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Llywodraeth Cynulliad Cymru
Welsh Assembly Government

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See Jonathan

JOINT NAO/WAO REPORT ON THE RED DRAGON PROJECT

Thank you for your letter of 22 May 2009 seeking my responses to a number of issues raised by the Audit Committee following its consideration of the above report.

As you know, St Athan has been chosen as the location for the new Defence Technical College. The fact that this site was brought into our ownership in 2003 for the purposes of safeguarding jobs and developing an aerospace park, together with the opportunity to put the super-hangar to use as teaching space, were instrumental in MoD arriving at this decision. This was recognised in the NAO/WAO Report as presenting the long term economic benefits for Wales.

The report, therefore, covers important topics which are highly relevant as we, together with MoD, move forward with this project.

Consequently, I take this opportunity to respond in detail to the specific questions raised by your Committee (Annex 1), and to demonstrate that the findings of the report have been taken on board in progressing the Defence Technical College project (Annex 2), on which the First Minister has undertaken to keep Assembly Members updated.

I trust this meets with the Committee's requirements, and I would be happy to assist further if required.

Yours sincerely

Gill

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RESPONSE TO QUESTIONS FROM JONATHAN MORGAN AM, CHAIR,
AUDIT COMMITTEE – LETTER DATED 22 MAY 2009 TO PERMANENT
SECRETARY, WELSH ASSEMBLY GOVERNMENT

Paragraphs 1 and 2

We very much note the Committee's concerns and have sought to respond to these in each of the detailed responses set out below. Also, in Annex 2, we have detailed actions demonstrating a joined up approach in taking forward the current St Athan project which has a common purpose and is very much seen as a joint project.

Paragraph 3a - "Why the project was not taken forward as a joint venture, rather than on a commercial basis?"

The project involved two related transactions, i.e. the sale to WDA and leaseback to MoD of the former RAF St Athan site, and an MoD PFI scheme for the super-hangar. For each of these MoD required WDA support. As for the former, I take comfort from the Auditor General's assessment that the business case was both reasonable and rational, which you acknowledge in numbered paragraph 1 of your letter. With regard to the PFI scheme, this was well advanced between MoD and its commercial partners when WDA was approached to assist with the financial shortfall on the building. Taking this forward by means of a joint venture (JV) would have meant unscrambling the commercial arrangements already in place and would have introduced costly delay to MoD.

Furthermore, a legal JV would have exposed the WDA to the costs and debts in respect of the Red Dragon PFI. JVs were used by WDA from time to time as a legal mechanism for delivering joint development proposals involving joint sharing of cost, profit and risk. Under the commercial arrangements entered into for the Red Dragon project, this took the form of a legal Composite Agreement flowing from Heads of Terms under which the WDA were not obliged to carry out any development, thus reducing its financial risk and ensuring that Welsh taxpayers' interests were safeguarded. This Agreement obliged both parties to work together in good faith on the on-going management and delivery of joint initiatives related to the project, which provided legal underpinnings to the commitment to joint working.

Paragraph 3b - “Why insufficient work was undertaken to determine the costs and benefits of the aerospace park?”

As you state in paragraph 1 of your letter, the Auditor General was satisfied that the business cases were both reasonable and rational for each individual organisation, i.e. WDA and MoD.

Detailed feasibility studies, including a demand study, which indicated an Aerospace Business Park (ABP) was potentially viable, were carried out prior to acquisition of the site by WDA. The details were set out in a report presented to the WDA Board on 9 January 2003, a copy of which is attached at **Appendix A**. This report highlighted that an aerospace park could be developed in the long term and on at least a ‘break even’ basis. Also, the WDA valuation advice was that the potential development land value exceeded the purchase price (see WDA Board report of 6 June 2002 at **Appendix B**).

Furthermore, the NAO/WAO report recognises at paragraph 2.19 the speculative nature of the proposed development meant that approval was sought only for the land transaction at this stage. Future reports were to be prepared as further detailed work was carried out on the Aerospace Park.

