



COMMONWEALTH OF AUSTRALIA

JOINT COMMITTEE

of

PUBLIC ACCOUNTS

Reference: Jindalee operational radar network (JORN)

CANBERRA

Thursday, 13 February 1997

OFFICIAL HANSARD REPORT

CANBERRA

JOINT COMMITTEE OF PUBLIC ACCOUNTS

Members

Mr Somlyay (Chairman)

Mr Griffin (Deputy Chairman)

Senator Crowley	Mr Anthony
Senator Gibson	Mr Beddall
Senator Hogg	Mr Broadbent
Senator Short	Mr Laurie Ferguson
Senator Watson	Mr Fitzgibbon
	Mr Georgiou
	Mrs Stone
	Mr Vaile

The terms of reference for this inquiry are:

As part of its statutory responsibility to examine reports from the Auditor-General, the Committee shall inquire into and report on Audit Report No. 28, 1995-96, Jindalee Operational Radar Network (JORN) Project, Department of Defence (June 1996) and any circumstances connected with matters raised in the audit report.

The committee's inquiry will focus on:

1. the management of the project by the Department of Defence
2. the performance of Telstra Corporation Ltd in its capacity as the prime contractor for the JORN project

WITNESSES

**BONIGHTON, Mr Ronald Bruce, First Assistant Secretary, Defence Material,
Department of Defence, Albert Park West, Constitution Avenue, Reid,
Australian Capital Territory 96**

**GORDON, Mr John Charles Hunter Patterson, Jindalee Business Manager,
Defence Jindalee, Anzac Park West, Constitution Avenue, Reid,
Australian Capital Territory 96**

**HEDGES, Air Commodore Richard Peter, Director General, Jindalee Project,
Department of Defence, Anzac Park West, Constitution Avenue, Reid,
Australian Capital Territory 2615 96**

JOINT COMMITTEE ON PUBLIC ACCOUNTS

Jindalee operational radar network (JORN)

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Present

Mr Somlyay (Chair)

Senator Gibson

Mr Broadbent

Mr Georgiou

Mrs Stone

The committee met at 10.05 a.m.

Mr Somlyay took the chair.

BONIGHTON, Mr Ronald Bruce, First Assistant Secretary, Defence Material, Department of Defence, Albert Park West, Constitution Avenue, Reid, Australian Capital Territory

HEDGES, Air Commodore Richard Peter, Director General, Jindalee Project, Department of Defence, Anzac Park West, Constitution Avenue, Reid, Australian Capital Territory 2615

GORDON, Mr John Charles Hunter Patterson, Jindalee Business Manager, Defence Jindalee, Anzac Park West, Constitution Avenue, Reid, Australian Capital Territory

CHAIR—Thank you for giving us your time. Coincidentally, the announcement was made yesterday as we all know. I hand over to you now to give us a briefing on the new arrangements.

Mr Bonighton—We were very pleased that the timing worked out this way and we could at last give you some understanding of what had happened. We have an arrangement agreed by all parties—that is, Lockheed Martin and Transfield Defence Systems—to operate through Telstar as a management company that will manage the current prime contract on behalf of Telstra. Telstra has entered into a share sale arrangement by which it disposes of its current 60 per cent interest in Telstar to Lockheed and Transfield. So we end up with a 50/50 ownership of Telstar.

Telstar will be granted full rights to manage the prime contract under a management agreement and that was signed on 7 February. It aims to take effect on 17 February. Obviously things like employee re-assignment will be problems for Telstar to organise.

Telstra has arranged a power of attorney which allows Telstar to operate with full management rights. Telstra will still have a residual role in funding the new management arrangements up to the time at which the estimated cost of the work to go is equal to the amount remaining to be paid by the Commonwealth. That sounds a little bit complex but basically Telstra will pay out its money and the Commonwealth will then take up the residual amount that we still have to pay.

Mr GEORGIU—How much is that?

Mr Bonighton—Our amount is about \$250 million, around about that. It is a little bit unsure because we do not yet have the fully updated figures. The exchange rate fluctuations and that sort of thing are still being sorted through the database. The management agreement will provide for regular financial accounting and management reports to be provided to Telstra on the progress of the project so they have visibility of what Telstar is doing.

During the first four months of the new management arrangements, Telstar will conduct a due diligence and the aim of that is to determine how much work remains to be carried out, the estimated cost of that work and the delivery schedule. So there is a critical four-month period coming up that we will be keenly interested in that will in fact set out what remains to be done. Until that happens we are not able to say what the estimated delivery date will be. We have an estimate from the best work that Telstra has been able to do so far that says that it will be another three years at least.

If Telstra and Telstar agree on the estimated cost to complete, arrangements will be put in place to novate the prime contract once Telstra has discharged its financial obligations. We expect that to happen around about the first quarter 1998. We would hope that by first quarter 1998 Telstra is out of the business and we have got Lockheed Martin and Transfield owning the contract.

CHAIR—Is that before or after the sale of Telstra?

Mr Bonighton—That is not one we have really been across.

