5

### 3 The Defence Equipment Plan

33. As outlined in the previous section, the transformation programme undertaken by the MoD has three strands. This chapter focuses on the final strand of the reform programme, the development of an affordable equipment plan.

#### A thermostat on the equipment budget? The SDSR and Equipment Plans

34. The Gray review, undertaken in 2009, reported that the MoD had a “substantially overheated equipment programme, with too many types of equipment being ordered for too large a range of tasks at too high a specification”.<sup>48</sup> The Gray review noted that maintaining a balanced equipment plan was “clearly a very significant objective”. It therefore recommended routine Strategic Defence Reviews, to be conducted in the first session of a new Parliament, in order to provide “a mechanism to ensure periodic ‘resetting’ of the MoD’s plans”.<sup>49</sup>

35. In 2010, the then Coalition Government published its Strategic Defence and Security Review (SDSR).<sup>50</sup> The SDSR was the first major review of defence since 2003, when the then Labour Government published a Defence White Paper, *Delivering Security in a Changing World*, following its 1998 Strategic Defence Review. According to SDSR 2010, one of the main lessons learned since SDR 1998 was the need more frequently to “reassess capabilities against a changing strategic environment”. In addition, it highlighted the need to “avoid the twin mistakes of retaining too much legacy equipment for which there is no requirement, or tying ourselves into unnecessarily ambitious future capabilities”.<sup>51</sup> The Government also made a commitment to undertake regular SDSRs every five years.<sup>52</sup>

36. Since 2012, the MoD has also published, on an annual basis, a Defence Equipment Plan, which sets out its blueprint for the next 10 years for delivering and support the equipment the UK Armed Forces require to fulfil their role. In the foreword to the 2012 Plan, the then Secretary of State for Defence, Rt Hon Philip Hammond MP, said that the publication of the Plan was “part of an ongoing commitment across Government to transparency” and argued that the Plan would “help deliver greater efficiency within the Department and enable the Defence Industry to plan future investment with greater confidence”.<sup>53</sup>

37. In its 2015 Report, published after the 2014–24 Plan was released before the SDSR 2015, the NAO noted that the MoD’s management of the Plan had “improved over time”. In addition, the NAO welcomed “several positive features” in the 2014 Plan, “not least the relative stability of the forecast project costs of core equipment”.<sup>54</sup>

48 Review of Acquisition, 2009, p.6

49 Review of Acquisition, 2009, p.7

50 HM Government, [Securing Britain in an Age of Uncertainty: The Strategic Defence and Security Review](#), 2010, Cm 7948

51 HM Government, [Securing Britain in an Age of Uncertainty: The Strategic Defence and Security Review](#), 2010, Cm 7948, p.9

52 HM Government, [Securing Britain in an Age of Uncertainty: The Strategic Defence and Security Review](#), 2010, Cm 7948, p.9

53 Ministry of Defence, [The Defence Equipment Plan 2012](#), p.4

54 National Audit Office, Reforming defence acquisition, Report by the Comptroller and Auditor General, HC 946, Session of 2014–15, 26 February 2015, p.12

## The SDSR 2015 and the 2016 Equipment Plan

38. In 2015, following that year's General Election, the Conservative Government published the latest SDSR.<sup>55</sup> The SDSR contained a Government pledge to spend £178 billion between 2015–25 on equipment and equipment support, with £24.4 billion worth of new commitments.<sup>56</sup> These commitments included:

- three new logistic ships;
- new mechanised infantry vehicles;
- eight Type 26 Global Combat Ships, to replace eight of the 13 current Type 23 frigates; and
- nine new Boeing P–8A Maritime Patrol Aircraft.<sup>57</sup>

In addition, the Government also reaffirmed its commitment to replace the Vanguard class of nuclear-armed submarines with a new class of four submarines (the Successor programme).<sup>58</sup> SDSR 2015 also included reform to the defence estate, which “does not meet the needs of our modern Armed Forces”. Accordingly, the Government intends to reduce the estate by some 30%, “releasing public sector land for 55,000 new homes to support wider prosperity objectives”.<sup>59</sup> In addition, the MoD is seeking savings of £2.4 billion by 2040 as a result of this reduction in the size of the defence estate.<sup>60</sup>

39. In January 2017, the MoD released the financial summary of the 2016 Plan. The Plan reflected the conclusions of SDSR 2015 and the 2015 Spending Review (the defence budget was agreed with the Treasury up until 2020–21 as part of the Spending Review settlement).<sup>61</sup> The key spending components of the £178 billion ten year plan were:

- £82 billion on the procurement of new equipment (an increase of nearly 20% on the £68.5 billion announced in the 2015 Plan);
- £23.4 billion on support arrangements for new equipment (an increase of nearly 28% from the 2015 Plan);
- £67.2 billion on support for existing, in-service equipment (an increase of over 2% from 2015); and
- Contingency provision of £5.25 billion (an increase of 23% from 2015).<sup>62</sup>

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55 HM Government, *National Security Strategy and Strategic Defence and Security Review 2015: A Secure and Prosperous United Kingdom*, 2015, Cm 9161

56 HM Government, *National Security Strategy and Strategic Defence and Security Review 2015: A Secure and Prosperous United Kingdom*, 2015, Cm 9161, p.27

57 National Audit Office, *The Equipment Plan 2016–2026*, Report by the Comptroller and Auditor General, HC 914, Session 2017–17, 27 January 2017, p.6

58 HM Government, *National Security Strategy and Strategic Defence and Security Review 2015: A Secure and Prosperous United Kingdom*, 2015, Cm 9161, p.35

59 HM Government, *National Security Strategy and Strategic Defence and Security Review 2015: A Secure and Prosperous United Kingdom*, 2015, Cm 9161, p.34

60 National Audit Office, [The Equipment Plan 2016 to 2026](#), Report by the Comptroller and Auditor General, HC 914, Session 2016–17, 27 January 2017, p.21

61 HM Government, *The Defence Equipment Plan 2016*, p.4; HM Treasury, [Spending Review and Autumn Statement 2015: key announcements](#), 25 November 2015

62 HM Government, *The Defence Equipment Plan 2016*, pp.4, 7

40. In July 2017, the Government announced that the National Security Adviser, Mark Sedwill, had been tasked with leading a National Security Capability Review (the Capability Review). This review, intended to support the implementation of the National Security Strategy (NSS) and the SDSR 2015, will, among other things, “help to ensure that the UK’s investment in national security capabilities is as joined-up, effective and efficient as possible, to address current national security challenges”.<sup>63</sup>

41. During an oral evidence session on F-35 Procurement on 17 October, Harriett Baldwin MP told us that defence formed a strand of the Capability Review and that “everything within defence is something that is being looked at in terms of capability”.<sup>64</sup> The review is expected to report in early 2018.

### ***The SDSR and the 2016 Equipment Plan: a reheated equipment programme?***

42. The NAO published an assessment of the 2016 Plan’s affordability. This came to the conclusion that the cost of the new commitments made by the SDSR “considerably exceed the increase in funding for the plan”.<sup>65</sup> For example, to meet the extra spending commitments arising from SDSR 2015 and the 2016 Plan, the MoD has had to allocate £7.3 billion previously held as equipment plan ‘headroom’—i.e. the margin set aside for developments such as cost increases—and allocate £3.4 billion of centrally held provision into the core equipment plan.<sup>66</sup> According to the NAO, the decision to reallocate all the headroom previously set aside in the plan has had the effect of “removing [the MoD’s] flexibility to accommodate additional capability requirements”.<sup>67</sup>

### ***‘Efficiency savings’***

43. ‘Efficiency savings’ are also an important part of the Plan’s affordability. However, we require greater clarity as to the difference between genuine improvements and efficiency and cuts in personnel, equipment and capability. Even before SDSR 2015, the MoD had assumed ‘efficiency savings’ of £7.1 billion, of which only £4.6 billion have been achieved.<sup>68</sup> SDSR 2015 added additional requirements for ‘efficiency savings’, with the 2016 Plan reliant upon the MoD being able to guarantee another £5.8 billion of ‘efficiency savings’ from within the core equipment plan alongside additional savings of £1.5 billion from the wider defence budget, such as the reduction of the defence estate, as well as the realisation of £7.1 billion of previously announced savings.<sup>69</sup> This gives a grand total of £14.4 billion of ‘efficiency savings’, less the £4.6 billion achieved so far, making a final target figure of £9.8 billion.

63 HM Government, [Strategic Defence and Security Review Implementation](#), 20 July 2017

64 Defence Committee, Oral evidence: F-35 Procurement, HC 326, Tuesday 17 October 2017, Q233

65 National Audit Office, [The Equipment Plan 2016 to 2026](#), Report by the Comptroller and Auditor General, HC 914, Session 2016–17, 27 January 2017, pp.6–8

66 HM Government, [The Defence Equipment Plan 2016](#), p.8

67 National Audit Office, [The Equipment Plan 2016 to 2026](#), Report by the Comptroller and Auditor General, HC 914, Session 2016–17, 27 January 2017, pp.6–8

68 National Audit Office, [The Equipment Plan 2016 to 2026](#), Report by the Comptroller and Auditor General, HC 914, Session 2016–17, 27 January 2017, pp.6–8

69 National Audit Office, [Impact of the Strategic Defence and Security Review on the Equipment Plan](#), HC 319, Session 2016–17, 14 June 2016, p.7; HM Government, [The Defence Equipment Plan 2016](#), p.8; National Audit Office, [The Equipment Plan 2016 to 2026](#), Report by the Comptroller and Auditor General, HC 914, Session 2016–17, 27 January 2017, pp.6–8

44. The tables below detail the efficiency savings required by the 2015 and 2016 Equipment Plans.

#### Efficiency savings in the Equipment Plan 2015–2025

Programme	Savings identified	Total Forecast Savings
Equipment Support Efficiencies	£2.5bn	£4.1bn
Submarine Enterprise Performance Programme (SEPP)	£0.58bn	£0.90bn
Complex Weapons Pipeline	£0.43bn (gross)	£2.1bn (gross, £1.2bn net)
<b>Total</b>	<b>£3.51bn</b>	<b>£7.10bn</b>

MoD, The Defence Equipment Plan 2015, p.12

#### Efficiency Savings in the Equipment Plan 2016–2026

Efficiency Programme	Saving £bn
Further Equipment Support Programme Efficiencies	£0.29bn
DE&S Transformation Efficiencies	£3.32bn
Single Source Contract Regulations	£1.73bn
Equipment Plan Efficiency Measures	£0.51bn
<b>Total</b>	<b>£5.85bn</b>

MoD, The Defence Equipment Plan 2016, pp.8–9

In addition, approximately £1.5 billion would be reassigned to the Plan from wider departmental efficiency savings.

