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MO 26/2

Minister(DP)

COMPETITION IN DEFENCE PROCUREMENT

I have been reflecting on various points arising from the presentation in your office on 20th September and the issues evident in some recent cases. Clearly major constraints arise from the nature of the industrial base and the strongly held views of the Department that it is in our own interests to allow the development contractor to carry the project forward at least to the completion of initial production. Nevertheless there remains considerable scope for the application of competition, and I regard it as a major objective to have competition applied wherever it is practicable and sensible to do so. I recognise that the Department has been giving increasing attention to this and that staff were reminded last year about the importance of competition. I should however like further instructions to be issued embodying the following:

- a. it should be made clear to a selected contractor that we expect him to exercise competition to the maximum extent possible not only in negotiating his sub-contracts but also in determining whether work should be done in-house by himself or by a specialist outside contractor. We should expect prime contractors as a matter of course to set out for us the steps they have taken to secure competitive prices for sub-components of the main contract. In this connection I have indicated that



I am attracted by the use of open tender procedures both by our own contracts staff and by our contractors for their sub-contractors. I shall wish to pursue this further;

b. having regard always to value for money, we should use competition as much as possible at the early stages of projects to ensure that we have the best available choice of concepts to consider, and to stimulate innovative ideas for meeting our requirements;

c. the arguments for giving the development contractor the initial tranche of production requirements should be carefully assessed at an appropriately senior level before any such commitment is accepted in the development contract. The objective is to secure a competitive situation wherever possible. In cases where such a commitment is accepted, the aim should be to have an incentive contract covering both full development and initial production and the contractual commitment, particularly in cases likely to involve extensive further requirements, should relate to initial production only and not be as open-ended as in the present Defcon 15. As for second and subsequent production orders the presumption will be that these will in all cases be the subject of competition. There may be realistic limits to this in particular fields eg. aero-engines, but here the point at a. about sub-contracting should again be brought to bear;

d. for existing contracts with the present Defcon 15 terms, it follows from c. above that we should be rigorous in exercising our rights to consider alternative production sources;

e. the staff levels at which authority is given to proceed on a non-competitive basis should be raised in the contracts area (where I understand formal approval levels already exist)



and formal levels should also be instituted in the project areas. Files should record the reasons for not going to competition, including any reasons arising from industrial base limitations. This should ensure that automatic allocation to a previous contractor does not take place.

f. In 1982/83, some 15% of equipment expenditure was spent on proprietary items. Competition should not be dispensed with in favour of one contractor's proprietary items until the contracts/project branches have satisfied themselves that there are no competing proprietary equipments that could fulfil the same requirement or that the benefits of continuing with the existing product are demonstrably more cost effective than the prospective benefits of competition. Even then every effort should be made to negotiate lower cash prices;

g. with the fall in inflation, we should avoid VOP clauses in new contracts wherever possible. As a minimum, VOP clauses should not be included in contracts of less than 2 years duration (compared with the present threshold of 1 year);

h. finally it is important that we get the contract conditions right at the outset and enforce them (including the withholding of interim payments if performance is not satisfactory). In this connection I fully endorse the previous CDP's minute of 21st June. Even if negotiation at the outset takes a little longer and delays the programme, we must ensure the soundest possible contractual terms from the start.

2. I should be grateful if CDP would ensure that instructions are issued to staff at all levels to convey the above approach. I also wish progress in increasing the use of competition monitored and would like you to set up a regular statistical/descriptive system



for this purpose. In particular I should like to see a monthly statistical return showing the number of contracts let with and without competition. I also believe that we must make a determined effort to reduce further the percentage (16% in 1982/83) of equipment expenditure which is subject to cost plus percentage fee terms.

3. Action should proceed case by case forthwith; but we should let the NDIC know - at a meeting early in the New Year for which a paper based on this minute should be circulated. Thereafter, I would wish the phraseology of Defcon 15 formally amended as indicated in paragraph 1c. above so that our standard conditions more clearly reflect our policies.

4. Finally, all the above relates to the UK contractors. I do not want to rule out overseas suppliers who might offer better value for money, but it is important that where the involvement of an overseas contractor is contemplated, the implications are carefully assessed (and for significant or potentially sensitive cases, Ministers consulted) to establish that the ensuing competition will be handled on the basis of normal criteria for assessing tenders, and within our international commitments.