Ministerial approval has been obtained for joint infrastructure works on the current scheme necessary to deliver both projects, and I can confirm that further approvals, based on cost benefit analysis, will be required for any significant aerospace park related investment going forward.

Paragraph 3c - “Why the MOD and Welsh Authorities’ appraisals did not extend to the overall impact of the project across the UK, as recommended in Treasury Guidance”?

The WDA’s remit was to intervene under the Welsh Development Agency Act 1975, as amended by Government of Wales Act 1998 (see Section 1 (2)(a)), to further the economic and social development of Wales and promote industrial efficiency in business in Wales. Assessment of the impact of MoD’s activities/rationalisation plans would have been beyond the scope of WDA’s remit. It would also have been extremely difficult since DARA was unwilling to share its detailed business plans with WDA for reasons of commercial confidentiality and MoD was not prepared to disclose the full End to End Review document although it did show extracts to WDA officials. The potential impacts disclosed were all positive as far as Wales was concerned.

Paragraph 3d - “Why the Welsh Authorities made assumptions about DARA’s entry into the civil repair market, when MoD did not seem to share this assumption”?

DARA was an integral part of MoD which operated on a trading fund basis. It was, therefore, assumed that pronouncements made by DARA, particularly those in the public domain, had the support of MoD, their sponsor Department. There was considerable discussion through joint working groups involving DARA and WDA regarding DARA plans to attract civil work which went on until 2004 when DARA decided they could no longer compete for civil work (see conclusion 1 c in **Appendix C**).

The super hangar was specifically designed by DARA to accommodate civil aircraft up to Boeing 737 size, which is referred to in paragraph 2.15 of the Audit Report. The WDA Board report of 9 January 2003 (**Appendix A**) refers to DARA having seven known enquiries from commercial aerospace companies. The Chief Executive of DARA made statements at public meetings on 28 January 2002 and 12 February 2002 confirming DARA’s intention to bring in civil operators (see notes of meetings at **Appendix D**).

Also, in an interview published in ‘Overhaul and Maintenance’ in May 2002 he stated “ ...we’d like to make St Athan a Maintenance , Repair and Overhaul (MRO) center (sic) for regional jets with partners who are already in that business. That way we’d combine both our military and civil business into one MRO facility” (see **Appendix E**). He made similar statements at a number of international MRO events.

Paragraph 3e - “Why the Welsh Authorities made assumptions about the extent of MOD’s financial exposure in agreeing the Red Dragon project (particularly the 5 year break clause) without verifying those assumptions with MOD”?

The Welsh Authorities’ primary responsibilities were to understand and limit their degree of financial exposure. WDA were satisfied that the super hangar deal was capped within an acceptable financial limit by reference to an independent valuation of the asset.

The MoD required that a 5 year break clause was included in the Funding Agreements. In the unlikely event that such a clause was exercised, WDA was of the view that this remained a beneficial deal as independent advice dated 1 August 2002 valued the building at £25m at that point. This would have generated receipts to WDA in excess of their expenditure whichever disposal mechanism triggered in the legal agreements was pursued. It was therefore concluded that the balance of risk to be positive and that the WDA would acquire a valuable asset at less than market rate.

It should be noted as indicated in the Audit Report (para 6.6) that MoD had their own valuation of the super-hangar carried out in December 2005, (i.e. three years prior to the date at which the 5 year break clause could come into effect), of between £48m and £60m.