45. According to the NAO, the MoD's progress towards realising its 2015 Plan targets has varied significantly, as can be shown by the efficiency tracker that the NAO published in its most recent equipment plan report:

#### MoD progress against previously announced 'efficiencies'

Source of savings	Target (£bn)	To be achieved by	Savings to date (£bn)
Support budget	£4.1bn	2023–24	£3.4bn
Complex Weapons pipeline	£2.1bn (gross, £1.2bn net)	2019–20	£0.6bn gross
Submarine Enterprise Performance Programme	£0.9bn	2020–21	£0.6bn
<b>Total</b>	<b>£7.1bn</b>		<b>£4.6bn</b>

National Audit Office, [The Equipment Plan 2016 to 2026](#), Report by the Comptroller and Auditor General, HC 914, Session 2016–17, 27 January 2017, p.23

While this leaves £2.5 billion still to be achieved from the previously announced efficiencies, the MoD estimates that it is more than 80% of the way to achieving its support budget savings target (compared with 61% last year), though the NAO notes that the MoD “no longer monitors progress against this target at project level”.<sup>70</sup>

46. In contrast, to the MoD’s performance in realising the support budget targets, the Department has only secured 27% of the ten year savings target within the Complex Weapons pipeline agreement.<sup>71</sup> According to the NAO, “this raises concerns about whether the target will be achieved”, with the prospect of shortfalls being met from elsewhere in Command budgets.<sup>72</sup>

47. With regards to the additional £7.3 billion of efficiency savings created by the 2016 Plan, the NAO’s report repeatedly highlights the lack of clarity as to the specific projects that would be targeted for ‘efficiency savings’. In the face of such “insufficient detail”, the NAO’s outlined additional steps that should be taken to explain “the source of the efficiency savings required to fund the Plan, both from within the Plan itself and the wider defence budget”.<sup>73</sup> For example, the NAO argued that the Government still needed to:

- “establish clear baselines against which savings are to be measured;
- establish a robust audit trail;
- put in place reporting arrangements which mitigate the risk of double-counting;
- report on risks to deliverability and sustainability of savings; and
- create clear lines of accountability for delivery within budget holders”.<sup>74</sup>

48. **We endorse the NAO’s overall conclusion that the “affordability of the plan is now at greater risk than at any time since reporting was introduced in 2012”, warning that the MoD “faces the risk that in future it may have to return to a situation where affordability of the portfolio is maintained by delaying or reducing the scope of projects”.**

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70 National Audit Office, [The Equipment Plan 2016 to 2026](#), Report by the Comptroller and Auditor General, HC 914, Session 2016–17, 27 January 2017, p.24

71 According to the NAO, this programme is “based on meeting the UK’s enduring requirement to have battle winning military capability through the use of Complex Weapons; to be assured that the weapons will perform as expected; and to retain the ability to develop leading edge Complex Weapons technologies. Within this context, the initiative aims to deliver:

- a) Improved, adaptable and flexible Complex Weapons that can be shaped to meet current and future military capability needs;
- b) Freedom of Action and Operational Advantage in our Complex Weapons through a sustained indigenous industrial construct” (National Audit Office, [The Major Projects Report 2013](#), Report by the Auditor and Comptroller General, HC 817-I, Session 2013–14, p.53)

72 National Audit Office, [The Equipment Plan 2016 to 2026](#), Report by the Comptroller and Auditor General, HC 914 Session 2016–17, 27 January 2017 pp.22–24

73 National Audit Office, [The Equipment Plan 2016 to 2026](#), Report by the Comptroller and Auditor General, HC 914 Session 2016–17, 27 January 2017, p.34

74 National Audit Office, [The Equipment Plan 2016 to 2026](#), Report by the Comptroller and Auditor General, HC 914, Session 2016–17, 27 January 2017, p.23

49. Concerns about this heavy reliance on 'efficiency savings' were reiterated during the course of our inquiry. Professor Trevor Taylor doubted the ability of the MoD to make the necessary efficiencies. He commented that the MoD had a "track record of relying on 'efficiency savings' " and that those efficiencies were "never of the scale that are needed to pay for everything that is required". He could not identify where these savings would be made.<sup>75</sup> Professor Matthew Uttley, Chair in Defence Studies at King's College London, agreed. He warned of the "risk of over-optimism" on the potential savings the MoD could make, noting that "history tells us that 'efficiency savings' are rarely met".<sup>76</sup>

50. Professor Andrew Dorman, Professor of International Security at King's College London, warned that the MoD was guilty of both making "big assumptions" about savings and being over-optimistic about the revenue that would be raised from the defence estate, not least because not all of the revenue generated would go to the MoD.<sup>77</sup> Indeed, he noted that the reduction in the defence estate would require moving "a whole series of units" and that at present, the MoD did not have "the cash to move the units".<sup>78</sup>

51. Since the 2017 General Election there has been growing speculation about the real size of the savings needed by the Department to meet its SDSR 2015 commitments and to balance the Equipment Plan. In September 2017, for example, *The Times* published a series of articles looking at alleged efficiency savings that need to be made to fill a reported £30 billion black hole in the MoD's figures. According to these reports, the MoD needs to achieve £3 billion a year in efficiencies to fund the commitments made in the 2015 SDSR. It is alleged that, to do so, the Armed Forces are considering, in the context of the Capability Review, a cut of around 1,000 personnel in the size of the Royal Marines as a means of funding shortfalls within the Royal Navy's budget, following a reduction in the number of minehunter vessels from 15 to 13 and a cut in the number of battlegroups being sent for training in Canada and Kenya. It was also reported that the purchase of F-35Bs might be slowed down from 48 jets by 2025 to 38.<sup>79</sup> It has also been reported that HMS Albion and HMS Bulwark are under threat, with suggestions that Brazil and Chile have been advised by UK Government officials that the vessels could become available for sale.<sup>80</sup>

52. When pressed on this speculation, during an appearance before the Committee on 17 October 2017, Stephen Lovegrove insisted that, while the Capability Review was "looking at a whole range of capabilities [ ... ] no decisions about any capabilities have been made at all". Similarly, the Minister for Defence Procurement, Harriett Baldwin MP, while recognising the press speculation about cuts, sought to assure the Committee that although "everything is being considered [ ... ] certainly nothing has come before Ministers for decisions".<sup>81</sup> Indeed, Mrs Baldwin had written to the Committee Chairman as recently as 25 January 2017, in respect of HMS Albion and HMS Bulwark:

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75 Q124

76 Q125

77 Qq124, 126

78 Q128

79 Haynes, D. (7 September 2017). Warships and battlefield training to be axed in defence cuts, *The Times*, <https://www.thetimes.co.uk/article/warships-and-battlefield-training-to-be-axed-in-defence-cuts-q7nr0stsz>; Haynes, D. (20 September 2017). Defence review puts 1,000 Marines in firing line to fund Navy shortfall, *The Times*, <https://www.thetimes.co.uk/article/defence-review-puts-1-000-marines-in-firing-line-to-fund-navy-shortfall-87d79d865>

80 Higuera, J. (24 October 2017). Brazil, Chile eye potential second hand acquisitions from UK, *HIS Jane's Navy International*, <http://www.janes.com/article/75174/brazil-chile-eye-potential-second-hand-acquisitions-from-uk>

81 Defence Committee, Oral evidence: F-35 Procurement, HC 326, Tuesday 17 October 2017, Qq233–234

There are no current plans to decommission the ships early, and I can reassure you that their out of service dates are 2033 and 2034 respectively.

53. While the MoD has sought to downplay concerns about the potential cuts to capability, there appears to be uncertainty within the Department over the true size and scale of the 'efficiency savings' required to keep the Plan and SDSR 2015 afloat.

54. During her appearance before our predecessor Committee in January 2017, Harriett Baldwin MP, the Minister for Defence Procurement, told us that the Plan, at £178 billion, was the "biggest equipment plan that the Ministry of Defence has had to work on [ ... ] for some considerable length of time".<sup>82</sup> Stephen Lovegrove accepted that "any programme with 1,000 projects in it is going to have risk in it". In particular, he noted that the MoD would have to deliver "a great many efficiencies" to make the plan affordable, and that this was where the risk to the plan lay.<sup>83</sup>

55. In our 17 October session, we also asked Stephen Lovegrove about the MoD's progress on realising its efficiency targets and put to him the figure of £14 billion of savings (less those already realised) over the decade ahead. He said that he "did not recognise" that sum and instead discussed an overall target of £30 billion over a ten-year period.<sup>84</sup> However, in June this year, he had told the Institute for Government that the Department needed to make £20 billion of efficiency savings.<sup>85</sup> When we discussed the MoD's efficiency targets with the then Secretary of State, Sir Michael Fallon MP, on 25 October 2017, he told us that he too had "been trying to drill down as to exactly how it [Lovegrove's £20 billion figure] was constructed".<sup>86</sup>

56. Since those evidence sessions, we have asked the NAO for further information as to the MoD's 'efficiency programmes'. According to the NAO, "the MoD does not publish a definitive list of its saving and efficiency programmes or targets, and it is not clear how, or whether, the programmes relate". Furthermore, the MoD, according to the NAO, "does not consistently report on progress against targets. Updates are included in a number of sources, using different categorisations", including SDSRs and the Department's Annual Report and Accounts.<sup>87</sup>

**57. We concur with the NAO that much more information is required from the MoD regarding the 'efficiency savings' proposed by the 2016 Equipment Plan. The number of savings required and their importance to the overall affordability of the Equipment Plan, make transparency of the utmost importance. This is particularly the case when, only two years after the SDSR 2015, the full range of defence capabilities are facing re-examination as part of the broader National Security Capability Review being undertaken by the National Security Adviser, Mark Sedwill.**

