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29/03/11

SECRETARY'S OPENING REMARKS

SENATE FOREIGN AFFAIRS, DEFENCE AND TRADE REFERENCES COMMITTEE

DEPARTMENT OF DEFENCE'S REQUEST FOR TENDER FOR AVIATION CONTRACT AND ASSOCIATED ISSUES

29 March 2011

Chair, Defence welcomes the opportunity to participate in these proceedings because it enables us to address the variety of claims and contentions that surround this matter.

1. Defence Submission to the Committee

You have received a written submission from Defence that addresses in detail each of the terms of reference for this inquiry. I emphasise that the tender for air sustainment services to the Middle East Area of Operations (the MEAO) was structured on sound commercial considerations, and resulted in significantly improved value for money. Defence makes significant financial savings – in the order of \$16 million annually, a reduction of 32%, compared to exercising a

final year option available under the previous contract, and the new single aircraft solution reduces coordination and management overheads and intra-theatre transport resources, and ensures that freight gets to our troops in Afghanistan faster and more reliably.

Further, the successful bid was a very significant saving on the other tenders.

The decision to re-test the market with the RFT on 29 March 2010 was sound, noting the impact of the economic climate of the time on the global aviation industry. Furthermore, the decision to utilise the Air Standing Offer Panel for potential providers was appropriate as it provided a valid, existing legal procurement framework with standardised terms and conditions with which to engage air charter services.

Defence personnel involved in the tendering process adhered to Commonwealth Procurements Guidelines and Defence Procurement Policy. Not one, but three independent reviews of the tender

process – by Deloitte Touche Tohmatsu, the Australian Government Solicitor and the Defence Chief Audit Executive – confirmed that the decision to award the contract to Adagold Aviation, for air sustainment services to the MEAO, was fair and defensible. Adagold has now been performing these services since November 2010, and Defence is satisfied with Adagold’s performance under this contract.

2. Key Issues

I would now like to address a number of issues that have been raised in public submissions to this Committee, which are similar to the matters raised during Defence’s own investigations into this matter.

Issues relating to Strategic Aviation

On 14 July 2010, Strategic Aviation wrote to the Inspector General asking that he ‘intervene to independently review the tender and its evaluation’. The Inspector-General – who does many of Defence’s internal reviews – works for the Chief Audit Executive and I asked

him to undertake an independent review into the concerns raised by Strategic Aviation.

Issues relating to Mr Charlton

Concerns have been raised with respect to a former employee of Strategic Aviation, Mr David Charlton, in his Army Reserve Officer capacity.

In its submission to this Committee, Strategic Aviation refers initially to two Reservists with a role in JMOVGRP, including tender specifications and outside employment. Defence is not aware of further allegations about any Reservist other than Mr Charlton in respect to concerns related to this contract.

It is not apparent who the second Reservist is. It could be Mr John Davies, a former Strategic Aviation employee who, at the time the tender process commenced in March 2010 was an Inactive Reservist, that is, a Reservist who is not posted to a unit, not maintaining

currency, and not undertaking any Reserve work with Defence.

Allegations relating to Messrs Charlton and Davies and the 2005 tender are the subject of a current Australian Federal Police investigation. On 10 September 2010, Defence referred allegations of serious impropriety relating to the 2005 tender process to the Australian Federal Police (AFP). This matter is subject to an ongoing AFP investigation and the AFP has requested us not to make further comment on the issue. Defence is rendering all possible assistance to the AFP as part of this investigation.

Thus, I will only address allegations in respect to Mr Charlton and his Reserve service in 2009 and 2010.

These allegations of conflict of interest relating to Mr Charlton were thoroughly examined by both Deloitte and the Chief Audit Executive, and neither examination could find evidence to support the allegations.

Mr Charlton first approached the Army Personnel Agency Brisbane on 20 March 2009, seeking to recommence Active Reserve service. The decision to post Mr Charlton to Joint Movement Control Office Brisbane – a sub-unit of 1st Joint Movement Group – was made independently by the Army Personnel Agency Brisbane to fill an established manning vacancy. Mr Charlton is a trained movements officer with the skills and experience to contribute to the operation of a movements unit. It was on that basis that he was posted to Joint Movement Control Office Brisbane with effect 24 June 2009, almost a year prior to any conflict of interest allegations.