CHAIR—Is that irrelevant or relevant?

Mr Bonighton—It has been irrelevant from our point of view. I am sure that it is weighing heavily on Telstra's mind. They would be keen to be out of it before the sale occurs. If agreement is not reached, the management agreement will continue; that is, Lockheed Martin and Transfield will manage until we get JORN delivered. The worst case for us is if that management agreement continues. The best case for us is having the contract novated. It then becomes fully the responsibility of Lockheed Martin and Transfield.

Mr GEORGIU—Why does it matter to Defence whether the contract is novated?

Mr Bonighton—I think we would feel more comfortable that we just had Lockheed Martin and Transfield doing the work with no involvement by Telstra. I think it is easier and simpler. There are fewer parties involved in the proceedings. We believe that Lockheed Martin can do the job. If they can get on and just do it, that would be great from our point of view.

Air Cdre Hedges—It just gives us more direct control. There is no question that there is a will from all parties to novate, but that will depend on a number of issues that might arise out of the estimate to complete. That is, is the Lockheed Martin estimate to complete in the order of the numbers they put forward to Telstra in July last year under which Telstra engaged them under this management agreement or negotiated the management agreement with them?

Mr GEORGIU—What numbers were provided to Telstra by Lockheed last year?

Air Cdre Hedges—I do not know what the numbers are, to be honest. I was not involved in that process. They put a bit on the table to Telstra, which allowed Telstra to then enter negotiations, or at least Telstra could see that it was within the ballpark of their estimate to complete. Lockheed Martin and Transfield are now moving into a more formal process of due diligence, which will arrive at an estimate to complete, or ETC. If that ETC is within range of Telstra's ETC, they will proceed to novate or recommend that they novate.

If the Lockheed estimate to complete is higher than the Telstra estimate to complete, there will be certain management interruption in that process. If there is less than \$10 million difference, there is a review committee to look at how they might resolve that \$10 million black hole or difference. If it is more than \$10 million, they will elevate it to a higher level. There are some very complex management processes in that decision making.

Mr GEORGIU—When were you briefed on this? Last September, we were led to believe that the conclusion of this was imminent, like tomorrow. It is now February and there has been no transfer of ownership. There appear to be fairly significant differences between our anticipations and the requirement by Lockheed that there be full due diligence. What prompted this?

Air Cdre Hedges—The difficulty Telstra had was the tax implications of the tax treatment of their losses and whether that would be treated as a capital cost or a loss. Under this management agreement with Lockheed Martin, Telstra will continue, if you like, to disperse their losses. When they reach a position where the cost to complete is a future Commonwealth outlay, that is when they will basically do it.

CHAIR—Do they get an opinion from Tax?

Air Cdre Hedges—That is a question that you will have to ask Telstra. I do not know.

CHAIR—We know that a certain amount of money was made available for the JORN project. There was a contingency above that from the Commonwealth. We heard from the Auditor-General that 30 percent of the work has been done and 80 percent of the money has been spent. Defence is not concerned because Telstra's contract said that they would pick up any blow-out.

In the very first hearing, I asked Lindsay Yelland. He said, 'Yes, we will make a loss.' So they are in a losing position. We then see the project about to be saved by selling it. Now you cannot sell something in a loss situation unless you pay out money. We are concerned about the bottom line for the budget. Any losses by Telstra, as far as

we are concerned, are losses to the shareholder, which is us, the Commonwealth.

We have no indication at this stage what your exposure is financially, what Telstra's exposure is and on what basis Lockheed and Transfield came in and how much they had to be paid to come in. I am convinced they had to be paid to come in. I would like to know what the bottom line figure is with Defence's commitment and Telstra's liability and add them together and say, 'There we are. That is it. That is what it is really costing us.'

It is like drawing teeth. We cannot get it from Telstra. You think back to the first hearing we had and it was all so rosy. Everyone said, 'Oh, she will be right. We get on very well with Telstra.' The secretary of Defence said, 'We get on very well with Telstra.' Lindsay said, 'Yes, we get on very well with them.' Then as the inquiry proceeded we find the damn thing is a shemozzle, the management is a shemozzle, and we cannot get a picture on the bottom line figure of what the blow out is. Does Defence know?

Mr Bonighton—We do not have insight into the Telstra bottom line.

CHAIR—They are your prime contractor. Your liability ends with that contract they wished they had never signed.

Mr Bonighton—Yes. I guess we have had differing objectives from Telstra. Our objective is to get a capability—

CHAIR—Well they are in business. They were in it to make a profit.

Mr Bonighton—Yes. Our aim has been not to expose the Defence budget any more than we have to and we have achieved that.

Mr BROADBENT—This is a whole restart, is it not? Obviously two groups are going to go back and re-do what was done last September, estimate of costs to finish—starting all over again.

Mr Bonighton—I think with greater insight into what is happening—

Mr BROADBENT—It does not matter. It is a whole restart. You talk about \$250 million. Why did Defence pay \$8 million to get this contract sort of churning over? You talked about \$10 million they are going to discuss at the end, yet we have just paid out \$8 million. I do not think anybody discussed that at great length, did they?