The Welsh Authorities did not believe MoD would pull out of the deal due to:

- The Minister for the Armed Forces (MoD) having approved expenditure on the construction of the super hangar by letter dated 20 February 2003 to the First Minister. This confirmed that he would shortly be signing the Composite Agreement with WDA, i.e. entering into contractual arrangements.
- As recorded in paragraph 3.17 of the audit report, Assembly Government took steps to obtain assurances from both MoD and HMT about the UK Government's commitment to the Red Dragon project in the light of the 5 year break clause. At a meeting in London with senior MoD officials in August 2002, the Assembly Government was advised that if Project Red Dragon was to proceed, then the MoD would be setting up the organisation for success. Failure would not be contemplated.
- Secondly, the Welsh Authorities took assurances from the HM Treasury approval of the 5 year break clause. Assembly Government officials, as Departmental sponsors of WDA, spoke to senior HMT officials on 7 February 2003. The file note recorded that 'HM Treasury was adequately convinced that MoD will treat DARA business and DARA itself strategically, not just as another 5 year contract'. On the strength of these assurances, it was not considered necessary to re-evaluate Welsh aspirations for the site as a result of the 5 year exit clause. Both these assurances were reported to Assembly Government Ministers as part of the decision making process.
- Additionally in August 2003, i.e. prior to signature of the Composite Agreement, the First Minister spoke to the Minister for Armed Forces (MAF). WAO have had sight of the official note of the conversation which records that MAF assured the First Minister that MoD had no intention of backing out of the St Athan project.
- In August 2003, at the same time as entering into the land transaction, MoD entered into a legal commitment to operating/regulating the airfield on the Welsh Authorities' behalf until 2019, i.e. co-terminus with the legal obligation on the Welsh Authorities to purchase the super hangar for £15m coming into effect.
- In his letter of 10 September 2003 (copy at **Appendix F**), the Minister for the Armed Forces assured the First Minister of MoD's continuing commitment to the Red Dragon project, stating 'I stand by the commitments I have made on the Red Dragon Project at St Athan. It is unlikely that we would embark on a course of action that ignored the very significant investment that we are making here'.
- The Welsh Authorities concluded that the deal was relatively low risk for the reasons set out in paragraphs 3.13 and 3.16 of the Audit Report.

Paragraph 4a - “whether the Assembly Government now expects that projects where it works with other UK public bodies should adopt a more formal partnering approach, as outlined in recommendation 1 of the joint report by the Auditor General for Wales and Comptroller and Auditor General”?

The Welsh Assembly Government has adopted the guidance contained in the Treasury’s Green Book – Appraisal and Evaluation in Central Government. This guidance states that where there are multiple funders, appraisals and evaluations should be carried out collaboratively wherever possible, and that key responsibilities need to be well defined. There is also guidance in paragraph 7.6 of ‘Managing Welsh Public Money’ on working together with other UK Government Departments. This outlines the different ways that such relationships can be structured based on particular circumstances, including joint ventures.

We are also taking forward the Civil Service wide “Professional Skills for Government” programme. Part of this is the development of programme and project management (PPM) skills which aim to up skill delivery teams to better deliver programmes and projects of all sizes and complexities, with the best delivery structure and level of governance required for that particular works and the organisations and stakeholders involved. This approach, therefore, seeks to maximise the collaboration and recognise the benefits of the joined up approach recommended in the report.

To support this, the Assembly Government has appointed a Head of Profession for Programme and Project Management who is responsible for managing a PPM Centre of Excellence to support Director Generals, Business Units and other Programmes and Projects across the organisation.

In the context of working with other UK bodies, Welsh assembly Government will seek to embed these ways of working into a more formalised partnership relationship for large scale projects. The precise arrangements to be adopted will depend upon the particular circumstances of each case but will be based upon the general principles set out in the first recommendation contained in the WAO/NAO report

Question 4b – “how the Assembly Government will ensure that all such projects involving the Assembly Government and other UK public bodies are taken forward on the basis of full disclosure of all relevant information”?