Mr Charlton's first parade, that is, the first day on which he turned up to perform Reserve work, at Joint Movement Control Office Brisbane was 6 July 2009. From that date, and on the basis of his known private business links with the aviation industry and his previous employment with Strategic Aviation, specific actions were taken by Defence to ensure Mr Charlton was distanced from any possible conflict of interest dealings with air charter work. This included distance from anything to do with the operation of the then air

sustainment services contract with Strategic Aviation. Throughout Mr Charlton's posting tenure – from June 2009 through to the commencement of the Middle East air sustainment request for tender (RFT) on 29 March 2010 – he remained employed solely in a training officer role and was kept away from all operational matters. On 31 March 2010, two days after the release of the RFT, Mr Charlton reported a potential conflict of interest in connection with the Middle East air sustainment request for tender and on the next day he ceased parading with the sub-unit and was employed by Army elsewhere in Brisbane until he was formally posted out of 1st Joint Movement Group on 30 June 2010. In view of subsequent conflict of interest allegations these actions were appropriate.

Contrary to allegations, no complex procurement activity occurs at the Brisbane office, and Mr Charlton had no access to Defence electronic systems or documentation relating to the tender. As such, Mr Charlton had no input into the development of the selection criteria for the 2010 tender, as was claimed by Strategic Aviation. Furthermore, at the time of the 2010 tender activities, the main focus

for the embarkation of personnel and cargo for carriage into the MEAO was Sydney, not Brisbane. During his tenure at Joint Movement Control Office Brisbane, only 21 flights out of a total of 100 (21%), either originated or terminated in Brisbane. Any work undertaken by Joint Movement Control Office Brisbane, in support of these flights, is restricted to low-level procedural contract activities and local coordination, and has nothing to do with determining future requirements.

The actions undertaken to ensure that Mr Charlton was distanced from any operational duties that could bring him into a conflict of interest situation were both appropriate and reasonable. Of note is the action to remove Mr Charlton completely from 1st Joint Movement Group entirely, as soon as he declared a potential conflict of interest.

Both the Deloitte and Chief Audit Executive examinations of the allegations surrounding Mr Charlton were thorough. The Deloitte examination was not a 'quick' examination because, while it was being conducted during the period 2-15 September 2009, it

constituted 996 hours of work by senior staff. Defence had conveyed to Deloitte the importance of completing the reviews as expeditiously as possible to meet the expected contract setup and transition requirements for the replacement contract. During the course of the assignment Deloitte noted that additional work would be required, and Defence advised that the assignment should not be compromised in any respect by artificial constraints, time or otherwise. We made it very clear that we did not and would not constrain the Review in any way.

The allegations surrounding the conduct of the tender and contract administration process had already delayed implementation of the new Middle East air sustainment charter contract and it was prudent to have these issues addressed immediately in order to minimise the operational and financial impacts of the delay and facilitate the transition between air charter contractors. It was important to maintain continuity of service during the 'Relief in Place', normal troop rotations, 'relief out of country leave', and supply chain activity to support operations occurring in the Middle East. Defence was also

keen to reap the significant financial benefits of the outcome of the competitive tender process. Finally, we wanted to have advice for the incoming government.

Mr Charlton was interviewed during the Chief Audit Executive Review and, at the request of Defence, provided a signed Statutory Declaration. Deloitte did not re-interview Mr Charlton, because they had access to the Chief Audit Executive's recording and transcript of interview, and the Statutory Declaration, and this was considered sufficient for the purposes of their examination.

Issues relating to the new air charter requirements

Concerns have been raised relating to the new requirements in the 2010 tender and the award of the contract to Adagold. I will address these concerns in turn.

Awarding contract to non-Australian airline & due diligence

The decision to award the contract to an aircraft broker, rather than an Australian regulated airline, including questioning whether the ADF conducted due diligence on the financials of Hi Fly and Adagold's capability to substitute the Hi Fly aircraft in case of Hi Fly failure has been raised.