Air Cdre Hedges—I am not sure where the \$8 million came from.

Mr BROADBENT—Have you paid out—

Mr Bonighton—There is certainly an incentive, but that is for early delivery. Once we know what the estimate to complete is—

Mr BROADBENT—So have you paid \$8 million as an incentive?

Air Cdre Hedges—No, we have not.

Mr GEORGIU—Can you tell us about the incentive for an early delivery? That might clarify our minds.

Mr Bonighton—Our interest is to get this thing delivered as quickly as possible. So once we have a date what we have done is set in an arrangement whereby there is a sum of \$8 million spread over nine months which is available to Lockheed or to the joint venture company—

CHAIR—Sorry for interrupting. Is that yet to be appropriated or does that come from the original?

Mr Bonighton—No, that will come from within the project funds.

Air Cdre Hedges—Within the budget allocations.

Mr Bonighton—So there will be \$8 million there if they come in nine months early and it diminishes on a daily basis of what—

Air Cdre Hedges—Well it is \$30,000 a day. So what we are saying is that if the project comes in nine months earlier than what they estimate, and we agreed what the delivery date is, if they can advance it nine months, they will earn an incentive of \$30,000 a day.

Mr GEORGIU—Excuse me but that seems like giving them \$8 million because they set the date for completion with the knowledge of the \$8 million bonus. You cannot check them because you do not know anything about the completion date. You have got no estimate of completion. There are fundamental conflicts about times. You give them an \$8 million bonus against a time which they set for completion when indeed—

Air Cdre Hedges—No, I do not accept that. We have to approve that final delivery date. We will over the next four months be working very, very closely—

Mr GEORGIU—Yes, but this is a project that has run over time for three years and right now it is clear that we have no idea of what the completion date is.

Mr BROADBENT—It is a common arrangement on a normal building contract. But it is not a common arrangement when the rorter is the one that is setting the date.

Mr GEORGIU—We are not in a position to say, ‘This is when you should finish. If you finish nine months earlier, we will give you \$8 million.’ What you are saying is, ‘When can you finish?’ In the process of that, you are saying, ‘When you finish, given that time, we will bring it back nine months and give you \$8 million.’

Mr BROADBENT—And it is not related to cost, because you do not know the cost.

Air Cdre Hedges—No, it is a complicated arrangement. I think that is oversimplifying it, with due respect. The re-baselining process will allow Lockheed Martin and Transfield to put a peg in the ground—a final delivery date. Over the four months we will be working closely in the derivation of that schedule. A lot of that schedule, of course, will be driven by the events of the Marconi subcontract. We, as a matter of course, will look very closely at the critical path and what are the schedule drivers. We will need to be convinced before we agree to that schedule that it is a realistic schedule. We do not want something that is soft at the end, if you like. It has to be realistic and achievable.

Once that peg is in the ground, there are still some risks in the possibility that they might slip beyond that date. So the \$8 million incentive is also balanced by an \$8 million disincentive. I describe the incentive as \$30,000 a day if they come in nine months early. Then, at the point of final delivery, there is a two-month grace period and then disincentives take effect, and they take effect at \$30,000 a day. So, if they were to come in 11 months late, they will pay us \$8 million. If they come in 12 months late, we have the right to terminate the contract and the right to sue under the agreement.

CHAIR—Or find another contractor.

Air Cdre Hedges—We have a right to recover the full cost of the contract. The other thing too is that Telstra have an agreement with Lockheed Martin under which there is an incentive to come in under cost. I mentioned the estimated cost to complete. If they come in at an actual cost of less than the estimated cost, there is a formula whereby Lockheed Martin and Transfield will share with Telstra that cost underrun on the basis of basically a 60 to 40 arrangement. So there is a fair amount of incentive there for Lockheed Martin and Transfield to come in early, and there are significant penalties if they come in late.

CHAIR—Is this written into a contract?

Air Cdre Hedges—This is in the facilitation agreement which we signed yesterday. So to all intents and purposes—

CHAIR—Can that be made available to the committee?

Air Cdre Hedges—It is still in escrow at the moment, because these agreements will not take effect until next Monday. I would have to check on that.

Mr GEORGIU—Can you tell us, within 12 months, what the estimated time of completion of this now is?

Air Cdre Hedges—Can I tell you what the estimated time of completion is today?

Mr GEORGIU—Yes.

Air Cdre Hedges—I would suggest certainly before December 2001, but I cannot do any better than that. Under the facilitation agreement, we have reinforced our expectation that JORN be delivered significantly earlier than December 2001. The other thing I should add is that there are other incentives, quite apart from the disincentive/incentive arrangement that I described, and that is the payment regime.

