



# Ministry of Defence

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*Dear Anne-Marie*

I committed to write to you following the UK Sovereign Capabilities Westminster Hall Debate on UK Sovereign Capability on 20 November 2018 to answer some of the specific points raised by you and other hon. Members.

## **Defence Industrial Strategy**

To begin with, I would like to highlight that the Ministry of Defence (MOD) does in fact have a Defence Industrial Strategy. Our strategy was set out in the 2012 National Security Through Technology White Paper and restated in the 2017 refreshed Defence Industrial Policy. We are clear that international competition remains at the heart of our approach; this allows our Armed Forces to secure the best equipment from an open, global marketplace to meet evolving threats. We also recognise that we need to protect the UK's freedom of action and operational advantage. In determining our critical operational advantage or freedom of action capabilities our policy is more concerned on how we can access the capabilities we require, rather than where the manufacturing resides. This is the essence of our approach in the National Shipbuilding Strategy, which sets out how we will act to protect access to those aspects of warship design and build required for national security. We are committed to shipbuilding on the Clyde, and BAE Systems have the certainty of a 20-year pipeline to invest in their infrastructure and people to sustain enduring warship design and construction. To ensure the best deal for the taxpayer in this long-term relationship, we are contracting for Type 26 batches 1 and 2 separately, thereby accruing the anticipated savings at the platform and programme level. This far outweighs any price differential at the component level and allows for the management of obsolescence.

More widely this Government is committed to maintaining access to UK industrial capabilities vital to our National Security. However, for national security reasons, we have no intention of publishing a detailed list of industrial capabilities that we wish to retain in the UK. I will not apologise for always seeking the best value for money for the taxpayer and the best equipment possible when procuring for our Armed Forces. This does sometimes mean that purchasing 'off the shelf' from other nations is the best

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solution. Recent single source procurements or our intention to go single source were highlighted during the debate as detrimental to UK Industry and sovereign capabilities. However, in these cases there have not been UK alternatives that would meet our requirements in time and offer a value for money solution. Taking the E-7 Wedgetail as an example, while we have not yet made our final investment decision, our market analysis confirmed that a competition would not identify options that could satisfy our Airborne Warning and Control System requirements faster or at better value. In addition, operating the same system as Australia opens opportunities for training and co-manning, as well as reducing the risk and providing opportunities to share development and sustainment costs through-life. Likewise, for the P-8A Maritime Patrol Aircraft, analysis of the available options concluded that only the operationally-proven P-8A would allow us to get the capability needed in the required timeline.

Even where our analysis leads us to procure our requirements from overseas, as in the examples above, we are committed to ensuring that the UK defence sector can grow and compete successfully. For programmes like Apache, P-8A and F-35, we have worked to secure significant supply chain opportunities for UK companies. At Farnborough International Airshow in 2016, the MOD and Boeing announced a long-term initiative to advance prosperity in the UK. Boeing has reinforced its commitment to deliver on the prosperity agenda through a step-change in its onshore presence and industrial engagement with the UK. To date, four bid workshops have been held in the UK involving 64 UK companies, and three supplier engagement events in the US have been held, involving 104 UK companies.

## **Prosperity**

In growing value for the UK as a whole in defence procurement, we take wider social and economic impacts, strategic international interests and national security objectives into account. As stated in our refreshed Defence Industrial Policy, we are overseeing the establishment of a more systematic approach to considering prosperity, international and industrial security interests earlier in the development of high value business cases. I welcomed Phillip Dunne MP's independent review into growing Defence's contribution to UK prosperity which was published in July 2018. The review contains 41 recommendations. We are considering the recommendations and will respond in due course.

As an example of our prosperity approach, ARTEC have assured us that they plan to produce a Mechanised Infantry Vehicle with 60% UK content by value and we have made it clear that this a key expectation of the UK customer in addition to demonstrating value for money. We expect industry to provide written evidence within the final proposal citing the UK supply chain content.

## **The National Shipbuilding Strategy**

The National Shipbuilding Strategy and the accompanying 30-year Master Plan provide a greater level of certainty for the shipbuilding industry, so they have the confidence to invest for the long term in their people and assets. This will allow industry to raise productivity, innovation and improve their competitiveness in the domestic and overseas markets. In the Strategic Defence and Security Review 2015 and National Shipbuilding Strategy, the Government committed to maintaining a surface fleet of 19 frigates and destroyers. HMS Queen Elizabeth, a powerful expression of national ambition and intent, is now in service and will be joined in future by new submarines, frigates, Offshore Patrol Vessels (OPVs), Royal Fleet Auxiliaries and aircraft, seeing the Royal Navy grow for the first time in a generation, while maintaining operational output.

The use of competition is at the heart of delivering the National Shipbuilding Strategy, and with our Fleet Solid Support (FSS) ships and Type 31e competitions we have engaged with UK shipyards and the wider supply chain to encourage their participation.