A handwritten signature in dark ink, appearing to be "H. J. A." or similar, written in a cursive style.

23rd November 1983

COMPETITION IN DEFENCE PROCUREMENT

Note by the Ministry of Defence

1. The Ministry of Defence needs to obtain maximum value for money in satisfying the equipment needs of the Armed Forces. Our approach to this has been set out most recently in the Defence Open Government Document, 83/01 - 'Value for Money in Defence Equipment Procurement' - which emphasises the importance the Ministry attached to competition, not only to achieve keenness in pricing but also to stimulate innovation and enterprise, and the encouragement of new ideas for the solution of defence problems. It stated our determination to secure competition whenever practicable and reasonable.
2. The feasibility of competition is constrained by two factors. First, the UK defence industrial base has evolved to the point where in several areas (for example aircraft, aero-engines and guided missiles), there is effectively only one UK supplier for advanced weapons systems. In other areas however (radar and communications for example), there are several competing UK suppliers. Secondly, the specialised nature of defence equipment often requires a succession of studies to assess feasibility, technical risks and costs, followed by a substantial development programme before production can be embarked upon. The cumulative costs of these phases, which often involve heavy investment in know-how and facilities are generally too high to justify paying competing suppliers to bring equipment to the point of production.
3. There are often significant advantages of cost and timescale in allotting the first tranche of production to the development contractor. Furthermore, to encourage contractors to incur the heavy investment required for the development of defence equipment, MOD practice in placing further production contracts, since the late 1950s and as endorsed in the Rayner Report (Cmd 4641) of 1971, has been to have regard to the reasonable needs of the development contractor for maintaining his manufacturing and design capacity, providing that he offers fair and reasonable prices. Many current contracts give both suppliers and MOD enforceable rights in this regard.
4. Competitive tendering in conformity with Government purchasing policy already plays an important role in our procurement practice. Where the constraints outlined above have compelled us to deal with a single supplier, our objective is to seek taut contractual terms offering the maximum incentive to contractors to supply the right equipment, at the right time, and at the lowest possible price. Annex A summarises the proportion by value of contracts let in 1982/83 on 'competitive', 'incentive' and 'cost plus' terms (this latter being the method of last resort when the work and costs involved are inherently too ill-defined to allow any other approach). All contracts other than 'cost plus' have some degree of pressure on the contractor.
5. Nevertheless there remains in our view considerable scope for the further application of competition, and Defence Ministers regard it as a major objective to exploit this to the full. The Defence

Secretary has recently issued instructions on the following lines in order to secure maximum competition within its procurement budget.

The Early Stages of a Project

6. Having regard always to value for money, competition will be sought as much as possible at the early stages of projects, to ensure the best available choice of concepts to consider, and to stimulate innovative ideas for meeting our requirements.

The Development Stage and the Interface of Development with Production

7. The objective here will be to secure a competitive situation wherever possible. For new projects, the arguments for giving the development contractor the initial tranche of production requirements will be subjected to increasingly careful scrutiny before any such commitment is accepted in the development contract.

8. In cases where, after such consideration, a commitment to production is accepted in a development contract, the aim will be to have an incentive contract covering both full development and initial production, with the contractual commitment related to initial production only, particularly in cases likely to involve extensive further requirements. Negotiations will shortly be opened with industry on the amendments necessary to standard contractual conditions to bring them into line with this objective. Meanwhile, as necessary, individual cases will be dealt with ad hoc.

9. As for second and subsequent production orders, the presumption will be that these will be the subject of competition. It is recognised that there are realistic limits to this in particular fields eg aero-engines: in such cases we shall be looking to prime contractors to exercise the responsibilities set out in paragraph 10 below.

Competition Below Prime Contractor Level

10. Our policy is to place increasing reliance, wherever it is sensible and cost effective, on a prime contractor for the overall industrial management and final testing of the product. The objectives of competition policy therefore will be achieved only if the approach set out above is fully reflected in the relationship between prime and sub-contractors. We shall accordingly be making clear to contractors that they are expected to exercise effective competition to the maximum extent possible; and that this should apply not only in negotiating sub-contracts, but also in determining whether work should be done in-house by themselves or by a specialist outside contractor. Prime contractors will be required as a matter of course, to report to our purchasing staff the steps they intend to take to secure competitive prices for sub-elements of the main contract.