The arrangement is a little complex but, on a monthly basis, we will pay 85 per cent of the earned value throughout the term of the project. This means that we are holding back 15 per cent, if you like. The 15 per cent is broken up like this: there is a four per cent payment associated with an interim operational capability, which is one radar site, and that will occur some time earlier than the final delivery date. There is a six per cent payment associated with final delivery. If the figure that we have to pay is \$250 million, as Mr Bonighton mentioned, that represents a significant payment. Those two payments represent \$25 million. So merely from the point of view that Lockheed Martin and Transfield will need to carry the cost of money, they are very anxious to get those payments. That is 10 per cent associated with two key milestones at the end.

There is five per cent left, and that five per cent will be paid out against their general performance throughout the term of the contract on a six-monthly appraisal of their performance. It is similar to an award fee structure that operates in a number of United States DOD contracts. If you like, you can simplify that by saying that is a significant withhold until the end of the project.

Mr BROADBENT—Who makes a decision on their performance, on how they are going?

Air Cdre Hedges—We will.

Mr BROADBENT—But your assessments of performances have been absolutely disastrous in the past.

Air Cdre Hedges—It has been. Under the prime contract we will be prescribing criteria under which we will judge the contract's performance. It is to do with their scheduled variance from the control reporting mechanism. Their general performance, their

relationship with their subcontractor. There is a number of criteria that we will spell out.

Mr BROADBENT—You have done all that before.

Air Cdre Hedges—We are going to do it better in future.

Mr Bonighton—I think there is certainly a whole new atmosphere about the project. One that is less odorous.

Air Cdre Hedges—These are very significant changes. Let me say that negotiating these sorts of changes into a deal whereby Telstra stands to lose several hundred million dollars has been extremely difficult. I think we have done the best we can for the Commonwealth.

CHAIR—What do you mean by several? What is your rough guess?

Mr GEORGIU—Not that you would know precisely.

Mr Bonighton—It has got to be more than \$200 million.

Air Cdre Hedges—I think that is a question that is worthy of asking Telstra.

CHAIR—We have asked them, and asked them, and asked them.

Mr BROADBENT—But several hundred million dollars is quite different to \$200 million. And as far as I am concerned, reading this press release, there is no deal being done. They still own the problem.

Mr GEORGIU—And they are paying somebody to manage it.

Mr Bonighton—That is true enough as an immediate step.

Air Cdre Hedges—To the extent that they are the bankers and they will actually disperse the money to Lockheed. That is about the extent of it.

CHAIR—How much more has defence got left in its budget to disperse?

Air Cdre Hedges—Against the contract?

Mr GEORGIU—Can we get sloppy and just say on this project? I keep on getting lost between the contract price and other contract prices that are out there. How much on this project?

CHAIR—The figure that we quoted was \$700 million plus the liability. So of the maximum that is available to Defence, how much have you spent so far?

Mr Gordon—On the contract, the precise figure is \$683 million.

Mr GEORGIU—On related things to this contract?

Mr Gordon—That is against the contract price.

Mr GEORGIU—Yes, I know but there are other appendages to this project that are not part of the contract price.

Mr Gordon—Sorry, non-prime contract stuff. It is an estimate of probably another \$100 million.

CHAIR—How much have you got left and how much is it going to cost to finish the project? Then we know how much Telstra has to pick up.

Air Cdre Hedges—I think this will come out because we have moved the contract from a variable price basis to a firm price basis as well. That means we have rolled in some estimate of future escalation into the firm price. There is some uncertainty about what that escalation is. So in terms of putting a peg in the ground and saying, 'This is the firm price for the contract,' we are not quite sure at the moment. Escalation will run out in June 1997 and we have rolled in some estimate of future escalation. That is all part of the arrangements and we will come to that in a moment, if you like.

Mr GEORGIU—Can I just go back to one point? When I asked you about why after all this time Lockheed Martin wanted due diligence, you told me about Telstra's problems. Why did after all this time Lockheed Martin want to go into a full due diligence?

Air Cdre Hedges—Because in their original estimate, they did not have any insight into GEC Marconi's work. Bearing in mind that in the middle of the year there were a number of interested parties to acquire JORN and GEC Marconi were also interested at one stage. So it was not appropriate therefore that Lockheed Martin and Transfield were given some insight into the GEC Marconi work. Come next Monday when they commence this due diligence process, they will gain some insight into the Marconi program and the risk attached to that. They will as necessary add in a component of risk in their estimate.

Mr GEORGIU—Can I just pursue this, because this really puzzles me? In September we were told that an agreement was imminent, not this agreement, but the Transfield—

CHAIR—We were told by Defence.

Mr GEORGIU—Throughout September, October, November, December we were told that the agreement was imminent. We were actually at some stages advised that perhaps we would not be interfering with that. At death's knock, somehow after all this, Lockheed Martin wants due diligence—

Air Cdre Hedges—Lockheed Martin always intended to do a much fuller due diligence than the initial quick look, if you like.

Mr GEORGIU—So what was the prospect of them entering into a contract in September? You will recollect that we expected it literally the next day.

Air Cdre Hedges—I do not think that was the expectation.

Mr GEORGIU—That was certainly an expectation this committee was given.