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82 Q243

83 Q244

84 Defence Committee, Oral evidence: F-35 Procurement, HC 326, Tuesday 17 October 2017, Q240

85 Haynes, D. (27 June 2017). MoD targets £20bn savings, *The Times*, <https://www.thetimes.co.uk/article/mod-targets-20bn-savings-9vxmmkglh>

86 Defence Committee, Oral evidence; Work of the Department 2017, HC 439, Wednesday 25 October 2017, Q9

87 WOD0001

### Currency fluctuations

58. The NAO also highlighted the importance of fluctuations in exchange rates to the Plan's affordability, noting that as of 10 January 2017 the pound had been 21.4% below the exchange rate with the US dollar used in the MoD's planning assumptions and 4.2% below the equivalent exchange rate for the euro. This is particularly important as £18.6 billion of the Plan is denominated in dollars and £2.6 billion in euros.<sup>88</sup> Noting that the MoD had hedged some of its currency risks, Professor Taylor argued that this was not enough "to cover anywhere near the major purchases that are in mind". After all, as he commented, "I do not think anybody anticipated [ ... ] that the pound might drop in value by 17%".<sup>89</sup>

59. In evidence to our predecessor Committee in January 2017, Stephen Lovegrove emphasized the "sophisticated" contingency arrangements that had been put in place to mitigate the potential risk of cost increases absorbing any efficiencies realised by the MoD. He said that about 6% of the programme was held as contingency within DE&S, with £5.3 billion "held in the centre" as contingency.<sup>90</sup>

60. Further details of the Department's hedging programme were provided to the current Committee on 17 October and to the Committee of Public Accounts (PAC) on 11 October. From the evidence provided in those two sessions, it is clear that the MoD has a "rolling three-year programme of hedging with the Bank of England", using an exchange rate of around \$1.50.<sup>91</sup> According to the evidence of Mr Lovegrove to the PAC, the MoD will soon be renegotiating its hedging programme with the Bank of England.<sup>92</sup>

### Conclusion

**61. SDSR 2015 allocated £178 billion to defence procurement over ten years. While this represents a sizable increase on previous budgets, it must be seen in the context of an ambitious equipment plan which includes major projects such as the replacement of the Royal Navy's frigates, the purchase of the P-8A maritime surveillance aircraft, the F-35 fighters and the Ajax fighting vehicle. It is therefore a cause for alarm that the NAO has concluded that the affordability of the plan is at greater risk now than at any time since the introduction of annual reporting in 2012. Above all, delivery of the plan is heavily dependent upon achieving cost-saving 'efficiencies' and will have to operate with minimal 'headroom' and contingency provision.**

**62. We seriously doubt the MoD's ability to generate the efficiencies required to deliver the equipment plan. In the past, the MoD has proven incapable of doing so—for example, in 2015, when only 65% of planned 'efficiency savings' were achieved. Even if all the efficiencies are realised, there will be little room for manoeuvre, in the absence of sufficient financial 'headroom' and contingency funding. This is not an adequate basis for delivering major projects at the heart of the UK's defence capability. Our confidence in the Department's ability to deliver these savings has not been enhanced**

88 National Audit Office, *A Short Guide to the Ministry of Defence*, September 2017, p.23

89 Q127

90 Q247

91 Public Accounts Committee, Oral evidence: *Delivering Carrier Strike*, HC 394, Wednesday 11 October 2017, Q70; Defence Committee, Oral evidence: *F-35 Procurement*, HC 326, Tuesday 17 October 2017, Qq215–216

92 Public Accounts Committee, Oral evidence: *Delivering Carrier Strike*, HC 394, Wednesday 11 October 2017, Q70

by the inconsistent set of targets referred to by the Permanent Secretary, including a £20 billion target that appeared to leave even the former Secretary of State for Defence confused.

63. *We recommend that the MoD should build on the Capability Review and undertake a comprehensive review of its efficiency plans and a detailed assessment of the likelihood of the target savings being achieved. This review should set out the basis for an adequate contingency, in the event of the current plan proving either unaffordable or undeliverable to the MoD's stated timetable.*

64. *To bolster confidence in the affordability of the equipment plan, we recommend that the MoD should publish an 'efficiency tracker' which would detail when, where and how efficiencies are to be made, together with a list of risks to the implementation of all major projects. Where risks are identified, the MoD must identify alternative, deliverable, sources of funding within each relevant financial year or, in the absence of any alternative sources, indicate by how much the defence budget is falling short of what is needed adequately to equip the Armed Forces.*

## 4 The Single Source Regulations Office

65. Single source procurement, whereby goods are procured from one supplier, is a prominent feature in the UK defence acquisition landscape. It amounts to some £8 billion, or 40% of the MoD's overall procurement budget, per annum, and is a consequence of the reduction in the quantities of equipment ordered for the Armed Forces, despite the increasing complexity and expense of that equipment.<sup>93</sup> Some of the UK's most important capabilities, including Astute and Successor submarines, Type 45 destroyers, the Queen Elizabeth class carriers, and Typhoon fast jets, are bought using single source procurement. Since 2014, this has been regulated by the Single Source Regulations Office (SSRO). This chapter examines the development, and effectiveness, of the regulatory framework for single source defence procurement.

### The Yellow Book and the Currie review

66. Before 2014, single source defence contracts were governed by the Government Profit Formula and its Associated Arrangements (GPFAA), also known as the 'Yellow Book'. Established in 1968, the Yellow Book took the form of an agreement between the Treasury and the Confederation of British Industry and was overseen by the Review Board for Government Projects, a non-departmental public body of the MoD.<sup>94</sup>

67. In 2011, Lord Currie of Marylebone was asked by the MoD to undertake an independent review of the Yellow Book.<sup>95</sup> In looking at increasing contractor efficiency and value for money for taxpayers, the Currie review was "complementary to, and consistent with" the Gray and Levene reports.<sup>96</sup> The Currie review found that there had "undoubtedly been inefficiencies in single source MoD spending", partly a result of inefficiencies on the side of industry and "from skilful deployment of Yellow Book regulations to secure returns that, although within the regulations, have not been appropriate".<sup>97</sup> Lord Currie's review saw the need for three main measures to redress these problems:

A fundamental recasting of the Yellow Book regulations and arrangements to ensure that the necessary data is available to senior MOD decision-makers in a usable form; changes in MOD procurement processes; and a new mechanism replacing the existing Review Board for external assurance of compliance with the single source procurement regime that we propose.<sup>98</sup>

68. As a result, Lord Currie proposed that the Review Board for Government Projects be replaced by a new body, the Single Source Regulations Office (SSRO). The SSRO would have a remit to scrutinise single source defence procurement, define and maintain a framework that encourages efficiency and value for money in MoD single source procurement.<sup>99</sup>

69. In 2013, the Government published a White Paper, *Better Defence Acquisition*, announcing a "new framework" in line with the Currie review's recommendations. According to the MoD, "in exchange for a fair profit for industry", the new framework

93 HM Government, *The Defence Equipment Plan 2016*, p.14

94 Newson, N. and S. Tudor, *Defence Reform Bill*, LLN 2013/038, 6 December 2013, p.15

95 [Review of Single Source Pricing Regulations](#), 2011

96 [Review of Single Source Pricing Regulations](#), 2011, pp.7-8

97 [Review of Single Source Pricing Regulations](#), 2011, p.9

98 [Review of Single Source Pricing Regulations](#), 2011, p.9

99 [Review of Single Source Pricing Regulations](#), 2011, p.65

would provide the Department with far greater transparency, helping it “to investigate whether suppliers are being as efficient as possible”.<sup>100</sup> The new framework has two key components:

New statutory regulations which help to ensure both that industry gets a fair return on single-source work and that the taxpayer is effectively protected.

A new governance regime, supported by the SSRO, which will help to ensure widespread application and adherence, and which will ensure the regulations are kept to date.<sup>101</sup>

## The SSRO

70. Established by the 2014 Act<sup>102</sup> and subsequent Single Source Contract Regulations (SSCRs), the SSRO regulates the UK government’s procurement of ‘single source’, or non-competitive, military goods, works and services. It is the independent statutory regulator of single source defence procurement, issuing statutory guidance, assessing compliance and determining how the regime applies to individual contracts.

71. The regulatory regime established a set of controls which cover the prices of applicable contracts (Qualifying Defence Contracts (QDCs) and Qualifying Sub-Contracts (QSCs)) and requires transparency on the part of contractors regarding their prices and capacity to meet their contractual obligations and the Government’s requirements. As the SSRO’s 2017 Annual Report on the single source regime explains, “a QDC is a non-competitively procured defence contract with a value of £5 million or more. If a sub-contract of a QDC is also awarded without competition, and has a value of more than £25 million, it becomes a QSC”.<sup>103</sup> However, government-to-government contracts are explicitly excluded from the remit of the SSRO. This means that key equipment items such as the P-8A Maritime Patrol Aircraft are excluded, as is the Apache helicopter upgrade. In addition, the SSRO can act as an arbiter where aspects of a contract are under dispute.

