

**NORTHERN TERRITORY GOVERNMENT
SUBMISSION**

**Senate Foreign Affairs, Defence and Trade
References Committee**

**Preliminary Report to the Inquiry into Procurement
Procedures for Defence Capital Projects**

Introduction

The Northern Territory Government is pleased that a number of concerns put forward in its initial submission to the inquiry into Defence procurement procedures were considered by the Committee. While the preliminary report did determine that industry sustainment receives little consideration during the capability development lifecycle, the Northern Territory Government's concern regarding the southern centric focus of sustainment contracts and impact on regional industry was not discussed.

This submission highlights the Northern Territory Government's concern that Defence sustainment contracts remain southern centric despite the growing strategic importance of northern Australia and in particular the Northern Territory to Defence. Importantly, this submission provides a summary of detailed cost data demonstrating the cost effectiveness of maintaining equipment close to where it is based. The submission also discusses the importance of considering industry sustainment in through life support and capability sustainment. The Northern Territory Government concludes that a change in Defence procurement policy can achieve major cost savings for Defence and is necessary to ensure sustainability of regional defence support industries.

Strategic Importance of the Northern Territory

The strategic importance of the Northern Territory to Defence is growing. The preliminary findings of the Australian Defence Force Posture Review confirm the Northern Territory's long-term significance and strategic importance to Defence and reflect a force posture shift to the north. The imminent arrival of up to 2500 United States (US) Marines on a rotational basis, increased rotations of US aircraft and the repositioning of US Defence and humanitarian relief equipment in the Northern Territory further reinforce this strategic importance.

In addition, the Northern Territory is home to a large volume of Defence equipment including 70% of Australia's Abrams Main Battle Tanks, 77% of Australia's Tiger Armed Reconnaissance Helicopters and 70% of Australia's Armidale Class Patrol Boats. There is also a large number of ASLAVs, M113AS4s, Bushmasters and artillery, and a squadron of F/A-18 Hornets.

In the future, there will be acquisitions under Project Overlander including MAN trucks, Haulmark trailers and Mercedes Benz G-wagons; as well as the Joint Strike Fighter and Offshore Combatant Vessels. A large proportion of these platforms are likely to be based in the Northern Territory.

Despite the growing strategic importance of the Northern Territory, sustainment contracts for equipment based in the Northern Territory have remained southern centric. Equipment and parts that are based in Darwin are in some cases transported to Adelaide and Bandiana for maintenance and repair at significant cost to Defence.

Costs to Defence of southern centric sustainment contracts

During February 2012, the Northern Territory Government engaged SMT Consulting to examine the cost of providing the through life support of Darwin-based armoured and non-armoured vehicles in Darwin, compared to the cost of providing the through life support of Darwin-based vehicles in Bandiana and Adelaide. The study found that the total cost of repair of a whole vehicle requiring 150 hours of work in Bandiana or Adelaide would be more than double the cost of the same repair in Darwin, despite the Bandiana facility being provided by Defence free of charge. The study also found that the total cost of repair of a component (rotable) requiring 20 hours of work in Bandiana or Adelaide would be almost double the cost of the same repair in Darwin. Under current arrangements SMT found that 78% of the total cost of repairing a whole vehicle and 76% of repairing a component in Bandiana is freight (refer Table 1).

Table 1 Cost Impact of Current TLS Approach on Individual Repair Jobs

Repair Job	Hours	Location	Repair Cost	Freight Cost	Total Cost	Freight %
Major Rotable	20	Bandiana	\$900	\$2,850	\$3,750	76%
Major Rotable	20	Adelaide	\$1,800	\$1,800	\$3,600	50%
Major Rotable	20	Darwin	\$1,900	\$0	\$1,900	0%
ASLAV	150	Bandiana	\$6,750	\$23,640	\$30,390	78%
ASLAV	150	Darwin	\$14,250	\$0	\$14,250	0%
M113	150	Adelaide	\$13,500	\$14,757	\$28,257	52%
M113	150	Darwin	\$14,250	\$0	\$14,250	0%

Most Defence entities have no visibility of these transport costs and therefore do not recognise the significant costs inherent in the current arrangements for carrying out repair and maintenance work in locations distant from the vehicles' home base in Darwin. On an annualised basis, the additional cost to Defence of maintaining equipment interstate is estimated at between \$4.5 million and \$6.5 million.

SMT concludes that Defence is not getting the best value for money from the current arrangement for through life support of its armoured and non-armoured vehicles based in Darwin. A change in procurement policy to preference the through life support of equipment close to where it is based would result in significant cost savings for Defence, consistent with the Defence Strategic Reform Program and the Defence Logistics Transformation Program (DLTP). The DLTP is seeking prospective tenderers to propose innovative approaches and continuously improve the Defence Logistics system such that levels of service are maintained or improved, while the total cost to serve is lowered over time. Such a change in procurement policy is likely to be opposed by a number of organisations within Defence which are primarily concerned with the most cost effective outcome based on repair dollars only, ignoring logistics costs.

Consideration of industry sustainment

The preliminary report identified that the Committee intends to consider the evidence that sustainment of industry is not a central consideration in through life support and capability sustainment.

Current Defence procurement policy, and consequently a number of contracts for the sustainment of equipment based in the Northern Territory, do not sufficiently consider industry sustainment. For example, procurement policy allows prime contractors to undertake base level maintenance of Defence equipment in Defence facilities on base and deeper level maintenance in their own facilities. With prime contractors based in southern states, this means equipment and parts based in the Northern Territory are regularly freighted interstate for repair and then returned at a cost to Defence and regional industry capability.

Recently Defence required a contractor which had won a major through life support contract to undertake vehicle maintenance on base. This requirement reduced the business case for the company's off base facility. As a result, the contractor could not take on commercial work in other industries, labour share nor take advantage of economies of scale. Consequently the contractor closed its Northern Territory facility which had previously provided sustainment

support for equipment based in Darwin prior to a formal contractual arrangement. Under its new contract, the contractor transports equipment and parts interstate for maintenance and repair where this cannot be done regionally in the government furnished facilities on base. This has resulted in increased transport costs to Defence, which appear to have no impact on the contractor and are borne by Defence. This demonstrates that industry sustainment and freight costs have not been considered in contracts such as this one.

The transport of equipment and components interstate for repair and maintenance is leading to reduced industry capability, fewer jobs in the regional Defence support industry and increased costs to Defence. This drift by Defence is also occurring at a time when other emerging sectors, such as oil and gas, are becoming more attractive contracting opportunities for regional industry capability.

A change in Defence procurement policy, preferencing support of equipment close to where it is based, would result in a greater critical mass of support in the region and a reduction in freight costs to Defence as demonstrated above.

Conclusion

The growth of Defence in northern Australia will require a strong and capable industry to support regional Defence operations.

The Northern Territory Government is committed to developing a strong, sustainable and growing Defence support industry with a capability aligned to the growing needs of Defence. However, the southern centric focus of sustainment contracts and invisibility of freight costs within Defence creates difficulties for maintaining and growing an industry in the Northern Territory that primarily undertakes sustainment activities. In conclusion, the Northern Territory Government believes that Defence sustainment contracts should preference equipment being maintained in close proximity to where it is based, providing clear cost benefits to Defence, regional capability development, industry development and broad economic returns to regions.

Further Information

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