Air Cdre Hedges—Let me stand corrected on that. The problem was that Telstra unearthed this taxation issue. There was a deal about to be signed. I think the corks were actually taken out of the bottles and Telstra's internal tax advisers advised Frank Blount there could be a problem in the tax treatment of their losses. They then went back to the drawing board to look for an alternative construct, and the construct they came up with was a management agreement under which Telstra would still be the prime contractor and then with the prospect of novation once Telstra dispersed their obligations.

Mr GEORGIU—Whilst this was going on, Lockheed-Martin was undertaking a due diligence?

Air Cdre Hedges—Lockheed-Martin undertook an initial due diligence back in the early part of this year, about June. That was purely for the objective of coming up with a figure that Telstra would be comfortable with. Bear in mind there was some nervousness in Telstra about doing a cosy deal with Lockheed-Martin and Transfield. So the CEO had to be convinced that Lockheed-Martin's expectations of cost to complete the project substantially matched Telstra's expectations.

Mr GEORGIU—So, after all this, why did the penny drop recently that Lockheed-Martin wanted to do a full due diligence? Honestly, I still have not had that question answered. Let us forget about September. We were expecting the sale to go through in November-December. What prompted Lockheed at this knock to say, 'We want a full due diligence'? I am afraid that answer is not supplied by saying they did not know about Marconi's part of it because Marconi was interested in buying it in June 1996. What forced this?

Mr Bonighton—My understanding was that there was always going to be a due

diligence and that the delay was caused by the tax problems. That caused a whole new management arrangement to be brought up to solve that problem.

Air Cdre Hedges—There was always going to be a due diligence. The gun was going to go off in September, but it did not because of the tax problem, but there was always going to be a due diligence. There has to be.

Mr GEORGIU—Once again, the gun was going to go off in November-December.

Mr Bonighton—And almost every day since.

Mr GEORGIU—And almost every day since, but now we are told the block to that is a due diligence.

Air Cdre Hedges—No, absolutely not. With effect next Monday, Lockheed-Martin and Transfield have full unfettered rights to manage this contract.

Mr GEORGIU—No, the initial contract essentially meant that Lockheed and Transfield would actually take it over and Telstra would be essentially out. If I have not explained that, my questions must have been confusing.

Air Cdre Hedges—No, I understand the process, but let me also say that, to all intents and purposes, the fact that they may be operating under the management agreement next week and maybe forever is not of enormous concern to Defence because they will be able to staff it with their own people. We will be dealing directly with Lockheed-Martin and Transfield.

Mr GEORGIU—I asked the question earlier: why did Defence care whether or not it went to the next stage? We were advised that it would make a significant difference.

Air Cdre Hedges—It will make a difference. We will put Lockheed-Martin and Transfield in a more direct and exclusive relationship with us and get Telstra out of the picture. I do not believe for a moment that the management agreement that has been structured will not work.

For instance, the facilitation agreement, or the heads of agreement, that we have signed up and will become the basis of agreed contract changes, those changes will go in the contract irrespective of whether this is operating on a management agreement or post-novation. The incentives, disincentives, the payment regime, the abandonment of all claims and a number of other things will all go in the prime contract. So we will see the benefit of that from next Monday.

CHAIR—When you say ‘we’, who do you mean?

Air Cdre Hedges—The Commonwealth—Defence.

CHAIR—Would you like to include us in that?

Mr BROADBENT—I have a problem with some of the figures that have been bandied about today. From my estimates of what you said you have spent, you have already spent \$800 million on a \$1.2 billion exercise. We are talking about Telstra losing some hundreds of millions of dollars. So the Commonwealth as a whole, for a \$1.2 billion project, has now spent about \$1.5 billion. There has been no estimate of what the rest of the cost is going to be or how long it will take to complete it. We have only a guess. There have been lots of guesses about when this will—and we discussed it last year—come to some finalisation.

We also do not know, under the technology that Defence is currently working on, what technology may be required to be upgraded in the next twelve months. We do not know where we are headed with that and what it is going to cost. So there is no date, no cost and a due diligence going on for something where there is no final design. In other words, we are weeks into the new year and it is still a complete and utter balls-up. This just proves it.

Air Cdre Hedges—No, I do not accept that for a moment.

Mr Bonighton—I think we have a clear way ahead.

Air Cdre Hedges—I do not accept that for a moment. When this contract was initially awarded, there was no significant drawn design. We are significantly further down the road. We have hardware built. We have a lot of hardware substantially designed. It is—

Mr BROADBENT—We have been out to have a look at it, and you have very expensive buildings and some hardware sitting on site. That all adds up to some millions of dollars.

Air Cdre Hedges—The facilities—\$120 million, yes.

Mr BROADBENT—Yes. One point is that, on my estimate, we do not know whether we are talking about \$2 billion here, and you have a couple of hundred million dollars worth of hardware sitting on the ground. It is a bit embarrassing. I do not think I would like to go out anywhere and say that. It would be very disappointing to go out there and try to look at those buildings and facilities and say, ‘Well, this is what we have got for what we have spent.’ Have you been out, Ron?