72. In discharging its duties, the 2014 Act stipulated that, the SSRO “must aim to ensure”:

- (1) that good value for money is obtained in government expenditure on qualifying defence contracts; and
- (2) that persons (other than the Secretary of State) who are parties to qualifying defence contracts are paid a fair and reasonable price under those contracts.<sup>104</sup>

## *The SSRO: an effective regulator?*

### *Delivering value for money and a fair and reasonable price*

73. As outlined above, the SSRO has two aims that guide it in regulating single source defence contracts. First, to ensure value for money and second, to make sure that

100 Ministry of Defence, [Better Defence Acquisition: Improving How We Procure and Support Defence Equipment](#), 2013, Cm 8626, p.8

101 Newson, N. and S. Tudor, Defence Reform Bill, LLN 2013/038, 6 December 2013, p.15

102 Defence Reform Act 2014, Part Two

103 SSRO, [Annual Report on the single source regime 2017](#), p.22

104 Defence Reform Act 2014, section 13(2)

contractors are “paid a fair and reasonable price”. The work of the SSRO and the SSCRs form an important part of the MoD’s overall ‘efficiency savings’ targets. According to the 2017 NAO report, *Improving value for money in non-competitive procurement of defence equipment*, the MoD has set a ten year target of saving £1.7 billion as a result of the SSCRs, with a “more detailed objective” of saving £637 million by 2020. In the NAO’s opinion, “achieving these savings is important for maintaining the affordability” of the Equipment Plan.<sup>105</sup>

74. The SSRO told our predecessor Committee in 2016 that, from the limited data reported to them, they believe they have identified £110 million of savings in the first 50 qualifying contracts. This is comprised of:

Nearly £35 million of savings through wage inflation, faulty workmanship or inflation indices [ ... ] We have also identified a further £45 million that we say is non-allowable cost under our guidance—either egregious, such as entertaining or charitable donations, or relating to some of the bigger issues around how one prices risk. A feature of our new approach to assessing profit has brought the cost down by £63 million.<sup>106</sup>

75. The NAO has concluded that by July 2017, the SSCRs had identified “a reduction of £313 million in contract prices (3.9% of total contract values), based on returns for 79 contracts”. According to the NAO, this is part cost avoidance and partially counts towards the £1.7 billion target. However, “as these savings are across the life of the contracts it is not clear how this maps onto the savings targets”.<sup>107</sup>

76. Industry have expressed concerns about the operation of the SSRO thus far. Paul Everitt of ADS told the Committee that he believed that the focus of the SSRO had been:

Rather more on demonstrating, or at least announcing, their efforts in terms of securing value for money for the taxpayer and not quite enough on recognising their dual responsibility to deliver a fair return for industry as well.<sup>108</sup>

Mr Everitt added that, from an industry perspective, they “would like to feel there was a stronger appreciation of how industry operates and in particular how it understands a fair return”.<sup>109</sup> In particular, he claimed that the methodology used by the SSRO to calculate the baseline profit rate was not “robust enough”.<sup>110</sup>

77. These tensions between industry, the SSRO and the MoD were also identified by the NAO report. According to this report, “the early stages of the Regulations have been characterised by differences of opinion between industry and the regulatory body, in part, prompted by the SSRO’s sometimes confrontational public tone [ ... ] the SSRO and the

105 National Audit Office, *Improving value for money in non-competitive procurement of defence equipment*, Report by the Comptroller and Auditor General, HC 412, Session 2017–18, 25 October 2017, p.34

106 Qq 209–10

107 National Audit Office, *Improving value for money in non-competitive procurement of defence equipment*, Report by the Comptroller and Auditor General, HC 412, Session 2017–18, 25 October 2017, p.34

108 Q58

109 Q61

110 Q61

Department have also disagreed about the former's interpretation of its remit". The same report, however, noted that all parties "are now seeking to make a fresh start in their relationships".<sup>111</sup>

**78. The SSRO was established with two objectives: first, to ensure good value for money, and secondly, to ensure that suppliers are paid a fair and reasonable price. While the SSRO has played a valuable role in delivering savings for the taxpayer, it is less clear that the SSRO has effectively discharged its second objective. While industry will always seek a bigger return on contracts, it is clear that the SSRO could do more to demonstrate that it is as focused on securing a fair and reasonable price for suppliers as it is on ensuring good value for money for taxpayer.**

### *The scope of the SSRO regulatory framework*

79. In its written evidence to the inquiry, the SSRO accepts that the single-source procurement regime has been "slow to embed", and that therefore the effectiveness of the regime has yet to be "fully realised". The SSRO also highlighted the fact that achieving value for money and a fair return for industry required "the application of the regulatory framework, including pricing controls, to as many contracts as possible."<sup>112</sup>

80. The SSRO argue that a greater proportion of single source contracts should become Qualifying Defence Contracts (QDCs) or Qualifying Sub-Contracts (QSCs) and therefore subject to price control and reporting. In support of its position, the SSRO reported that in 2015, only 15–20% of MoD single source expenditure was within the SSRO regime.<sup>113</sup> Such limited coverage was, in its opinion, contrary to the aims of the 2014 Act.<sup>114</sup>

81. In particular, the SSRO expressed concerns about the thresholds for contracts becoming QSCs and the level of excluded and exempted contracts. At present the QSC threshold is set at £25 million, a level that the SSRO claimed "can exclude significant sub-contracts from being subject to the statutory regime". According to its analysis, "reducing the threshold to £5 million would bring approximately 48% of sub-contracts into the regime".<sup>115</sup>

82. The Secretary of State has the power of direction to exempt contracts that would otherwise fall within the regulatory framework. These are in addition to excluded contracts which fall into the following categories:

- contracts with a foreign government;
- contracts for the purpose of intelligence activities;
- contracts for the acquisition, management or maintenance of land/buildings; and

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111 National Audit Office, Improving value for money in non-competitive procurement of defence equipment, Report by the Comptroller and Auditor General, HC 412, Session 2017–18, 25 October 2017, p.28

112 ACQ0008

113 ACQ0008; Q185

114 ACQ0008

115 ACQ0008

- contracts made within the framework of a cooperative international defence programme, based on research and development.<sup>116</sup>

83. The SSRO complained that there was currently “a lack of information and transparency around the provisions under which a contract was exempted or excluded”. This made it difficult for the SSRO to “assess the impact of the legislation [the 2014 Act]”.<sup>117</sup>

84. The then Chief Executive of the SSRO, Marcine Waterman, told our predecessor Committee that one of the “key recommendations” of Lord Currie’s review was that the SSRO should see all single source spend, “whether it qualifies or not”.<sup>118</sup> The SSRO have called for the MoD to record and publish the data of contracts falling outside the regime, arguing that it would enable the SSRO and other stakeholders “to better analyse the efficacy of the regime and would also increase transparency in MoD spending of taxpayers money”.<sup>119</sup> In the case of government-to-government contracts, Marcine Waterman suggested that all the Secretary of State needed to do was redact the more sensitive aspects of the contractual arrangements.<sup>120</sup>

85. The Secretary of State is required by the 2014 Act to undertake periodic reviews of the single source regulatory regime, the first of which is due to be completed in December 2017. As the SSRO explains, in conducting these reviews, the Secretary of State “must have regard to any recommendations made by the SSRO, provided these are submitted six months before the date on which the review is to be completed”.<sup>121</sup>

86. On 30 January 2017, the SSRO launched a consultation into their proposed recommendations for the first periodic review.<sup>122</sup> The SSRO focused its proposed recommendations for change on three key areas:

- ensuring that single source spending is appropriately covered by the regime;
- enhancing transparency; and
- providing effective enforcement of the regime.<sup>123</sup>

Included in the recommendations put out for consultation were the following relating to the scope of the regulatory framework:

- a) material contract amendments should be brought within the SSRO regime;
- b) the definition of a QSC should be amended to make clear that a contract may be a QSC if it provides anything for a proposed QDC or QSC;

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116 Ministry of Defence, *An overview: Single Source Procurement Framework*, June 2014, p.4

117 ACQ0008

118 Q204

119 ACQ0008

120 Q207

121 SSRO, *Consultation on recommendations: Review of Part 2 of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014*, January 2017, p.2

122 SSRO, *Consultation on recommendations: Review of Part 2 of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014*, January 2017, pp.1–5

123 SSRO, *Consultation on recommendations: Review of Part 2 of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014*, January 2017, p.6

- c) the current price threshold for QSCs should be reduced from £25 million to £10 million; bringing the threshold closer in alignment with that which applies for QDCs (£5 million);
- d) the international cooperative defence programme (according to the SSRO an essential element in defining such a programme is that it is “established or mandated by more than one government”, e.g. NATO<sup>124</sup>) exclusion should be restricted to contracts made wholly within the relevant framework, and that contracts wholly for the purposes of intelligence activities should not be excluded if the subject matter of the contract does not disclose the associated operational purpose;
- e) all steps of the contract profit rate calculation should be specified as grounds for referral to the SSRO, as should questions relating to whether a contract is a QDC or QSC.<sup>125</sup>

The SSRO is also consulting on the matter of the exclusion of government-to-government contracts.<sup>126</sup>

87. By contrast, in industry there appears to be less enthusiasm for the extension of the SSRO’s coverage. Paul Everitt, from ADS, said that industry was “very comfortable” with the SSRO’s current scope, but he emphasized that the SSRO was a “relatively new organisation” and that all involved were “still going through a settling down period”.<sup>127</sup> In light of the “growing pains” with the SSRO’s relationship with industry, he suggested that it was “a bit early” for the SSRO to be “expanding [its scope] just at this particular point in time”.<sup>128</sup>

88. Professor Uttley highlighted the “anomalous” situation where the system “imposes regulations on domestically-sourced equipment”, but not on foreign military sales.<sup>129</sup> According to Professor Uttley, the biggest issue with the single source regulatory system was the “uneven application of the SSRO for significant areas of procurement that are conducted through single sourcing, and that is the foreign military sales”.<sup>130</sup>

89. Harriett Baldwin MP told us that 66 QDCs and eight QSCs “with a value of more than £10 billion” were now covered by the SSRO rules.<sup>131</sup> The Minister told us that the issues of foreign military sales and the exclusion of government-to-government contracts had been considered by the MoD at the time the 2014 Act was being brought into effect and that the current exclusions had been decided upon for two reasons:

First of all, obviously the Department of Defense in the US already has its own way of assuring cost. We have heard about some extra efforts on the F-35 programme today, but they do already have some very rigorous ways of doing that cost control themselves. Secondly, in terms of the legal

124 SSRO, [SSRO answers to frequently asked questions](#), 26 May 2016, p.10

125 SSRO, Consultation on recommendations: Review of Part 2 of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014, January 2017, pp.11, 16–17, 19, 23, 32

126 SSRO, Consultation on recommendations: Review of Part 2 of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014, January 2017, p.37–38

127 Q65

128 Q58

129 Q162

130 Q162

131 Q299

jurisdiction and the ability to enforce that in the US courts with US suppliers when we have gone in as part of a government-to-government contract, it was felt that that was not a legal position that was going to be a reasonable one to take.<sup>132</sup>

