Dear Julian,

Thank you for your letter to the Rt Hon Gavin Williamson CBE MP, Secretary of State for Defence, dated 8 May 2018 about the procurement of the Fleet Solid Support (FSS) ships. I have been asked to respond as this matter falls within my area of responsibility. I have addressed each of your points in turn below; please note that I have provided a single response to cover points 2 and 3 of your letter:

1. **Please set out a detailed timeline for the FSS procurement process with information on the likely costs and specifications**

The FSS ships programme began a four-year assessment phase in April 2016. As part of the programme’s pre-procurement activity, industry days were held in 2016 and 2017. The FSS ships programme undertook a period of Market Engagement between November 2017 to March 2018, which involved holding informal, non-binding discussions with UK and international shipbuilders to share information about the programme with potential bidders.

A third industry day in June 2018 will be used to formally launch the international competition. A pre-qualification process will be conducted before the formal issue of the documentation inviting bids for the design and build contract, planned for December 2018. The documentation issued to industry at this point will include the Technical, Integrated Logistic Support (ILS), and Programme Management (PM) specifications, in addition to the contractual terms and conditions, and bid evaluation criteria. On completion of the competition, subject to formal Departmental approval, the contract will be awarded to design and build the ships in 2020.

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As with all defence equipment procurement programmes, the FSS budget will be fixed at the main investment decision point. As the FSS ships are being procured through international competition, it would be inappropriate to provide the Department’s current cost estimates as to do so would be contrary to the commercial interests of the Ministry of Defence (MOD).

2. Will an alternative procurement process to international competition for the FSS be considered under the Modernising Defence Programme to ensure sovereign capabilities and a sovereign skills base?

3. What assessment have you made of the effect on the timetable for the delivery of the FSS of adopting an alternative procurement process?

The National Shipbuilding Strategy (NSbS) made clear that Royal Navy warships will be built in the UK. This recognises that preserving the sovereign capability to design, integrate and build Royal Navy warships is critical to national security, ensuring the retention of operational advantage and freedom of movement. The Strategy defines warships as frigates, destroyers and aircraft carriers.

As the FSS ships are Naval Auxiliary Support Ships and not warships, the Department is required by law to procure them through competition in accordance with its obligations under the Defence and Security Public Contracts Regulations (DSPCR) 2011 where there is no lawful exemption which can be applied. The MOD considers that there is no national security interest which requires the design and construction of the FSS ships to be limited to UK companies. Therefore, Article 346 of the Treaty on the Functioning of the European Union (EU) does not apply, and, consequently, alternative procurement strategies have not been considered.

The FSS programme schedule is predicated on an open international competition. Any change to this strategy will require very careful consideration, including the potential for legal challenge, and would likely lead to delay in introducing this crucial capability.

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. The FSS procurement strategy takes this into account and is considered to be the most proportionate measure to take.

4. Given that FSS will carry armaments and deploy to hostile areas in support of Royal Navy and allied ships, on what grounds has your Department determined that they are not warships and the exemption under Article 346 of the Treaty on the Functioning of the European Union, allowing any member nation to reserve a procurement for reasons of national security, does not apply to the design, construction and commissioning of FSS.
The primary role of the FSS ships is the carriage and subsequent replenishment of naval vessels with bulk stores and Ordnance, Munitions and Explosives (OME). Whilst they carry OME, they are non-combatant Naval Auxiliary Support Ships that are manned by civilian Royal Fleet Auxiliary (RFA) crews and are fitted with weapon systems solely for self-defence; therefore the FSS ships are not warships. Furthermore, the designation of a naval vessel as a warship does not rely on how it is deployed, rather it depends on its capability and in this respect the position is clear: the FSS ships will be equipped with self-defence capability only, as well as the communications and other military equipment required for them to operate effectively as part of a Maritime Task Group.

5. What have you done to address concerns that independent, shareholder owned UK shipbuilders are at a disadvantage in the FSS competition because potential overseas competitors, which are wholly or partly state owned, are able to take on a higher level of financial risk since they can rely on their principal state shareholder to underwrite such risks?

UK shipbuilders have been engaged throughout the programme’s pre-procurement phase, including attendance at industry days in 2016 and 2017. The project team expects continued engagement with UK shipbuilders during the pre-qualification process.

The Department has 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. In fact, the Department’s competitive evaluation process takes all relevant factors into account when assessing bidders’ responses, including Technical, ILS and PM specifications, in addition to the offered price. The specific evaluation criteria for the FSS ships competition will be made available to the bidders when the tenders are issued. This is in line with the Department’s policy and competition regulations.

6. Will you consider excluding from the international competition for FSS companies that are state-owned, state-aided or have been rescued from bankruptcy by their national governments?

The regulations governing competitive procurements conducted by the Department, the DSPCR 2011, do not allow any company to be excluded from a competition because it is state-owned. Equally, there is no legal justification for excluding any company from a competitive procurement simply because it had previously been rescued from bankruptcy.

State aid is generally prohibited under the Treaty of the Functioning of the EU, apart from under a few specific exemptions stipulated by legislation. It is defined as any advantage granted by public authorities through state resources on a selective basis to any organisations carrying out an economic activity that could potentially distort competition and trade in the EU. Although the EU laws governing state aid do not apply to activity conducted outside its boundary, the Department treats all bidders who participate in its competitions equally. Under EU and UK law, the mechanism available
to the Department for addressing state aid concerns is through the concept of an anomalously low tender, related to a specific competitive procurement. The Department has the right to reject a tender if the grant of the aid was not in accordance with EU and UK law.

In respect of FSS, there are robust mechanisms for identifying any potential issues during the bidding process and although the EU laws on state aid do not apply to activity performed outside of the EU, the Department makes no such differentiation in the application of its competitive acquisition process. This will ensure that bidders do not secure advantage through the inappropriate receipt of state aid.

The Department takes open competition very seriously and is confident in the measures in place to ensure that competitive process for the FSS ships is conducted strictly in accordance with the EU regulations on state aid.

7. What comparative assessment has your Department made of the likely economic and social effects of domestic versus offshore production of the FSS?

All the 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.

8. Will the MoD and the Treasury consult on, and produce, a model for an agreed methodology to score bids between UK suppliers and foreign competitors for defence contracts which take into account the revenue that the Treasury would receive in the form of taxation, corporation tax and lower welfare payments?

Competition remains the cornerstone of defence procurement policy. It ensures Defence attracts the best, most affordable solutions and its economic benefits are proven to maximise value for money for UK taxpayers. This approach is at the heart of the NSbS.

HMT has already provided the appraisal methodology in its Green Book, which has just been revised. 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, for example 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.
In the context of procurements under the DSPCR 2011, it should be noted that there are strict regulations around evaluation criteria. In particular, they have to relate to the subject matter of the contract. The specific evaluation criteria for the FSS competition will be made available to the bidders when the tenders are issued. This is in line with competition regulations.

In closing, I should emphasise that a key element of our vision for a modern and efficient maritime sector, capable of meeting the country’s future defence and security needs, is one that can compete in the overseas market as well as in the domestic market. The MOD has actively engaged with potential UK and international suppliers since the FSS ships programme commenced its assessment phase two years ago. The planned release of the pre-qualification questionnaire in the next few months will mark the start of the formal competitive process. Shipyards around the UK have been positive about the opportunity the FSS programme represents, and the MOD anticipates strong bids from UK shipyards.

The Committee should be assured that the MOD has actively encouraged UK shipyards to take part as it is in the Department’s and the taxpayer’s interest to have a strong competition.

Yours sincerely,

[Signature]

GUTO BEBB MP