Mr Bonighton—Not yet. I have been a bit busy worrying about the new contract. Where I have been, though, is Jindalee. That works, and that encourages me to believe

that we can get this to work and get it to work even better. It is going to cost money. As I have said, our aim has been to minimise the cost to Defence—

Mr BROADBENT—Ron, you have more trouble than you can poke a stick at.

Mr Bonighton—Some have greatness thrust upon them.

Mr BROADBENT—Great amounts.

CHAIR—From our point of view, the issue is wider than Defence. We have to look at the bottom line—the costs, the budget. You talk about Telstra having to fork out several hundred million dollars, and then you think it may be two. That is Commonwealth money we are talking about. That is what we are interested in.

Air Cdre Hedges—I think, Mr Chairman, that really you are possibly better trying to pressure Telstra to divulge that information. I certainly have some figures which I would feel very uncomfortable about—

Mr Bonighton—We have some backdoor indications, but we do not really know what the bottom line is that they are working toward.

Air Cdre Hedges—For that reason we can speak of several hundred million but—

Mr BROADBENT—I want to make a point on that issue. I think what the committee was led to believe last year and what has actually happened are two different things. We were led to believe that this was all about intellectual property and drawing the line on the cost to Telstra. That line has not been drawn and, from the information you have given us today, will not be drawn. You think it might be drawn in perhaps nine months time. Perhaps in nine months time there might be a line drawn on Telstra. At the moment, there is no indication that anybody is going to let Telstra off the hook on this one. Therefore, it has ramifications for the sale of Telstra and a whole lot of other things, because there is a liability hanging over the whole thing. It is still there. What you thought was a resolution of matters and a way ahead is not resolved at all.

Mr Bonighton—I would agree with that. I guess our aim in these negotiations, apart from making sure we got a clear way ahead, is to try to make sure that Telstra get the best deal they can as well. We have not been altogether—

Mr BROADBENT—Do you think Defence has been too close to Telstra on this?

Air Cdre Hedges—You mean on the project or this deal?

Mr BROADBENT—Not this deal, no.

Air Cdre Hedges—I have only been on the project 12 months. Ask this guy.

Mr GEORGIU—Thank God for personnel turnover.

Air Cdre Hedges—This guy has been in it for five years.

Mr BROADBENT—I am not asking you, John. I see you as purely in finances.

Air Cdre Hedges—No. He is not just in finances.

Mr Gordon—Since the start, I have been involved in the project management side. Lately, with some reorganisation, Dick has done it. I have taken over as business manager. But I have sort of been involved as the deputy project director.

Mr BROADBENT—I would not admit that if were you. You mentioned before that part of the project will be operational earlier than the completion date. I am not going to ask you about its capability. I just want to know what part that is.

Air Cdre Hedges—It is radar site one, the Longreach site, which is the first site to come on line. We propose to put an event in the schedule, which is operational radar site one, out at the JORN coordination centre at Edinburgh. It will have a target detection capability. That will be before we actually network the other radar.

Mr BROADBENT—Have you got a date?

Air Cdre Hedges—We have obviously asked Lockheed Martin and Transfield to identify that date as part of their base lining. I would expect that would be appreciably earlier than the final delivery date. That has, as I mentioned before, a four per cent payment attached to it. So there is an incentive to work towards getting that date as early as possible.

Mr BROADBENT—If it is a bridge, a ship or something we can see and feel, we do it reasonably well. Is the problem with this that the design is not finished and it is this massive government hobby for defence ministers? I know that it is a simple question.

CHAIR—You are paying someone to invent something.

Mr Bonighton—That is probably a fair description of what is happening. We had the surety that this works because of what DSTO has managed to do at Jindalee. So we see that it works. Our problem has been in translating that into the final capability. That is where we run into the management problems we have had, such as the difficulties between Telstra and its subcontractors and our problems in managing it and getting a proper oversight of what is going on. I do not think Defence is standing here and saying, 'Blame us'.

Mr BROADBENT—It is not your concern, but we are taking a lot of political heat for a lot fewer figures in other areas of expenditure than this. It is of some concern to me that this project continues with the problems. Whilst we are raising funds in other areas of Commonwealth expenditure, there are some people out there bleeding over it. That is all.

Mr Bonighton—Understood, absolutely. I guess all we can say is that we are doing our utmost to get a figure.

Mr GEORGIU—Could I get a yes or no answer to the question which was raised by Lindsay Yelland's press release.

Air Cdre Hedges—I have not seen it yet.

Mr GEORGIU—I will just read it to you. Mr Yelland says:

The combination of the agreement with Lockheed and the intensive internal re-engineering effort by Telstra should ensure the successful completion of the \$1 billion project on or before the agreed date for final acceptance by the Commonwealth.

As I understand it, there is no agreed date for final acceptance by the Commonwealth. The question is easy: is there one or not?

Mr Bonighton—No, all we have got in the implementation agreement is that we expect it to be operational significantly before December 2001.

Air Cdre Hedges—We do have an agreed date. It is 13 June 1997 under the existing contract. We know that is not going to be met.

Mr GEORGIU—Significantly ahead of 2001.