However, the Minister noted that the SSRO had launched its consultation and that the Department would respond to its recommendations later in the year when the outcomes of the periodic review were due to be published.<sup>133</sup>

90. According to the NAO's 2017 report on the SSRO and SSCRs, by July 2017, 110 contracts (95 QDCs and 15 QSCs) had been brought within the single source regulatory regime, "with a combined value of £23.9 billion".<sup>134</sup> The NAO found that there had been particular challenges facing the MoD with certain suppliers with contracts above the QDC threshold (£5 million) "who are either refusing to be subject to the Regulations or will not provide the required information about costs and prices" and with contracts pre-dating the SSCRs that may be brought within them on amendment. In the latter case, "if an amendment is identified as being eligible, the contractors must agree to the contract being brought within the regime". As the NAO report notes, as a result, only eight contracts (with a total value of around £7 billion) have been converted to QDCs on amendment.<sup>135</sup>

91. The NAO also found that it was "not clear" how far the SSCRs were being applied to QSCs. Where contracts are above £25 million, it is left to the contractors to assess whether the sub-contracts are QSCs and to then notify the MoD and SSRO. According to the NAO, as of August 2017, "only 15 such contracts had been signed". Their report suggested that confusion existed among suppliers as to whether a sub-contracts qualifies for the SSCRs and in some cases had disagreed with the MoD and SSRO about their status. In addition, "a number of suppliers have told the SSRO that they support improvement and clarification regarding the definition of QSCs".<sup>136</sup>

### *The regulatory powers of the SSRO*

92. The SSRO possesses only limited regulatory powers. At present, it has neither enforcement powers nor the ability to "require the provision of information, including the contracts themselves".<sup>137</sup> This is in contrast to the powers of a number of other regulatory bodies:

- Ofcom holds statutory information-gathering powers under the Communications Act 2003, the Wireless Telegraphy Act 2006 and the Postal Services Act 2011. In addition, Ofcom, under the Communications Act 2003, sets and enforces regulatory rules for the sectors for which it has responsibility and has the powers to enforce competition law and to issue penalty notices in these sectors.<sup>138</sup>

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132 Q299

133 Q299

134 National Audit Office, Improving value for money in non-competitive procurement of defence equipment, Report by the Comptroller and Auditor General, HC 412, Session 2017–19, 25 October 2017, p.30

135 National Audit Office, Improving value for money in non-competitive procurement of defence equipment, Report by the Comptroller and Auditor General, HC 412, Session 2017–19, 25 October 2017, p.31

136 National Audit Office, Improving value for money in non-competitive procurement of defence equipment, Report by the Comptroller and Auditor General, HC 412, Session 2017–19, 25 October 2017, p.31

137 ACQ0008

138 Ofcom, *What is OFCOM?*

- The Civil Aviation Authority (the CAA) has information-gathering powers, which are set out in the Civil Aviation Act 2012, and has civil powers, as set out in the Enterprise Act 2002, to take enforcement action in relation to a range of passenger rights legislation and general consumer law. The CAA can seek undertakings from businesses that require them to comply with the law and can also request enforcement orders from the Courts.<sup>139</sup>

93. The SSRO has argued that its powers should be more in line with those of other comparable regulators and drew attention to the Currie report which recommended that it should have powers to gather information on single source contracts from the MoD and contractors, including:

- details of all single source contracts, whether they qualify as QDCs or not;
- copies of contracts for all contracts valued at £50 million or more, and others on request;
- post-contracting reports;
- notification of the application of contractual terms; and
- details of independent costing exercises (date, total cost, risk and material changes).

According to the SSRO, the absence of powers to extract that information “frustrates its regulatory role and undermines its compliance assessment of reporting requirements”.<sup>140</sup>

94. The SSRO undertakes compliance assessments and can make recommendations for the MoD to issue a compliance notice.<sup>141</sup> The SSRO does not, however, have the power to compel contractors to comply with the regulatory framework.<sup>142</sup>

95. Ahead of the first periodic review of the single source regulatory framework, the SSRO has put out for consultation a number of recommendations on information-gathering and enforcement powers (see Para. 86). For example, the SSRO proposes to recommend that the 2014 Act is amended “to empower it to require by notice in writing that contractors provide the SSRO with information”. This would apply in circumstances where the information is needed to enable the SSRO to discharge its statutory functions; the request is proportionate; and, when the information requested is neither included in reports under the 2014 Act nor in the public domain.<sup>143</sup> In order to ensure that any such notices are complied with, the SSRO has also proposed to recommend that “responsibility for issuing compliance and penalty notices is transferred to the SSRO in respect of reporting and QSC assessments only”.<sup>144</sup>

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139 Civil Aviation Authority, *Our Statutory Duties*; Civil Aviation Authority, *Competition Powers*

140 ACQ0008

141 ACQ0008

142 SSRO, Consultation on recommendations: Review of Part 2 of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014, January 2017, p.34

143 SSRO, Consultation on recommendations: Review of Part 2 of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014, January 2017, p.27

144 The SSRO recommends that responsibility for issuing notices relating to the duty to keep records and the duty to notify should remain with the MoD; SSRO, Consultation on recommendations: Review of Part 2 of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014, January 2017, p35

96. The Single Source Regulations Office was created to scrutinise single source defence contracts and deliver savings for the taxpayer. However, by its own admission, the SSRO's ability to be a truly effective regulator has been handicapped by the narrow scope of the regulatory framework and the limited number of contracts that fall within its remit and that are referred to it. While there was a lack of enthusiasm among industry for the SSRO's coverage to be extended, it is clear that the SSRO cannot be fully effective when only 15–20% of the MoD's single source expenditure falls within its regulatory regime.

97. *To be fully effective, the SSRO's scope should be extended to include the right to examine government-to-government contracts and any single source contracts that it chooses, save in exceptional circumstances.*

98. *If all appropriate contracts are to be brought within the SSCR regime then there needs to be greater clarity and certainty regarding the definition of QDCs, QDCs 'on amendment' and QSCs. The Department should also assess whether the current 'honesty box' approach whereby the onus is on contractors themselves to assess whether sub-contracts qualify and to then notify the Department and the SSRO, as well as the current veto provided to suppliers on bringing a contract within the SSCR regime as a QDC 'on amendment', are satisfactory ways to proceed in the future.*

99. *In addition, the SSRO must be given a range of powers similar to those available to other regulators. In particular, the SSRO requires enhanced powers of information gathering, enforcement and compliance. We recommend that, following the SSRO's consultation on extending the scope of the single source regulatory regime, the MoD should bring forward proposals to align the powers of the SSRO with those of other regulators.*

## Guaranteeing the independence of the SSRO

### *The role of the Chief Executive*

100. The SSRO is headed by a Chair, George Jenkins OBE, and a Chief Executive. Until October 2017, the SSRO's Chief Executive was Marcine Waterman. She has now stepped down. Mr Jenkins is the third person to hold the Chair's post since 2014. The Chief Executive's responsibilities are as follows:

- to keep the Single Source Contract Regulations and Part 2 of the Act under review, encouraging compliance with the legislation and demonstrating that single source can be a credible alternative where it provides value for money and competitive procurement is not viable, and appropriate oversight is in place;
- to provide the Secretary of State with its assessment of the appropriate baseline profit rate, capital servicing rates and funding adjustment for each year. Following the SSRO's recommendation, the Secretary of State determines the rates and adjustment for that year;
- to provide opinions and legally binding determinations in response to referrals from the MOD, contractors and sub-contractors;

- to publish statutory guidance on the determination of penalty amounts to be used by the MOD in issuing penalty notices, and acting as the appeal body for penalties;
- to assess compliance with reporting requirements and publishing an annual Compliance Report to measure industry and MOD compliance with their duties and obligations under the Act and Regulations; and
- to provide independent insights into single source defence contracts, relevant to value for money and fair pricing, that enable prices to be estimated, contracts negotiated and projects managed in a more informed and effective manner.<sup>145</sup>

101. The SSRO was established as an executive non-departmental public body, sponsored by the MoD, to provide guidance to both the Department and industry on the costs allowable within single source arrangements, with the intent to offer industry greater certainty, and to offer the Department and the taxpayer better value for money. In the event of a dispute between the MoD and a contractor, the SSRO, under the terms of the 2014 Act, acts as an independent regulator and adjudicator.

102. However, while the SSRO was created by the 2014 Act as an independent regulator, the MoD makes all of the senior appointments to the SSRO's board and, since 1 April 2017, provides half of its funding (the other half is provided by industry via a funding adjustment on contract profit for QDCs).<sup>146</sup> As the SSRO's written evidence to this inquiry acknowledges, "there is a recognised difficulty in any regulator receiving funding and senior appointments from one of the organisations it regulates". Indeed, it notes that there are "inevitable tensions arising from the position of the MoD as the specifier, buyer and user of the equipment and services we regulate".<sup>147</sup> The lack of a clear demarcation between the SSRO and the MoD is underlined by the fact that the SSRO has no enforcement powers, meaning that, in the words of the SSRO's former Chief Executive, Marcine Waterman, "the MoD can clearly just ignore us".<sup>148</sup>

103. Ms Waterman emphasized the importance of clarifying what an "appropriate relationship" with the MOD should be, "if we are to be truly independent".<sup>149</sup> At the time of our predecessor Committee's evidence session with Ms Waterman on 6 December 2016, the SSRO had lost two Chairs within the first two years of the organisation's existence. Notably, she mentioned that both individuals had "felt strongly about the importance of clarity - whether a chairman reports to the MoD or to his board and what the explicit arrangement is around our independence".<sup>150</sup>

104. On the question of how the boundaries between the SSRO and MoD could be made clearer, Ms Waterman mentioned the question of parliamentary scrutiny of the SSRO's Chair and welcomed the idea of a pre-appointment hearing between ourselves and the

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145 [About us - Single Source Regulations Office](#)

146 [SSRO, SSRO answers to frequently asked questions](#), 26 May 2016, p.8

147 ACQ0008

148 Q227

149 Q238

150 Q233

next Chair as an “excellent suggestion”.<sup>151</sup> According to Ms Waterman, such a hearing would “enable you [the Defence Committee] to hear his or her priorities and to set what their objective is in becoming the chair and settling this organisation”.<sup>152</sup>

105. On 22 December 2016, George Jenkins OBE was appointed as the new Chair of the SSRO, assuming the post on 1 January 2017. The appointment was made without offering us the Defence Committee with an opportunity to hold a pre-appointment hearing, despite Committee members indicating an interest in, and Ms Waterman’s enthusiasm for, such a hearing during our evidence session with the SSRO on 6 December 2016.