Further Orders for Existing Products

11. For existing projects to which the present contractual conditions apply we shall, in line with the approach in paragraph 8 above, be

rigorous in exercising our rights to consider alternative production sources for products whatever their value. In the last few years, significant price reductions have been secured by introducing competition in this way for later production orders.

12. In 1982/83, some 15% by value of contracts placed was spent on proprietary items. This is a significant sum of money where a degree of automaticity has inevitably developed. In future, competition in favour of one contractor's proprietary items will not be dispensed with until we have satisfied ourselves that there are no competing proprietary equipments that could fulfil the same requirement or that the benefits of continuing with the existing product are demonstrably more cost effective than the prospective benefits of competition. Even then we shall continue to make every effort to negotiate keen prices.

Monitoring the Policy

13. Arrangements are being set up for Ministers to monitor progress in increasing the use of competition. Decisions to place non-competitive contracts and the reasons for so doing will be scrutinised to ensure, inter alia, that procedures to ensure that automatic allocation to a previous contractor does not take place, are being respected. A monthly descriptive/statistical system is being set up to check implementation.

Contracts Practice

14. In addition, increased emphasis is being placed on 2 further aspects; first, getting the contract terms right at the outset and, second, ensuring that performance is in accordance with them. The achievement of taut contract terms is a significant objective in its own right; and considerations such as technical state and customer timescale will not be regarded, without examination, as more important than the time needed to secure the right contract conditions. Project and contracts staff together will seek to ensure first that this approach will not result in undue delay, and secondly that the contract terms can and will be effectively enforced. In considering projects at high level within the Ministry increasing attention will be paid to the contracts strategy being adopted.

15. The intention is that wherever possible, not only should contracts be let on a taut fixed price or other incentive basis but also, within that broad framework, that appropriate incentives should be attached to discrete activities within the contract so that above average performance should be rewarded and below average performance should incur sanctions. In this way it is hoped to reduce further the percentage (16% in 1982/83) of equipment expenditure subject to cost plus percentage fee terms. Variation of Price (VOP) clauses will be avoided in new contracts wherever possible, and such clauses will not be included in any contracts of less than two years duration (compared with the threshold of 1 year that applied until recently).

General

16. The foregoing summarises the Ministry's approach. Appropriate instructions have been issued to staff to secure effective implementation. Consideration is also being given to the adoption of an 'open tendering' approach at both prime (if it can be shown to be cost effective) and sub-contract level, particularly the latter.

VALUE OF CONTRACTS (including amendments)
PLACED IN 1982/83

	<u>Value</u> <u>£M</u>	<u>% of</u> <u>Total</u>
Contracts placed by competitive tender ie priced at the outset (typically such contracts are for the production of equipment where several sources of supply are available)	1,439	21
Contracts placed on a single source basis but priced at the outset by some reference to market forces (typically for proprietary items or for stock items where commercial price lists are available)	1,065	15
Contracts placed on a single source basis and priced by reference to estimates of costs either at the outset or as soon thereafter as practicable (typically for production of aircraft, aero-engines, weapons etc)	3,049	45
Contracts placed on a single source basis where the contractor's cost containment is incentivised eg by establishing a maximum price limit or a target cost arrangement under which cost over or under runs are shared (typically where the work specification cannot be defined precisely enough to fix prices on estimates of costs but nevertheless is capable of adequate definition for a target and/or top limit to be agreed).	145	3
Contracts placed on a single source basis where costs are reimbursed together with a percentage fee for profit (typically "cost plus" contracts are used for the design and early stages of development of equipments when the work to be done cannot be defined with any reasonable accuracy)	1,132	16
TOTAL	6,830	100

(3) if he will take steps to publish each January, a full breakdown by force area of the number of people stopped and breathalysed by the police during the Christmas holiday and New Year period, and the number of breath tests which proved positive.

