By Tony Purton

In view of the highly political nature of UK defence procurement and the need perceived by all parties in the House to foster an effective and sustainable UK defence industry, it is time to consider a return to the non-competitive 'cost-plus' procurement regime abandoned by MoD in 1985 in favour of competition and the commercial approach.

Advances in the facilities and techniques for effective real-time management and control of defence project timescales and costs through techniques such as Earned Evaluation Management (EVM) should make it possible to prevent the run-away costs that prompted the 1985 reforms. The civil sector is said to be making use of such techniques to manage full cost-reimbursement/no blame/no loss contracts (e.g. BAA with Heathrow Terminal 5), and MoD has acknowledged that it is studying contracting procedures used by the oil and gas industries.

The recent re-writing of the fixed price contracts MoD agreed with industry for the Nimrod MPA4 aircraft and the Astute class submarines eight years ago signals the failure of any form of commercial approach to UK defence procurement where our own defence industry is concerned. The government that awarded those contracts would not have been prepared politically to award them outside the UK. The industry was put under contrived commercial pressure to accept taut contracts; they had to secure the contracts to remain viable. When industry failed to meet its contractual obligations, the political imperative to rescue it from difficulties of its own creation was overwhelming.

With its commitment to order all warships from UK yards and systematic ministerial direction to award all major contracts in pursuit of the government's Defence Industrial Policy published in October 2002, there is little scope for the application by MoD of the normal commercial judgements and pressures where major projects are concerned. Indeed, the existence of a taut commercial contracts binding on price, performance and timescale simply creates difficulties for both industry and government to work together in a spirit of partnership. The recent award of the Advanced Hawk trainer aircraft to BAE Systems to promote job retention and facilitate the export order to India illustrates the nature of the political/industrial imperative in defence procurement decisions.

If a return to 'cost-plus' defence contracting is perceived as heralding an increase in the costs of defence projects, this should be publicly acknowledged as the price of maintaining the UK's defence industrial capability, securing with it UK jobs and the potential for arms export sales creating further UK jobs; even at the expense of obtaining best military value for the defence budget. In evidence to the Public Accounts Committee, Mike Turner CEL of BAE Systems asserted, several times, that any price charged by British industry for any defence product would always be far less than the cost of an American equivalent [PAC corrected evidence 23 February 2004 Questions 5,7,34.66,77].

Senior MoD managers have given evidence at Defence Committee hearings of the need for flexibility in a constantly changing world. Flexibility is the last thing one gets with a fixed price, tight timescale contract. The military want the product to give them the military capability they perceive the need for rather than a binding definition of an equipment configuration – they will change their minds.

The political direction of defence procurement decisions is now so embedded in the defence management system that it is no longer possible to determine whether the problems suffered by the MoD are of their own making or the result of the political direction of MoD against its better judgement. At the PAC hearing on 23 February, MoD's Permanent Under Secretary Sir Kevin Tebbit explained the process of ministerial decision-making on the Advanced Hawk trainer order that clearly shows that MoD is constitutionally prevented both from divulging the advice it gives to ministers or the directions it receives from ministers. This is due to changes in the Treasury's Guidance to Accounting Officers in 2001 introducing new paragraphs 10 & 11 as a result of recommendation 34 of the Cabinet Office report "Wiring it up". These paragraphs encouraged 'cross-cutting' to promote 'joined up government'. There are now almost no circumstances under which MoD's Accounting Officers can challenge ministers who ignore their advice. The last open ministerial direction under the old paragraphs 13, 14 & 15 was in 1994 when defence secretary Malcolm Rifkind announced in the House that he had over-ridden the advice of his Chief of Defence Procurement (Malcolm McIntosh) to split the order for the RAF's Support Helicopters between the Chinook and the EH101 Merlin.

The MoD still has in place the accounting conventions for non-competitive government contracting. Despite an abortive Treasury-led attempt in 1999 to re-write these conventions, they are now undergoing a general review under the aegis of The Review Board for Non-competitive Government Contracts, the results of which should be announced later this year.

The US DoD has a long history of defence procurement cost management monitored by the Congress through the General Accounting Office (GAO). Fixed price contracting for US major weapon systems production was abandoned in the 1960s as a result of problems with the Lockheed C5A transport aircraft and Corsair 7 combat aircraft options contracts. The US Defense Contract Management Agency has recently completed a programme of modernisation of its cost monitoring systems to make them less bureaucratic and more project management orientated. It has taken the UK more than 40 years to realise that this is the sort of regime needed in the UK if government priority is the protection of our domestic defence industry.

There is also a legal argument supporting a return to non-competitive contracting where political pressures to award the contract domestically are present. In two cases [Harmon v House of Commons and Pratt Contractors v Transit New Zealand] the House of Lords Privy Council condemned the rigging of competitive tenders. Their Lordships emphasised "The duty to act fairly meant that all tenderers had to be treated equally." The implication of these cases is that where a contracting authority invites competitive tenders there is an implied contract that the authority will decide the award of contract against the terms set out in the tender documents and not against some pre-determined or post-bid-generated political agenda.

This means that the MoD should seek ministerial direction before it invites any tenders rather than after the bids are received. In his evidence to the PAC on 25 February 2004, MoD's Chief of Defence Procurement Sir Peter Spencer expressed his intention to clear his political lines before inviting tenders in future [Corrected evidence Q185]. Sir Peter is, after all, the official who would stand accused of "misfeasance in public office" for the abuse of the tendering process [see House of Commons v Harmon].

This is based on a submission to the HCDC annual inquiry into defence procurement 2004 which bears reprinting
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