106. When we put this to the Minister, Harriett Baldwin MP, she suggested that she had not been aware of any request for a pre-appointment hearing and claimed that she had been keen to ensure that a new Chair was appointed in time for the beginning of 2017.<sup>153</sup> However, she acknowledged that a pre-appointment hearing for future appointments was a “very sensible request for the Committee to be making”, which the MoD would “take very seriously”.<sup>154</sup>

107. As for the SSRO’s relationship with the MoD, the Minister emphasized that, while established as an independent body, the SSRO had been set up by the MoD to perform a specific function for the Department.<sup>155</sup> Ms Baldwin spoke of the SSRO in terms of an organisation that was working well “on behalf of the Ministry of Defence” and “making recommendations to the Secretary of State”.<sup>156</sup>

108. In October 2017 it was announced that Marcine Waterman had resigned as Chief Executive of the SSRO.<sup>157</sup>

**109. If the SSRO is to be successful, it needs to be independent of both Government and industry. At present, the boundaries between the SSRO and the MoD lack clarity, with the MoD responsible for all of the senior appointments to the SSRO’s board and for the provision of half of its funding. Indeed, it is clear to us that MoD considers the role of the SSRO to be one of performing functions on behalf of the Department rather than acting as a regulator to provide fair and effective oversight of both the MoD and industry, on behalf of the public.**

**110. The resignation of Marcine Waterman as Chief Executive is an unwelcome development. While we do not know the circumstances of her departure, we hope that a permanent appointment will be made shortly.**

***111. If the SSRO is to serve as a fully-fledged regulator, rather than just as a unit to assist the MoD, its personnel must be chosen, and its funds provided, independently of the MoD. We would also expect future appointments to positions of the Chair and the Chief Executive of the SSRO to be subject to pre-appointment hearings by our own Committee. The Department should start with a pre-appointment hearing for Ms Waterman’s permanent successor.***

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151 Q231

152 Q238

153 Q306

154 Qq307, 309

155 Qq300–302, 305

156 Qq302, 305

157 Single Source Regulations Office (2 October 2017), Chief Executive Announcement, <https://www.gov.uk/government/news/chief-executive-announcement>

## 5 Acquisition and a Defence Industrial Strategy

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### Defence industrial policy and an industrial strategy

112. In SDSR 2015, the Government made a commitment to refresh its defence industrial policy and to take “further action to help the UK’s defence and security industries to grow and compete successfully”. It also pledged to “drive greater innovation into the UK’s defence procurement to ensure that future investment decisions contribute to a more dynamic and productive economy”.<sup>158</sup> This refreshing of industrial policy would be guided by the Government’s continuing commitment to the principles outlined in 2012 in its previous defence industrial policy, *National Security Through Technology*:

- (1) The Open Procurement Principle: “wherever possible, we will seek to fulfil the UK’s defence and security requirements through open competition in the domestic and global market”; which is qualified by
- (2) The ‘Technology Advantage principle’: “we will take action to protect our operational advantages and freedom of action, but only where this is essential for national security”. This can be considered to be the sovereign capability principle.<sup>159</sup>

113. On 23 November 2016, the Government announced the beginning of the defence industrial policy refresh. It confirmed that it would “make clear that competition remains our preferred approach, delivering value for money and incentivising an innovative and productive industrial base”.<sup>160</sup>

114. On 23 January 2017, the Government published its Green Paper *Building our Industrial Strategy*.<sup>161</sup> The paper identified ten “pillars” which the Government believed were “important to drive forward our industrial strategy across the entire economy”. Two of those pillars are of direct relevance for defence acquisition and procurement policy: improving procurement (pillar 5) and encouraging trade and inward investment (pillar 6).<sup>162</sup> The Green Paper also made reference to the refresh of defence industrial policy currently underway, noting that this policy will “aim to improve the support to growth and competitiveness within the UK industrial base as well as help SME and non-traditional suppliers to bid for defence and security contracts more easily”.<sup>163</sup>

**115. The development of a successful defence industrial policy is of the utmost importance to this Committee. This chapter’s conclusions and recommendations are our preliminary thoughts and we plan to return to this issue in the future.**

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158 HM Government, *National Security Strategy and Strategic Defence and Security Review 2015*, Cm 9161, November 2015, p.75

159 Ministry of Defence, [National Security Through Technology: Technology, Equipment, and Support for UK Defence and Security](#), 2012, Cm 8278, pp.13–14

160 HM Government, [The Minister for Defence Procurement has announced the start of the Defence Industrial Policy Refresh consultation](#), 23 November 2016

161 HM Government, *Building our Industrial Strategy*, January 2017

162 HM Government, *Building our Industrial Strategy*, January 2017, pp.74–75, 83

163 HM Government, *Building our Industrial Strategy*, January 2017, p.74

## What should underpin a new defence industrial policy?

116. There was broad support from both industry and the trade unions for the idea of a refreshed defence industrial policy, particularly as a means of identifying and defining capabilities which are central to UK defence.<sup>164</sup> According to Tony Burke, Assistant General Secretary of Unite, a robust industrial policy for defence would require the Government to look at a number of key issues, including:

What our sovereign capabilities are, and what kit we are going to need for the future. We should be planning for the long term to ensure that we have a stable manufacturing base, certainly in the defence and aerospace industries.<sup>165</sup>

### Defining value for money

117. Professor Uttley argued in his evidence that the current defence industrial policy was predicated on, among other factors, “a particular view of value for money.”<sup>166</sup> He suggested that there was “some mileage” in a broader conception of value for money that looked at the:

Net economic and security benefits of different acquisition options in terms [ ... ] of where the pound goes: the economic and employment multipliers that are derived from investing in suitable onshore alternatives, fiscal revenues, strategic influence that can be derived from exporting national defence goods and so on”.<sup>167</sup>

This broader definition of value for money would be “cognisant of employment, industrial and economic implications of [ ... ] huge amounts of Government expenditure in a sector in which Governments are the only legitimate purchasers and exporters”.<sup>168</sup>

118. Paul Everitt further argued that, while industry had been comfortable with the idea that procurement was a competitive system, there was a concern that the MoD’s “very narrow interpretation” of the meaning of value for money had limited opportunities for UK businesses. He suggests that the “wider economic and industrial implications of significant expenditure” should be a consideration of any refreshed defence industrial policy.<sup>169</sup> Similar arguments were made to us by Safran Helicopters and Unite the Union.<sup>170</sup>

**119. The combination of a defence industrial policy refresh and a new overall industrial strategy provides an important opportunity for the Government to rethink the role of, and support provided to, the defence industry as part of the wider UK economy.**

**120. *To maximise this opportunity, we recommend that those updating the defence industrial policy should consider adopting a broader definition of ‘value for money’***

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164 See, for example: ACQ0004 and ACQ0006; Q143. However, some scepticism was expressed by Dr Warren Chin from King’s College London. While not arguing against a defence industrial policy in and of itself, Dr Chin warned of the possibility that, as a result of continuing technological developments, the Government “will bet on the wrong horse and end up preserving capability that proves to be obsolete”( Q143, 148).

165 Q106

166 Q148

167 Q148

168 Q148

169 Q38

170 ACQ0006; ACQ0012

*that incorporates the impact of major defence projects on local economies, skills and employment levels. Accordingly, the Department should implement the Government's revised procurement guidelines so that 'local value' can be taken into account.*<sup>171</sup>

### **Procurement, the UK's skills and industrial base, and sovereign capability**

121. A further consideration in respect of value for money was the need to maintain the UK's skills base and sovereign capability. Professor Trevor Taylor stated that, at present, there is a contradictory attitude within the MoD where "the need to support and build our domestic sources of supply" competed with the desire to buy from the world market in order to gain the "maximum freedom possible".<sup>172</sup>

122. The MoD has agreed to a number of significant off-the-shelf purchases from the United States of America, including the P-8A Maritime Patrol Aircraft and the Apache AH-64E helicopter.<sup>173</sup> The Government has also committed to the purchase of 138 F-35s as part of an international alliance of customer countries, of which the US is the primary consumer, from a consortium led by Lockheed Martin. Those purchases have been of little benefit to the UK's domestic skills base and sovereign capability—albeit that 15% of total F-35 production takes place in the UK. Indeed, as David Pitchforth, the Vice-President and Managing Director of Boeing Defence UK, acknowledged, the P-8A cannot be refuelled by UK tankers or take UK weapons.<sup>174</sup> By contrast, Professor Taylor highlighted collaborative projects, such as the Typhoon and A400M, which had a "major role in helping the UK to keep substantive capabilities" and where the UK has retained a significant degree of "sovereign control".<sup>175</sup>

123. Professor Uttley argued that the procurement of off-the-shelf equipment had a negative impact on the number of qualified scientists and engineers employed in the UK.<sup>176</sup> In a similar vein, Defence Synergia warned that while increased levels of procurement from the USA may increase "commonality" and "inter-operability" with our key ally, it also had the effect of reducing UK expertise in industrial design, manufacturing and support.<sup>177</sup> However, Professor Taylor noted that there are UK benefits "that are pretty well publicised with the F-35 in terms of the work that BAE Systems and others do on the back of the airplane".<sup>178</sup>

124. Nonetheless, Professor Taylor told us that defence industrial capability in the UK was reducing "because of such procurement decisions".<sup>179</sup> This had implications not only for the UK's skills base, but also for the UK's export potential. As Professor Dorman has noted, "one of the big questions for the UK defence industry is, what is the next generation

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171 The Secretary of State for Business, Energy and the Industrial Strategy drew attention to this change in Government procurement policy in response to a parliamentary question on 27 June 2017 that asked about the steps that the Government was undertaking "to ensure that Government Departments, local services, emergency services, councils and other public bodies back British industry and British jobs" (HC Deb (27 June 2017) Vol.626, c.459).

