



1 March 2011

Dr Kathleen Dermody

Secretary

Senate Committee on Foreign Affairs, Defence and Trade

Parliament House

CANBERRA ACT 2601

Dear Dr Dermody

Thank you for the opportunity for Strategic Airlines (Strategic) to make a submission to the Committee Inquiry into matters related to the Middle East Area of Operations (MEAO) Air Sustainment Support contract (RFT A0101 4109-1 0). This contract, and the tendering process leading to its awarding to Adagold, raises a number of Commonwealth procurement issues which require thorough investigation by the Committee.

For the record, Strategic held the previous contract for the provision of support to the Australian Defence Force (ADF) and had performed the contract in a highly successful manner, in accordance with the terms and conditions of the contract with Defence. This included having a number of extensions to the contract, due principally to Strategic's quality performance over more than five years.

The airline employed approximately 200 Australians in support of the Defence contract and in support of other government aviation contracts, including, for example, with the Department of Immigration and Citizenship and Department of the Prime Minister and Cabinet, the latter during the 2010 Federal Election campaign.

In all of its dealings with Defence, over many years, Strategic offered aviation support which was flexible, efficient, cost effective and clearly gave sound value-for-money to the Australian taxpayer.

In gearing up for the next round of tendering activity by Defence during the early part of last year, Strategic became concerned about certain behaviour within Defence related to the planned new tender. These concerns related to aspects of the new requirement, particularly regarding payload impacting on aircraft type and the behaviour of two ADF reserve personnel working within the Joint Movement Group (JMOVGP), which conflicted with the requirements of Commonwealth procurement policy.

Consequently, Strategic wrote to the Inspector General in Defence seeking an independent review of the tendering process. The Secretary of the Department of Defence, Dr Ian Watt, commissioned his own internal probity audit whose conclusions raised further issues, particularly regarding the behaviour of JMOVGP in

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relation to this tender. A subsequent, quick external review by an outside consultant, Deloitte, only added to Strategic's concerns, noting that at no time, for example, were either of the reserve personnel ever questioned about their role in JMOVGP, including in regard to development of the specifications for the tender nor their employment outside the ADF.

Of particular concern to Strategic related to JMOVGP's decision to reemploy a reservist, Mr Charlton, at the very time that the tender process was underway within that organisation. This raises serious procurement issues. Not least being the appearance of, if not an actual, conflict of interest.

Mr Charlton has, according to numerous media reports, had a checkered record as an aviation consultant, including, apparently, presiding over a recent \$93M Sky Air World airline collapse in Queensland. This included, we understand, the unexplained loss of \$2.5M of Commonwealth funds by that airline.

Strategic understands that, as well as his JMOVGP employment, Mr Charlton was also engaged by Adagold, the winning tenderer. This issue was not properly canvassed in either of the reviews undertaken at Defence's instigation.

Given the failure of Defence to consider fully the conflict of interest issues raised in regard to Mr Charlton, Strategic seeks fuller probing by the Senate Committee in regard to this and related matters. This is essential to ensure that Commonwealth procurement policy requirements apply to tenders of this type.

One area of probing relates to Adagold Aviation's previous tender status within JMOVGP, during which that entity undertook occasional aviation support for the ADF, knowing that one of its own staff, Mr Charlton, was employed by Adagold. In the Chief Probity Audit's report, he indicates that Mr Charlton declared a possible conflict of interest by declaring his relationship with Adagold after tender release. This raises the question: if Defence's own probity officer concluded that Mr Charlton was clearly conflicted, how could JMOVGP possibly award such a multi-million contract to Adagold?

Added to this, Mr Charlton, in conjunction with Mr Mark-Warren Clark, jointly visited the Danish Defence Force in early 2009. Mr Charlton quoted Adagold in the 2008 tender process for the MEAO tender process. The company for which he was engaged, Sky Air World, ceased operations in March 2009, and is subject to a Public Enquiry by the Liquidator. Oddly, despite this situation, within a very short time, Mr Charlton was again employed within JMOVGP. This is the very group responsible for subsequently awarding a lucrative contract to Adagold.

Mr Charlton was employed as a movement officer within the JMOVGP in Brisbane, the focal area for deployment of ADF personnel and equipment to the Middle East. There is a clear conflict of interest issue here, too, noting that Charlton directly or indirectly provided, or assisted in the provision of, information which 'justified' stringent increased criteria in the particular tender process in question.