A Memorandum of Understanding (MoU) between the UK Government and the Devolved Administrations was agreed in 1999 as a key component of the new devolution arrangements introduced at that time. The MoU provides protocols for the four Administrations working together on matters of mutual interest, including sharing of information as appropriate. These arrangements were to be supported by bilateral concordats with Whitehall Departments, and the concordat with the MoD, also agreed in

1999, includes arrangements for information sharing. The MoU is in the process of being updated in light of developments, and I anticipate that it will be approved by the four Administrations later this year. In parallel with that exercise, the Welsh Assembly Government has begun a process of updating, or putting in place new, bilateral concordats with Whitehall. It is intended to initiate early discussions with MoD to review the existing concordat, with a view to ensuring that there is greater transparency in the provision of information on joint projects.

At the same time, we are mindful that the principles of sharing information and mutual cooperation are enshrined in Heads of Terms and legal agreements pertaining to such projects. This is the case with regard to the Heads of Terms with the MoD on the current development scheme. For example, the Heads of Terms on the current St Athan scheme make it clear that the “new legal agreement will contain agreed protocols to ensure full Assembly Government and MoD cooperation, governance, communication and audit and which terms shall include terms of reference, authority and accountability”. It should be noted that in the negotiations so far there has been extensive cooperation and sharing of information at all levels between the Assembly Government, MoD and Metrix.

Question 4c – “how the Assembly Government will ensure that its appraisals for projects involving other UK public bodies focus on the overall impact of a project, rather than each constituent part”.

In support of the requirements of the Green Book, we have undertaken a significant amount of work aimed at embedding the Five Case Model in development and management of our business cases. Consequently, it is envisaged that we will follow a robust business case process which will thoroughly examine all aspects of projects, taking account of their strategic, economic and management impacts. We promote this approach as the model of best practice for adoption by the wider Welsh public sector.

From a procurement perspective, we are progressing actions to implement a procurement strategy for construction, agreed by Cabinet in April 2009, which seeks to ensure that maximum benefits are derived from our investment in capital projects. We recognise that projects of this nature represent a major opportunity for securing a wide range of benefits covering economic, environmental and social which support many of the Assembly's One Wales aspirations. The strategy is being progressed in collaboration with colleagues from across the Wales.

We have also made great effort to integrate the Gateway review process into our project delivery plans. Gateway will provide our project teams with an independent, expert assessment of the likelihood of their projects being successful and whether they are on course to maximise anticipated benefits.

Question 5 – “Given the importance of the current plans for the St Athan site, we would like some assurance that the lessons from the earlier problems with the Red Dragon project have been incorporated into the current approach to the Defence Training Academy and the aerospace park. In particular, we would like to know whether the project is now being run in line with the partnering principles outlined in recommendation 1, or whether the relationship with MoD remains, fundamentally, based on commercial negotiations”.

All parties are mindful of the Audit Office report conclusions and are developing formal governance arrangements to ensure the partnering principles outlined in recommendation 1 are followed.

As stated by the Auditor General for Wales at the time of the publication of this report, there is effective cooperation and collaborative working between the three partners on the current development proposals. The relationship is a strong one based on mutual trust and interest. As set out in **Annex 2**, robust Governance arrangements involving all three parties are in place which supports the common goal of regenerating the St Athan site. Senior MoD officials are in regular contact with the Director General for the Economy & Transport to share emerging thinking on their assessment of the Metrix bid. All parties have worked closely together in agreeing the Heads of Terms which will lead to a full legal agreement which will commit MoD and WAG to sharing of costs, benefits, risks, and timescales.

A conscious effort is being made to ensure openness and regularity of dialogue and joint working at all levels. Evidence of this working in practice can be found in the very extensive preparatory activity involving surveys, identification of risks and solutions, creation of complementary master plans, extensive joint public consultation and comprehensive proposals for development of the St Athan site submitted simultaneously by MoD and Welsh Assembly Government with a full range of joint supporting documents.

Taking on Board the Lessons Learnt from the Red Dragon Audit Report in Progressing the Defence Training College/Aerospace Park Project

Introduction

1. Noting the comments of the Auditor General to your Committee that Red Dragon was one of the most complex projects that he has ever come across, it is imperative that the important lessons learnt, especially on governance issues, have been or are being taken forward as we progress the current plans for the redevelopment of the site.