Mr Bonighton—December 2001.

Mr GEORGIU—December 2001. When you scrutinise the proposal for timing put by Lockheed so you can pay them this \$8 million incentive, or penalise them by \$8 million, does that impact on that date?

Mr Bonighton—That date comes out of the re-baselining exercise.

Air Cdre Hedges—That will be the date that will go into the prime contract. I should add that at the time this was occurring, at the time Telstra were courting Lockheed Martin and Transfield to take over this project, they were in the process of doing a re-plan or re-baseline themselves in terms of identifying a new schedule.

They were in the process of negotiating a new subcontract with Marconi to peg the

dates in the Marconi subcontract, which obviously is going to drive the prime contract. So if this never happened, Telstra would be in the throes now and probably would have been very close to coming up with a final delivery date. In the event of Lockheed Martin and Transfield taking over, essentially Lockheed Martin and Transfield are doing their own re-baselining, so the process is continuing.

Mr BROADBENT—Just from a common sense point of view, if I were running Marconi that is driving the main contract and I were doing a deal with you, I would put not only nine months in there but 18 months in there, which is very easy to do over a four or five-year period—wack an extra 18 months in there to cover your backside.

Air Cdre Hedges—18 months early?

Mr BROADBENT—I would add 18 months.

Mr Gordon—That is going to be one of the challenges.

Mr BROADBENT—You cannot—

Mr Gordon—You will not get it all.

Mr GEORGIU—I agree. You simply have not been able to do that sort of stuff. You are totally dependent on their estimates—totally.

Air Cdre Hedges—Yes, but we are also very dependent on the skills of my people to see when they are being bluffed.

Mr Bonighton—We have people on site.

Air Cdre Hedges—I believe that we will winkle out any ambit schedule.

Mr BROADBENT—I wish you all the best, but over a five-year period it is very easy to run an extra 18 months into that five-year period, and it is very hard to find where they have run the 18 months in to guarantee they get the \$8 million, and they will want that \$8 million.

Air Cdre Hedges—Let me assure you, they are going to have to work for that \$8 million.

Mr GEORGIU—Well, let me put it this way: why was there a need to put it in?

Mr Bonighton—The need to put it in was so that we could do whatever we possibly could to bring this forward, and our whole negotiating position has been based on

incentivising it.

Mr BROADBENT—In other words, you have given them \$8 million to get this going.

Air Cdre Hedges—No.

Mr BROADBENT—Yes.

Air Cdre Hedges—No. Let me just say that we wanted liquidated damages in there initially but Lockheed Martin was not prepared to accept that without some quid pro quo. It is a reasonable commercial position to take. They were not prepared to be threatened by \$8 million unless they had the capacity to earn \$8 million, and we had a substantial amount of negotiation to get through that.

I should also say that under the cost sharing arrangement with Telstra, if they come in under cost, we have first claim on Telstra's savings to the tune of \$4 million. So against that \$8 million we might pay out there is also a prospect we will get \$4 million back from Telstra through Lockheed Martin underrunning on cost.

CHAIR—Has anyone considered what a public outcry there is going to be when the media gets hold of the fact that Telstra has lost several hundred million dollars?

Mr BROADBENT—It is not much good Dick saying, 'Well, we are getting some more money out of Telstra too.'

Air Cdre Hedges—You have to understand where we are coming from though.

Mr Bonighton—It is reasonably well known, is it not, Mr Chairman, that they have made provision in their books for some couple of hundred million dollars for this project?

Mr BROADBENT—No, it is not.

CHAIR—No, it is not the picture they gave us.

Mr BROADBENT—It is very important.

Mr Bonighton—Okay, I thought that was exposed.

Mr Gordon—There is a number out there. In the press this morning they said greater than one hundred.

Mr BROADBENT—One hundred and thirteen—that is an old figure.

Mr Gordon—About 150.

Mr BROADBENT—And I do not think anybody is very keen to talk about it.

Air Cdre Hedges—I am prepared to tell you, because it is in the management agreements, that they are paying \$65 million for Lockheed Martin and Transfield to manage the contract under the management agreement.

Mr BROADBENT—And you are paying \$8 million.

Air Cdre Hedges—No.

Mr Bonighton—We might. We might pay none. We might pay \$4 million.

Air Cdre Hedges—We have done an expenditure profile on this. We have factored in the \$8 million. We factored in a \$20 million payment up front as an offset against moving from a variable to a firm price contract. We have factored all those in. We are still coming in within the project budget provisions.

Mr BROADBENT—So it is \$8 million plus \$65 million plus \$25 million?

Air Cdre Hedges—No. Telstra is paying Lockheed Martin \$65 million. It has nothing to do with us. That is an outlay from Telstra.

Mr BROADBENT—You factored in another \$25 million as well as the \$8 million?

Air Cdre Hedges—This is from the Commonwealth. This is from Defence.

Mr BROADBENT—So it is \$8 million, and \$25 million to get the contract going again?

Air Cdre Hedges—No.