This was not unusual. At the time of its successful 2005, 2006 and 2008 bids for air sustainment services contracts, the extant contractor Strategic Aviation, apparently held the same aircraft broker status as Adagold holds now.

The major Australian airlines are generally not competitive in tenders for services required by the ADF. In addition, there are few Australian based airframes with seating for more than 100 passengers available from the smaller operators. To have mandated an all Australian solution would have excluded 12 of the current 13 Air Standing Offer Panellists, who typically comprise Australian Broker-

Foreign Aircraft Operator arrangements. In assessing this contract, Defence considered Australian Industry requirements consistent with the Commonwealth Procurement Guidelines.

Based on the evaluation undertaken by Defence's Financial Investigation Services, and work done by the Deloitte Examination in conducting 'fit and proper' checks, as well as risk mitigation strategies, Defence is satisfied that the preferred tenderer, Adagold, and associated companies, have the financial and commercial capacity to deliver the air sustainment services to the MEAO.

The process of assessing a broker and foreign airline together

The thoroughness of Defence's process in assessing a broker and a foreign airline together has also been questioned. The evaluation by Defence's Financial Investigation Services was supported by an additional assessment by Deloitte, as to whether the respondents and associated companies supplying aviation services to the respondents, had the financial and commercial capacity to deliver the services

submitted in their responses. They found no evidence to indicate that the potential risks associated with the financial and commercial capacity of the preferred tenderer, Adagold, had not been recognised.

Concerns about the aircraft/load requirements

I will now address a number of concerns raised with respect to the requirements specified in the 2010 tender.

The increased air uplift capacity set out in the tender was derived primarily from a combination of historical data, supplemented by a forecast of requirements based on wide consultation. This included the Royal Australian Air Force regarding available military airlift capacity over the proposed contract period, Joint Logistics Command on future logistics support requirements, and an assessment of future operational tempo and force structure support plans from Headquarters Joint Operations Command.

The original Airbus A330-300 sustainment aircraft specified in the 2008 contract had a ten aircraft pallet capacity but a relatively shorter range. A smaller Airbus A330-200 aircraft, introduced at the recommendation of Strategic Aviation under a 2009 revision to the 2008 contract, provided an eight pallet capacity, but delivered a longer range and the reduced flight times, fuel and stopover costs. By 2010, however, it was evident that this smaller aircraft was already falling short of the required space needed to handle cargo loads. To overcome this problem, arrangements were made for Strategic Aviation to move freight in excess of the eight pallet capacity. However, these load splitting arrangements were found to impose considerable coordination and management overheads on Defence. Over this period, in comparison to use of the contracted sustainment aircraft, deployed commanders reported routine delivery delays of approximately 10-14 days in around half of the separate commercial movements of cargo pallets into Abu Dhabi, and then onwards to Tarin Kot or Al Minhad. Defence also found it difficult to accurately track these commercial consignments and therefore lost control over the delivery of essential logistics support. Getting cargo into the

MEAO in a timely manner to support our personnel on the ground is an essential priority for Defence.

A single aircraft with the capacity to move all freight requirements into the Australian base at Al Minhad simplifies the supply chain, reduces coordination effort, saves time, resources and ensures certainty of delivery that use of the commercial freight system cannot provide. The air sustainment services into the Middle East fly under official Australian Government diplomatic clearances and this ensures concessional treatment that exempts ADF freight from customs restrictions and associated clearance delays, often long delays, that can affect normal commercial freight movements. That is, itself, a significant benefit.

While a single aircraft solution was preferred, tenderers were informed that Defence would also consider innovative cargo solutions such as multiple aircraft, or aircraft plus freight forwarding, if they were deemed to offer significant value to the Commonwealth. This was specified in the Request for Tender documentation, and also

conveyed verbally at the Industry Brief. As such, the requirements were not so stringent as to deter tenderers, with seven panel members submitting a total of 11 different tender solutions that were all fully evaluated. This included two bids from Strategic Aviation, one for a single aircraft solution (being an Airbus A340-300), and the other for an aircraft (an A330-200) plus freight forwarding solution.