172 Q148

173 Qq149–150

174 Qq87, 91 and 101

175 Q152

176 Q150

177 ACQ0004

178 Q149

179 Q152

of equipment and is it going to sell, or is this the last generation of equipment [as a result of the UK being the junior partner on platforms such as the F-35]?" To emphasise this point he noted that the UK had not sold a new destroyer, frigate or submarine since the 1970s.<sup>180</sup>

125. The lack of a regular, high quantity turnover in domestic defence procurement activity has also been a challenge to the UK's skills base and to our sovereign capabilities.<sup>181</sup> This was demonstrated by the problems suffered in the Astute shipbuilding programme, where a ten-year gap between the Vanguard and Astute class submarines resulted in substantial reductions in the workforce at Barrow, from around 12,000 in 1990 to under 2,000 in 2000. Losses in key skills and capabilities as a result of those reductions were a key factor in the series of well-publicised problems for the submarine-building programme, ranging from the nuclear reactor to the quality of work and equipment.<sup>182</sup> The result was the first vessel of the Astute Class being launched four years late, with the cost of the first three boats (HMS Astute, HMS Ambush and HMS Artful) over a billion pounds above the original approved budget.<sup>183</sup>

126. Bob Keen, the Head of Government Relations at BAE, acknowledged that the Astute programme had been a "painful" experience for BAE, but he believed that "lessons have undoubtedly been learned as a result".<sup>184</sup> He pointed to the announcement made by the Secretary of State for Defence in November 2016 that steel would be cut on the Type 26 frigates in the summer of 2017 as evidence of "an understanding that a regular drumbeat of shipbuilding is necessary to sustain the skills and capabilities we have".<sup>185</sup>

127. In oral evidence, Harriett Baldwin MP defended the decision to purchase equipment, such as the P-8A, either off-the-shelf and/or through government-to-government contracts. According to Ms Baldwin, the P-8A deal had a number of advantages for the UK, most notably the fact that bulk-buying alongside the USA "helps bring down the unit cost".<sup>186</sup> The Minister also pointed to the fact that Boeing had recently announced that the UK had been chosen as its base for its European defence business. As a result, Boeing had committed to increase the number of people it employs in the UK by 50% by 2020.<sup>187</sup> However, we need details to ensure that these are not just existing jobs rebadged under the Boeing brand but new jobs and new capability. With regard to the F-35, Ms Baldwin told us that 15% of each of the 3,000 planes being produced would be manufactured in the UK.<sup>188</sup> According to Bob Keen, the F-35 programme was the "biggest defence programme in history" and the UK's contribution was "hugely important to the UK manufacturing industry".<sup>189</sup>

128. Harriett Baldwin also emphasised that the UK/US relationship was a "two-way" arrangement which had delivered significant benefits to the UK, including the locating

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180 Q156

181 ACQ0004

182 We were told by BAE during our visit to Barrow that as a result of this production gap the company had to rebuild its nuclear capabilities from scratch and with the assistance of American colleagues.

183 According to the NAO, the first three boats cost £3.536 billion, £1.3 billion above the original approved budget of £2.233 billion National Audit Office, Major Projects Report 2015, Report by the Comptroller and Auditor General, HC 488-I, Session 2015–16, 22 October 2015, pp.42, 47

184 Q15

185 Q15

186 Q290

187 Q290

188 Q294

189 Q45

of the global maintenance and repair hub for the F-35 in North Wales and the creation of a £100 million base for the P-8s in Lossiemouth, which would provide employment for some 400 people.<sup>190</sup>

**129. While we understand the factors that may lead to off-the-shelf procurement, the MoD must have a clear understanding of the impact of those procurement decisions on the UK's labour force, skills base and sovereign capability. Without that understanding, the difficulties that blighted the early stages of the Astute programme—which arose from a ten-year gap in submarine-building in Barrow—could easily be repeated, to the detriment of UK skills and industrial capability.**

*130. We therefore recommend that the new defence industrial policy emphasises the importance of a regular drumbeat of activity to sustain a successful and high-skilled work force and to maintain the UK's sovereign capabilities. It should also look at the types and quantity of defence equipment that is currently sourced externally, with a view to identifying where such equipment could be sourced domestically.*

### **Investing in research and development**

131. In their 2013 report, Defence Acquisition, one of our predecessor Committees emphasised that spending on defence science and technology by the MoD should be increased. The Report argued that failures to invest in this area, taken together with off-the-shelf procurement, represented “a serious threat to the technical skills base [ ... ] within the United Kingdom”.<sup>191</sup> It therefore recommended that the UK Government should commit itself to a target of 2% of the defence budget being spent on UK based research and development.<sup>192</sup>

132. SDSR 2015 committed the Government to continue spending 1.2% of the defence budget on science and technology and to continue to meet the NATO target to spend 20% on researching, developing and procuring new equipment.<sup>193</sup> The 1.2% investment in science and technology is the same percentage as in 2013, when it was compared unfavourably to spending in other countries and when the then Minister for Defence Procurement accepted that it was not enough and that a 2% target would be better.<sup>194</sup>

**133. We agree with our predecessor Committee's conclusions that the UK needs to invest more in defence science and technology and research and development. Such investment is of key importance to the sustainability and future success of the UK's technical skills base. It is therefore regrettable that the Government have continued with the 1.2% commitment, rather than agreeing to pledge to spend at least 2% of the defence budget on science and technology.**

**134. The defence industrial policy refresh and development of an industrial strategy provide an important opportunity for the Government to change direction and invest more in defence innovation and the UK's technical skills base. We recommend that the**

190 Q294

191 House of Commons Defence Committee, Defence Acquisition, Seventh Report of Session 2012–13, HC 9, para. 111

192 House of Commons Defence Committee, Defence Acquisition, Seventh Report of Session 2012–13, HC 9, para. 114

193 HM Government, National Security Strategy and Strategic Defence and Security Review 2015, Cm 9161, p.27

194 House of Commons Defence Committee, Defence Acquisition, Seventh Report of Session 2012–13, HC 9, para. 110

***Government should make a commitment, as part of the defence industrial policy refresh and the overall industrial strategy, to spend at least 2% of the defence budget on science and technology.***

## Conclusions and recommendations

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### Reforming defence acquisition

1. At least where 'big ticket' equipment items are concerned, such as the F-35 and the carriers, it is questionable to what extent real responsibility resides with the individual Service Chiefs, rather than remaining under central MoD control. Under such circumstances, the Service Chiefs risk taking the blame for equipment acquisition delays and cost overruns primarily caused by Ministerial or MoD miscalculation. (Paragraph 13)
2. It is clear that the MoD has made some progress in implementing the reforms recommended by the Gray and Levene reviews. While the direction of the transformation programme appears to command general support, we note the concerns raised about the pace of reform and, in particular, the ability of DE&S to be truly "match fit" this year. Indeed, the MoD has itself acknowledged that it has more to do in delivering the transformation programme. It is therefore a source of concern that Mr Douglas has announced his departure, after a little more than two years in post, as Chief Executive of DE&S and the Committee is unclear as to the reasons for his departure. (Paragraph 30)
3. *While DE&S has made some progress to date, it is still too soon to judge whether it has adequately matured as an organisation. We remain sceptical about how this goal can be objectively measured. The MoD should provide us with a list of the criteria which have to be met; details of which aspects of the transformation programme have yet to be completed; and an explanation of how to measure the resultant improvements.* (Paragraph 31)
4. *With a National Security and Defence Capability Review underway and due to report early in 2018, the Department must act swiftly to appoint an interim Chief Executive of DE&S, while a full competition is run for a permanent successor to Tony Douglas. The appointment process should also include a pre-appointment hearing with this Committee.* (Paragraph 32)

### The Defence Equipment Plan

5. We endorse the NAO's overall conclusion that the "affordability of the plan is now at greater risk than at any time since reporting was introduced in 2012", warning that the MoD "faces the risk that in future it may have to return to a situation where affordability of the portfolio is maintained by delaying or reducing the scope of projects". (Paragraph 48)
6. We concur with the NAO that much more information is required from the MoD regarding the 'efficiency savings' proposed by the 2016 Equipment Plan. The number of savings required and their importance to the overall affordability of the Equipment Plan, make transparency of the utmost importance. This is particularly the case when, only two years after the SDSR 2015, the full range of defence capabilities are facing re-examination as part of the broader National Security Capability Review being undertaken by the National Security Adviser, Mark Sedwill. (Paragraph 57)

7. SDSR 2015 allocated £178 billion to defence procurement over ten years. While this represents a sizable increase on previous budgets, it must be seen in the context of an ambitious equipment plan which includes major projects such as the replacement of the Royal Navy's frigates, the purchase of the P-8A maritime surveillance aircraft, the F-35 fighters and the Ajax fighting vehicle. It is therefore a cause for alarm that the NAO has concluded that the affordability of the plan is at greater risk now than at any time since the introduction of annual reporting in 2012. Above all, delivery of the plan is heavily dependent upon achieving cost-saving 'efficiencies' and will have to operate with minimal 'headroom' and contingency provision. (Paragraph 61)
8. We seriously doubt the MoD's ability to generate the efficiencies required to deliver the equipment plan. In the past, the MoD has proven incapable of doing so—for example, in 2015, when only 65% of planned 'efficiency savings' were achieved. Even if all the efficiencies are realised, there will be little room for manoeuvre, in the absence of sufficient financial 'headroom' and contingency funding. This is not an adequate basis for delivering major projects at the heart of the UK's defence capability. Our confidence in the Department's ability to deliver these savings has not been enhanced by the inconsistent set of targets referred to by the Permanent Secretary, including a £20 billion target that appeared to leave even the former Secretary of State for Defence confused. (Paragraph 62)
9. *We recommend that the MoD should build on the Capability Review and undertake a comprehensive review of its efficiency plans and a detailed assessment of the likelihood of the target savings being achieved. This review should set out the basis for an adequate contingency, in the event of the current plan proving either unaffordable or undeliverable to the MoD's stated timetable.* (Paragraph 63)
10. *To bolster confidence in the affordability of the equipment plan, we recommend that the MoD should publish an 'efficiency tracker' which would detail when, where and how efficiencies are to be made, together with a list of risks to the implementation of all major projects. Where risks are identified, the MoD must identify alternative, deliverable, sources of funding within each relevant financial year or, in the absence of any alternative sources, indicate by how much the defence budget is falling short of what is needed adequately to equip the Armed Forces.* (Paragraph 64)