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Strategic is surprised with JMOVGP's decision to award the contract to an aircraft broker, Adagold Aviation, over an Australian regulated airline. Whilst acknowledging Adagold's previous history in providing defence with 'ad hoc' charter flights, it is not clear whether Defence gave consideration as to the methodology of how a broker would handle an 'airline based' operation. For example, it is unclear 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. A significant part of Strategic's offer was provision of "contingency" and in the last tender process, Defence were able to assess our entire business. In the 2010 tender, a broker and a foreign airline had to be assessed together and separately and the thoroughness of this process is somewhat questionable.

In terms of operational requirements, JMOVGP attached very stringent criteria (dedicated aircraft, 42,000kgs payload, 150cbm cargo capacity) to the tender, limiting best value for money capability. This detail becomes relevant when on the subsequent tender for the six-week period post 23 October 2010, the change in these criteria allowed for exactly the same delivery of passengers and cargo at significantly improved value for money. That is, the contract could be delivered without the need for a "single aircraft" and achieve a saving of some 20-25%. This 20-25% increase in cost resulted in a minimal increase in cargo and no increase in passengers, when far cheaper alternatives existed for the movement of cargo. Ironically, JMOVGP accepted this alternate cargo transfer method in a subsequent tender. Therefore, they could have achieved a saving of \$10M per year under value for money considerations of the SRP.

It would appear that Tender respondents were unable to offer a compliant tender response without a "dedicated" aircraft.

With the specific criteria of a "dedicated" aircraft, 42,000kgs payload, 150cbm capacity, a CASA AOC and/or Foreign Air Operator's AOC, JMOVGP specifically excluded Australian Operators from offering compliant tender bids. The ADF was intentionally or unintentionally promoting an aircraft type and/or operator not available locally and exporting this Australian contract to an overseas operator.

Some other unanswered questions that Strategic had asked to be considered during the investigation period were:

- Did ADF consider total value for money implications and not just the cost implications to Defence?

A brokered, foreign solution may see a relative minimal return to the taxpayer through company tax and a small number of employees. An Australian solution, whether Strategic or any other Carrier, returns profits via taxes, jobs, work for other Australian businesses – significantly more than what can be expected via a foreign solution.

- Why did the ADF invest in 4 x C17 freighter aircraft at the cost of \$USD 2Billion dollars?

Seemingly, the capacity these freighters offer is insufficient if the ADF saw fit to specifically increase the cargo volume only of the contentious tender.

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- Is it true that a significant number of flights on the existing 'smaller' aircraft do not go out at full capacity? If so, why does the ADF need a larger, more expensive (higher fuel consuming) aircraft?
- Is the convenience of delivery of all cargo into one point (Al Minhad) worth \$USD 10M? Is the difference of the airframe 1-3 pallets per flight? The tender called for 65 flights – to meet the 150cbm requirement of the tender, this is a difference of 1 pallet. With commercial options available and delivery directly into Al Minhad, the cost of the additional freight forwarding service is approximately \$500K per year, still saving the Commonwealth \$USD 9.5M? It is difficult for the ADF to justify the argument of “value for money” for the sake of this minor “convenience”.
- Why would ADF give Strategic the extension of six weeks unless it amply demonstrated value for money under the specifications of the tender document issued in September 2010? i.e. Why were these specifications not used in March 2010? Why is the Commonwealth not using these specifications now and not taking advantage of a potential 20-25% saving on contract costs?
- Is it true that the ADF uses some civilian services for delivery of cargo into Afghanistan from the UAE? Is it true that there are significantly more cost effective services from the UAE ports of Sharjah, Abu Dhabi and Dubai compared to the higher costs of departing ex Al Minhad? Has the total context of service delivery costs been considered?
- As indicated by the Chief Audit Executive Response, Strategic had a continuing relationship with the preferred carrier Hi Fly, utilising their aircraft in May 2010, to cover maintenance/service requirements in May 2010. The tender release was on March 29th, 2010, yet on the same night (morning hours in Europe), Strategic was advised that Hi Fly was already dealing with “another party” – a deal which seemingly was completed in a matter of a few hours or through the previous night in Portugal. Had Adagold briefed Hi Fly during the periods prior to the tender release about the impending tender? If so, how did they have this information?

In examining these and other questions, the Senate Committee, via this inquiry, has the opportunity to examine a large number of issues related directly to the new tender, as well as other issues regarding the appropriateness of having JMOVGP as the entity responsible for awarding contracts over \$100 million.

We look forward to further assisting the Committee in its inquiry, including appearing as witnesses.

Yours sincerely

David Blake
CEO, Strategic Aviation Group.

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