2. Whilst the whole approach of the parties, i.e. Assembly Government, MoD and the Metrix consortium is one of joint working, this has not been manifested in a legal joint venture on account of the fact that the Assembly Government cannot be party to MoD's PFI contract with the Metrix consortium. However, appropriate legal mechanisms have been and are being put in place e.g. in July 2006 Welsh Assembly Government entered into an Options agreement at MoD's request to enable DTC to proceed at St Athan, joint Heads of Terms for a new legal agreement signed by MoD and Assembly Government in May 2009 and work is proceeding on the full legal agreement. These enshrine the principles of joint partnership working on governance, planning, infrastructure costs, procurement, delivery, etc.

Governance

3. The multi-level governance structure in place for the St Athan project draws on membership from MoD, Welsh Assembly Government, Metrix (the appointed consortium) and the Vale of Glamorgan Council. This is underpinned by the free flow of information about each others objectives and key business assumptions through regular minutes meetings and informal contact.
 - a. The overarching governance is provided by the Ministerial Steering Group (MSG) which provides strategic direction and general oversight of progress and engagement. This is chaired by the Deputy First Minister and attended by the Finance Minister, Deputy Minister for Skills, 3 star and 2 star leads from MOD, Chair of the Metrix consortium, Leader of Vale of Glamorgan County Council and Gareth Hall, Director General of the lead Department, Economy and Transport and appropriate officials.

- b. The MSG is supported by a senior level Inter-governmental Steering Group (IGSG), which meets quarterly chaired by the Director General Training and Education (DT&E), MoD with senior officials from MoD, including Defence Estates, and Welsh Assembly Government as members.
 - c. At the operational level there is the Steering Group (SASG) which meets fortnightly and is augmented by a number of sub-groups involving MoD, Metrix, Assembly Government and Vale of Glamorgan (VoG) officials.
4. The IGSG and SASG have a defined remit to maintain common goals and intent across WAG, MoD and Metrix in order to avoid the pitfalls identified by the NAO/WAO report. Both Groups have identified coherence and information sharing as a key tenet of the consultation processes, both formal and informal, in progressing the project.
5. The Assembly Government's internal governance for the St Athan project has a robust accountability structure with a Senior Forum, including the Director General, which meets regularly to monitor progress on the delivery of the project. The Project team itself operates on the integrated delivery model with a small, multi-disciplinary core drawn from across the Economic Development Group and is supported as necessary by internal and external partners such as property professionals, the local planning authority, statutory bodies, MoD and Metrix to deliver the many tasks required by the project.
6. Considerable progress has been made on the development plans for the site in recent months. Planning applications for the Defence Technical College and an Aerospace Business Park were submitted to the Vale of Glamorgan Council on 12 May 2009. Subject to statutory and other approvals, it is anticipated that construction of the new College could start in the fourth quarter of 2010 with a view to opening in 2014/15. As the report acknowledges, the plans have the potential to provide a significant boost for jobs, skills training and supply chain opportunities.
7. The next critical stage once these approvals are in place is to ensure that the opportunities for Welsh businesses to compete for construction contracts (totalling over £700m) and supply opportunities over the next 30 years on a training programme amounting to c. £11 billion over this time are fully exploited. To this end, this is a priority of the Vale of Glamorgan Local Service Board (LSB) who are cooperating with adjoining LSBs at senior level and will work with an inter-departmental group in the Assembly Government on initiatives such as 'meet the buyer' events and involvement of Higher and Further Education institutions in skills provision at the Defence Technical College.
8. In conclusion, I believe that we have made significant progress on this front, as was noted by the Auditor General at the time of the publication

of his report, when he acknowledged that the Welsh Assembly Government and the MoD are collaborating effectively to secure a viable future for the St Athan site.