### The Single Source Regulations Office

11. The SSRO was established with two objectives: first, to ensure good value for money, and secondly, to ensure that suppliers are paid a fair and reasonable price. While the SSRO has played a valuable role in delivering savings for the taxpayer, it is less clear that the SSRO has effectively discharged its second objective. While industry will always seek a bigger return on contracts, it is clear that the SSRO could do more to demonstrate that it is as focused on securing a fair and reasonable price for suppliers as it is on ensuring good value for money for taxpayer. (Paragraph 78)
12. The Single Source Regulations Office was created to scrutinise single source defence contracts and deliver savings for the taxpayer. However, by its own admission, the SSRO's ability to be a truly effective regulator has been handicapped by the narrow scope of the regulatory framework and the limited number of contracts that fall within its remit and that are referred to it. While there was a lack of enthusiasm

among industry for the SSRO's coverage to be extended, it is clear that the SSRO cannot be fully effective when only 15–20% of the MoD's single source expenditure falls within its regulatory regime. (Paragraph 96)

13. *To be fully effective, the SSRO's scope should be extended to include the right to examine government-to-government contracts and any single source contracts that it chooses, save in exceptional circumstances.* (Paragraph 97)
14. *If all appropriate contracts are to be brought within the SSCR regime then there needs to be greater clarity and certainty regarding the definition of QDCs, QDCs 'on amendment' and QSCs. The Department should also assess whether the current 'honesty box' approach whereby the onus is on contractors themselves to assess whether sub-contracts qualify and to then notify the Department and the SSRO, as well as the current veto provided to suppliers on bringing a contract within the SSCR regime as a QDC 'on amendment', are satisfactory ways to proceed in the future.* (Paragraph 98)
15. *In addition, the SSRO must be given a range of powers similar to those available to other regulators. In particular, the SSRO requires enhanced powers of information gathering, enforcement and compliance. We recommend that, following the SSRO's consultation on extending the scope of the single source regulatory regime, the MoD should bring forward proposals to align the powers of the SSRO with those of other regulators.* (Paragraph 99)
16. *If the SSRO is to be successful, it needs to be independent of both Government and industry. At present, the boundaries between the SSRO and the MoD lack clarity, with the MoD responsible for all of the senior appointments to the SSRO's board and for the provision of half of its funding. Indeed, it is clear to us that MoD considers the role of the SSRO to be one of performing functions on behalf of the Department rather than acting as a regulator to provide fair and effective oversight of both the MoD and industry, on behalf of the public.* (Paragraph 109)
17. *The resignation of Marcine Waterman as Chief Executive is an unwelcome development. While we do not know the circumstances of her departure, we hope that a permanent appointment will be made shortly.* (Paragraph 110)
18. *If the SSRO is to serve as a fully-fledged regulator, rather than just as a unit to assist the MoD, its personnel must be chosen, and its funds provided, independently of the MoD. We would also expect future appointments to positions of the Chair and the Chief Executive of the SSRO to be subject to pre-appointment hearings by our own Committee. The Department should start with a pre-appointment hearing for Ms Waterman's permanent successor.* (Paragraph 111)

### Acquisition and a Defence Industrial Strategy

19. *The development of a successful defence industrial policy is of the utmost importance to this Committee. This chapter's conclusions and recommendations are our preliminary thoughts and we plan to return to this issue in the future.* (Paragraph 115)

20. The combination of a defence industrial policy refresh and a new overall industrial strategy provides an important opportunity for the Government to rethink the role of, and support provided to, the defence industry as part of the wider UK economy. (Paragraph 119)
21. *To maximise this opportunity, we recommend that those updating the defence industrial policy should consider adopting a broader definition of 'value for money' that incorporates the impact of major defence projects on local economies, skills and employment levels. Accordingly, the Department should implement the Government's revised procurement guidelines so that 'local value' can be taken into account. (Paragraph 120)*
22. While we understand the factors that may lead to off-the-shelf procurement, the MoD must have a clear understanding of the impact of those procurement decisions on the UK's labour force, skills base and sovereign capability. Without that understanding, the difficulties that blighted the early stages of the Astute programme—which arose from a ten-year gap in submarine-building in Barrow—could easily be repeated, to the detriment of UK skills and industrial capability. (Paragraph 129)
23. *We therefore recommend that the new defence industrial policy emphasises the importance of a regular drumbeat of activity to sustain a successful and high-skilled work force and to maintain the UK's sovereign capabilities. It should also look at the types and quantity of defence equipment that is currently sourced externally, with a view to identifying where such equipment could be sourced domestically. (Paragraph 130)*
24. We agree with our predecessor Committee's conclusions that the UK needs to invest more in defence science and technology and research and development. Such investment is of key importance to the sustainability and future success of the UK's technical skills base. It is therefore regrettable that the Government have continued with the 1.2% commitment, rather than agreeing to pledge to spend at least 2% of the defence budget on science and technology. (Paragraph 133)
25. The defence industrial policy refresh and development of an industrial strategy provide an important opportunity for the Government to change direction and invest more in defence innovation and the UK's technical skills base. *We recommend that the Government should make a commitment, as part of the defence industrial policy refresh and the overall industrial strategy, to spend at least 2% of the defence budget on science and technology. (Paragraph 134)*

# Formal Minutes

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**Tuesday 12 December 2017**

Members present:

Rt Hon Dr Julian Lewis, in the Chair

Leo Docherty	Ruth Smeeth
Rt Hon Mr Mark Francois	Rt Hon John Spellar
Graham P. Jones	Phil Wilson
Gavin Robinson	

Draft Report (*Gambling on 'Efficiency': Defence Acquisition and Procurement*), proposed by the Chair, brought up and read.

*Ordered*, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 134 read and agreed to.

Summary agreed to.

*Resolved*, That the Report be the First Report of the Committee to the House.

*Ordered*, That the Chair make the Report to the House.

*Ordered*, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Tuesday 19 December at 10.45 am]

## Witnesses

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The following witnesses gave evidence in the previous Parliament and can be viewed on the [inquiry publications page](#) of the Committee's website.

### Tuesday 8 November 2016

*Question number*

**Bob Keen**, Head of Government Relations, BAE Systems, and **Paul Everitt**, Chief Executive, ADS Group [Q1–65](#)

**David Pitchforth**, Vice President and Managing Director, Boeing Defence UK Ltd, and **Nick Whitney**, Director, Global Sales and Marketing, Boeing Defence UK Ltd [Q66–104](#)

**Tony Burke**, Assistant General Secretary for Manufacturing, Unite, **Jonathan Green**, Head of Research, Prospect, and **Phil Rudd**, Spokesman, Trades Union Delegates Conference, BAE Systems [Q105–122](#)

### Tuesday 15 November 2016

**Dr Warren Chin**, Senior Lecturer, Defence Studies Department, King's College London, **Professor Andrew Dorman**, Professor of International Security, King's College London, **Professor Trevor Taylor**, Professorial Research Fellow in Defence Management, RUSI, and **Professor Matthew Uttley**, Chair in Defence Studies, King's College London [Q123–168](#)

### Tuesday 6 December 2016

**Marcine Waterman**, Chief Executive, and **Matthew Rees**, Director of Analysis and Reporting, Single Source Regulations Office (SSRO) [Q169–241](#)

### Tuesday 31 January 2017

**Harriett Baldwin MP**, Minister for Defence Procurement, **Stephen Lovegrove CB**, Permanent Secretary, Ministry of Defence, **Lieutenant General Mark Poffley OBE**, Deputy Chief of the Defence Staff (Military Capability), and **Tony Douglas**, Chief Executive Officer, Defence Equipment and Support [Q242–309](#)

## Published written evidence

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The following written evidence was received by the Committee in the previous Parliament and can be viewed on the [inquiry publications page](#).

ACQ numbers are generated by the evidence processing system and so may not be complete.

- 1 ADS Group ([ACQ0015](#))
- 2 Dair Farrar-Hockley ([ACQ0024](#))
- 3 Defence Analysis ([ACQ0001](#))
- 4 Defence Economics Research Team ([ACQ0010](#))
- 5 DefenceSynergia ([ACQ0004](#))
- 6 Dr Aris Georgopoulos ([ACQ0018](#))
- 7 Ministry of Defence ([ACQ0017](#))
- 8 Ministry of Defence ([ACQ0025](#))
- 9 Ministry of Defence ([ACQ0026](#))
- 10 Ministry of Defence ([ACQ0027](#))
- 11 Mr Frederick Dupuy ([ACQ0005](#))
- 12 Mr Ian Holder ([ACQ0002](#))
- 13 Mr Ian Holder ([ACQ0003](#))
- 14 Mr Jag Patel ([ACQ0013](#))
- 15 Mr Jag Patel ([ACQ0019](#))
- 16 Professor Trevor Taylor ([ACQ0014](#))
- 17 Professor Trevor Taylor ([ACQ0022](#))
- 18 Prospect ([ACQ0009](#))
- 19 Royal Aeronautical Society ([ACQ0011](#))
- 20 Safran Helicopter Engines UK Ltd ([ACQ0012](#))
- 21 Single Source Regulations Office ([ACQ0021](#))
- 22 Single Source Regulations Office ([ACQ0008](#))
- 23 Strategic Defence Initiatives ([ACQ0023](#))
- 24 techUK ([ACQ0016](#))
- 25 Trades Unions Delegates Conference at BAE Systems ([ACQ0007](#))
- 26 Unite the Union ([ACQ0006](#))

## List of Reports from the Committee during the current Parliament

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All publications from the Committee are available on the [publications page](#) of the Committee's website.

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

### Session 2017–19

First Special Report	SDSR 2015 and the Army	HC 311
Second Special Report	Armed Forces Covenant Annual Report 2016	HC 310
Third Special Report	Investigations into fatalities in Northern Ireland involving British military personnel: Government Response	HC 549