Mr. Hurd: Police forces submit throughout the year returns to the Home Office on breath tests but the returns take some time to compile and process and all police forces have not yet compiled their figures covering the Christmas and New Year period. Considerable disruption and expense would be involved in asking them to alter the existing arrangements for submitting these returns now and bringing forward the normal schedule for processing them. When all the returns for 1983 have been received it is planned to publish, probably in April or May, a statistical bulletin on the use of breath tests in 1983, including a special analysis of the figures for the Christmas period.

Humberside Police

Mr. McNamara asked the Secretary of State for the Home Department whether he will call for a report from the Chief Constable of Humberside police on the questionnaire compiled for Humberside police for the purpose of conducting a public opinion poll on the attitude of the public on Humberside to the police with a view to bringing a copy in the Library.

Mr. Hurd: No. It is not the practice to make available publicly reports by chief officers of police to the Home Secretary.

Canvey Island (Fire Cover)

Dr. McDonald asked the Secretary of State for the Home Department what reports he has received about the adequacy of fire cover especially in the Thurrock/Canvey Island area of Essex; and if he will make a statement.

Mr. Mellor: There is no reason to believe on the basis of available information that the fire authority has not made adequate arrangements to discharge its statutory obligations.

Essex Police

Dr. McDonald asked the Secretary of State for the Home Department if he is satisfied with Essex police numbers, bearing in mind the dualling of the A13 and the completion of the M25 with their consequent demands on the police force; and if he will make a statement.

Mr. Hurd: It is the responsibility of the police authority to maintain an adequate and efficient police force for its area, and to fix the establishment, subject to the approval of my right hon. and learned Friend. Police force establishments are kept under review by chief officers, police authorities and Her Majesty's Inspectors of Constabulary.

Ten additional posts were approved for the Essex police in August 1983 for the financial year 1983-84, bringing the establishment of the force to 2,653. A total of 128 additional posts have been approved since May 1979. We will consider carefully, in the light of advice from Her Majesty's Inspector of Constabulary, any further application which the police authority may make.

Drink-driving (Police Guidance)

Mr. Norris asked the Secretary of State for the Home Department if he will call for a report from each chief constable as to the operational guidance given to individual officers as to whether, and in what circumstances, to stop and breathalyse motorists; and if he will take steps to secure the development of a consistent practice amongst all forces.

Mr. Hurd: Within the framework of the Road Traffic Act 1972, as amended, operational guidance to individual officers is a matter for chief officers of police. They already review road traffic law enforcement practice among police forces regularly.

DEFENCE

MCV80 and AT105 Vehicles

Mr. Hawksley asked the Secretary of State for Defence whether a decision has been taken on the production arrangements for MCV80 and AT105 vehicles.

Mr. Pattie: The MCV80 is a programme to provide the Army with a highly mobile armoured personnel carrier and combat vehicle to replace the aging FV430 series fleet. A very successful development phase for the basic vehicle, for which GKN Sankey is the prime contractor, is nearing completion and detailed planning for production is now being undertaken.

Negotiations with GKN Sankey for an initial production order are well advanced, but further orders for the Army's MCV80 requirements will be open to competitive tendering by both GKN Sankey and other interested and qualified manufacturers. In addition, agreement has been reached with GKN Sankey on means by which competitive pressures will be exercised on the prices of the initial batch of vehicles which MOD intends to order from the firm.

These arrangements, which allow competitive pressure to be brought to bear on the whole of the production programme, reflect in a major defence project the particular emphasis which the Government place on securing as much competition as feasible in public purchasing, as a means of securing value for money in terms of lower costs, tighter time scales and sound products.

In parallel with preparations for production, the Ministry will be contracting with GKN Sankey for full development of variant and derivative vehicles, subject to the satisfactory completion of preliminary studies. In due course, these vehicles will be embraced in the production arrangements mentioned above.

Separately, GKN Sankey will be awarded an order for the SAXON (AT105) wheeled armoured personnel carrier which was designed and developed as a private venture by it. The order will be broken into batches to allow for the kind of flexibility we would expect in an order of this size.

Falkland Islands

Mr. Dalyell asked the Secretary of State for Defence if he will take steps to safeguard wrecks of ocean-going sailing ships in the Falklands.

Mr. Whitney: I have been asked to reply.

The protection from unauthorised interference of wrecks and the sites on which they lie in Falklands

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