### **Definition of a warship**

The National Shipbuilding Strategy definition of a warship is based on the UK's requirement to retain the ability to design, build and integrate frigates, destroyers and aircraft carriers for reasons of national security, freedom of action and operational advantage. It does not replace the international legal definition of a warship. The complex nature of a warship and the sensors and weapons that make up the capability mean we have to build and integrate it on-shore. These systems are not just bolted on but are at the heart of design – Type 26 for example will only be an effective Anti-Submarine Warfare platform because it has been designed and built to be so from the outset.

This definition allows the MOD to consider global suppliers when there is not a national security justification, as in the case for the FSS ships, OPVs and future amphibious ships. This provides greater options to deliver what the Royal Navy wants, when they need it and in the most affordable way – thus ensuring the defence budget can deliver more capability to our armed forces overall.

### **Procurement of the Fleet Solid Support Ships**

Turning specifically to the FSS ships, the National Shipbuilding Strategy was clear that the FSS ships will be subject to international competition because there is no national security interest which requires the design and construction of FSS to be limited to UK companies. We have encouraged UK companies to participate in the competition and have been pleased with the positive engagement with UK shipyards and the wider supply chain to date. As with the Military Afloat Reach and Sustainability (MARS) Tankers, the Tide Class, there will be sensitive elements of the FSS ships that for security reasons will be subject to a separate customisation package competition,

involving only UK companies. We have no evidence that any state-owned shipyard has a competitive advantage in the FSS ships programme because it can take on a higher level of financial risk. Under EU and UK law, the mechanism available to the MOD for addressing State Aid concerns is through the concept of an abnormally low bid, related to a specific competitive procurement. We have the right to reject a tender if the grant of the aid was not in accordance with EU and UK law.

I must emphasise that the competition for the FSS ships is an entirely separate competition to the MARS tankers and we will rigorously enforce the rules around illegal state aid as we would in any competition. As I confirmed during the debate, although the EU rules governing state aid do not apply to companies from outside the EU, the MOD shall apply the same rules to all bidders who participate in the FSS competition, no matter where a bidder is based. Like all procurements, FSS bids will be assessed using HM Treasury's (HMT) Green Book methodology, which provides guidance to all government Departments. This framework enables us to take into account all relevant social and economic impacts on the whole of the UK arising from each bid, where the effects are relevant and there is objective evidence.

### **Bid Appraisal**

HMT has recently revised the appraisal methodology in its Green Book. There has been no change in the treatment of tax revenues in relation to procurement decisions. The appraisal of individual spending decisions is largely undertaken in the context of pre-determined budgets set by and agreed with HMT. The cost of raising public funds e.g. the cost of issuing debt or the impact of taxes, is therefore not considered in the appraisal of short-listed options. There is a strong economic rationale for this. HMT controls fiscal policy and directs departments to maximise social and economic welfare for the UK, not government revenue. HMT also decides how much it wishes to raise through taxation and borrowing and does this separately from, and in advance, of individual departmental spending decisions. It neither needs nor wants "help" from other departments in doing this.

### **Type 31e**

We have stated our requirements for the Type 31e, and it is for industry to propose build strategies (which may or may not include block build) that will meet this date. The requirements have not changed as a result of the pause in the procurement process. The Type 31e will be a frigate that meets the requirements of the Royal Navy and will be designed with exportability in mind.

The procurement approach is to invite credible bidders to participate in a funded Competitive Design Phase and submit a manufacturing proposal in 2019. The preferred bidder for the design and manufacture of the ships will be announced in December 2019. This is an ambitious timescale and cannot be reduced. The Type 31e combat

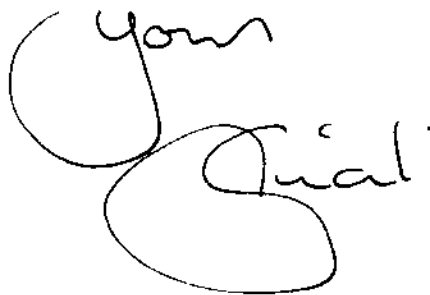
system is being procured as part of the whole ship procurement. International partners are permitted to participate provided that they meet our national security requirements.

### **Appledore**

The Government was very disappointed to learn of Babcock's decision to cease operations at Appledore and we did all we could to try to avert this course of action. While this is a commercial decision for Babcock, I recognise how concerning the news is for Appledore employees, their families and the wider community. Babcock has confirmed that it will offer new opportunities to all those affected by the closure, and the Government is standing by to provide any additional support. Moving forward, BEIS is now engaged with local and national stakeholders regarding the future of Appledore and new investment opportunities for the yard are being actively sought. Appledore, however, is not central to successful delivery of our National Shipbuilding Strategy, and more broadly, we are committed to encouraging a more competitive industry, driving innovation and growing the Royal Navy fleet.

I hope this further clarifies our position and answers in greater detail some of the questions I was not able to cover during the debate. These are important subjects and I look forward to further debates with you over the coming months as we move towards Type 31e and FSS decision points.

A copy of this letter will be placed in the Library of the House.

A handwritten signature in black ink, appearing to read 'Stuart Andrew', with a large, stylized initial 'S'.

**STUART ANDREW MP**