Strategic Aviation provided the air sustainment services under a short term contract from 23 October 2010, until Adagold took over the provision of services on 23 November 2010. Although this short term, temporary contract achieved a saving on the previous contract price which Strategic put at 20-25%, it was a strictly temporary saving because Strategic Aviation did not offer this saving in their 2010 tender bid. It was therefore not relevant to the evaluation of the 2010 tender and not relevant to the competitiveness of Strategic's bid.

Query about aircraft not being full

It has been claimed by Strategic Aviation that, during the previous contract period, aircraft departed Australia at less than full capacity, implying that larger capacity was not necessary. This statement is not correct. While passenger loads varied, and averaged around 100 per flight, the scheduled weekly sustainment aircraft flights into the MEAO consistently departed Australia with all eight available pallet spaces utilised, with significant volumes of cargo moved by separate commercial means.

In the initial four months of the Adagold contract for the larger A340-300 aircraft, all ten available pallet spaces have consistently been utilised on every single flight. An average of 20,033 kilograms has been moved per flight, representing about 80% of the contracted maximum payload and an increase of 37% over that moved in the last five months of the previous contract with Strategic Aviation.

In conclusion, and regardless of the allegations and queries raised by Strategic Aviation, the independent reviews of the tender process confirm that the process was sound and that there was no reason to invalidate the decision to select Adagold as the preferred tenderer or that the decision was not fair and defensible.

3. Procurement Initiatives

While Defence is of the view that the 2010 tender process for air sustainment services to the MEAO was sound, I would like to inform you of a number of initiatives underway within Defence to improve procurement practices, and policy on managing conflicts of interest. These initiatives emphasise the continuing efforts toward improving these two important areas that impact on Defence business.

Defence awards a large number of contracts each year. For example in Financial Year 2009/10, the Defence Materiel Organisation alone awarded approximately 3000 contracts over 100,000 dollars, totalling 7.136 billion dollars, with an average contract value of 2.5 million

dollars. Defence endeavours to maximise value for money in all its procurements.

Defence recognises that having a sound procurement policy framework alone will not remove risks created by poor processes or sub-optimal decisions that do not comply with the framework.

Defence will implement a further assurance mechanism that is to be designed to reduce risks around major complex non-equipment acquisition projects.

Reforms are already underway as part of the White Paper reforms and flowing on from the Deloitte and other reviews. As a result, selected future procurements will go through a Procurement Gate Assurance Review process. Mr Lewis can provide further information.

4. Defence's management of potential conflicts of interest

Turning to the issue of Defence's management of potential conflicts of interest, the existing Defence policy requires all members to

disclose any private interest, pecuniary or otherwise, which may conflict with their ADF or Public Service duties.

Defence members who consider that a conflict of interest may occur because of their own or another member's position or duties are required to report these concerns through their management chain.

Where there is considered to be a risk of a conflict of interest arising, either real or perceived, personnel may be reassigned to other duties, or have restricted access to information.

In light of this Inquiry, Defence has reviewed its policy relating to conflicts of interest and will revise Defence Instruction (General) Personnel 25-4 *Notification of Post Separation Employment*, with more detailed guidance to Defence ADF and APS people on how to deal with potential conflicts of interest. The revised policy will be issued shortly. As well, we are working on strengthening our policy around engagement of Reservists to ensure that:

- all reservists on full time or part time service employed in procurement and contract management activity must complete a declaration in respect to conflict of interest prior to their engagement for that duty; and
- Commanding Officers/Supervisors must make a risk based decision on which other Reserve personnel need to complete a declaration in respect to conflict of interest and which personnel do not, and that this decision will be documented.

We are also making enhancements to the methods of communicating current policies, including maintaining a web presence on the main Departmental web site. The internal departmental website has a new page promoting our Conflict of Interest policies, which was established on 24 March 2011.

Additionally, in order to maximise Reservist access and compliance on this policy, Defence will engage the broader Reserve community

to ensure that Reservists and employers can access relevant information, including through the Defence Reserves website.

Thank you, Chair.