Mr BROADBENT—You and I disagree on the \$8 million. You also paid \$25 million to go from one type of contract to another.

Air Cdre Hedges—Can I just talk about the \$20 million for a minute. I need to characterise that. Escalation under this contract, in our view, should finish on 30 June 1997. In other words, if Telstra were to continue, it should be carrying the cost of money with no further escalation.

Mr BROADBENT—Was it \$20 million or \$25 million?

Air Cdre Hedges—It was \$20 million. So the \$20 million is a one-time adjustment to move to a firm price contract. It is also in consideration of the abandonment of a number of claims that Telstra has either placed on Defence or is about to place on Defence. We have received one of those claims, and it is for \$21 million. It is claiming \$21 million from Defence for work it has done with the electromagnetic protection of facilities. You saw the facilities at Longreach.

Telstra is claiming that Defence should be paying that \$21 million, which is the cost of that shielding. We have disputed that claim, but we have not fought it out. Telstra also claim that there is another \$70 million worth of claims that they are about to levy on Defence. Under the agreement we have reached, we have abandoned all disputes and potential claims et cetera. So, in consideration of that, the \$20 million that covers escalation also covers the abandonment of claims.

Mr BROADBENT—I have no doubt that you have good reason for doing what you are doing. I am just trying to establish how much it was. The cost of moving from where we were before Christmas to where we are now, on my estimate, is now \$93 million. Sixty-five million dollars is coming from Telstra, \$20 million is coming from you plus \$8 million. You are saying that that is a good deal.

Air Cdre Hedges—I would like you to put them in different pots.

Mr BROADBENT—Yes. I just happen to have a box with three figures. I am looking at the Commonwealth. From where we were before Christmas to where we are now, it is \$93 million to get this deal done.

CHAIR—I presume that any additional work being done by the prime contractor will have a profit component in it as well?

Air Cdre Hedges—Absolutely.

Mr BROADBENT—Which they can take up front.

CHAIR—Under normal circumstances, you would expect Lockheed to pay for the management price.

Mr BROADBENT—What is Defence being paid for the intellectual property that may come out of this? Is that being handed over to the new Telstar?

Mr Bonighton—It is covered. One problem the committee has been concerned about is intellectual property and our rights in it. What we have done in the process of renegotiating this is to get guarantees that the IP is vested in the Commonwealth. There were some worries that GEC Marconi had got hold of some. We now have agreement from them to come back into the fold, if you like. So the JORN intellectual property will

now be vested in the Commonwealth.

Mr BROADBENT—So you have actually bought that back and that is part of the \$25 million?

Mr Bonighton—No, not bought it back. We have retrieved a rabbit that got out of the hole, I would say.

Mr BROADBENT—At a cost?

Mr Bonighton—We certainly would not see any cost. We were rectifying a wrong.

Mr GEORGIU—Can you understand a little of the committee's frustration. We are a long way from the assurances and soothing of mid-last year, when everything was, 'Yes, there were problems before. But it is all on track.' We are a long way from there.

Air Cdre Hedges—I thought you would be very soothed by the events of the year.

Mr GEORGIU—Having failed to be soothed by the soothing noises made mid-last year, and having come through the year, we should now be soothed again?

Air Cdre Hedges—We now have a deal. We have a range of agreements which have been signed. We have a contract. We are going ahead. We were briefed for four hours yesterday afternoon by the new project director for this project. Lockheed has had 15 years experience in getting a whole lot of very difficult projects out of holes. We have a highly skilled and very impressive fellow who has got tremendous insight into what is needed in this project.

Mr Bonighton—We have also now brought DSTO into it. A whole new relationship has been formed.

Mr GEORGIU—But when this committee was briefed in the first public hearings, we were told that it was all hunky dory.

CHAIR—What influence has this committee had on what has happened?

Mr Bonighton—I think it has been a very useful catalyst to get a deal done. Certainly from my point of view, having come into this—I will not say fresh, because that only lasts a day—people were aware that this report was coming. It was a useful pressure point for us to use on both parties, in fact. We spent a fair bit of time talking independently to Lockheed and Telstra when they got to sticking points to try and push them along a bit and come to a deal.

Mr BROADBENT—My problem is this: you see this as a deal. I can understand

that. I see this through the committee's eyes as what we have been looking at for 12 months. I have to say to you that we have been here before. We have been with Lindsay Yelland's press release before. We still do not know, and you do not know, the overall cost, time and date and all those things. Plus, Telstra is still in this. There is no resolution. You are suggesting that it might be nine months away.

Air Cdre Hedges—It might not be.

Mr Bonighton—If they get a tax ruling.

Air Cdre Hedges—The chairman asked me before about a taxation ruling. I know that they have gone for a taxation ruling. I do not know what that ruling is. Telstra are anxious to extract themselves out of this as soon as possible. That is really the only issue.

Mr BROADBENT—How can we be soothed when Telstra is not out of this?

Mr Bonighton—Because we believe that there is a clear way that gets them out, or, if they are still there, they are harmless.

CHAIR—Yes, they are harmless, but we are talking about Commonwealth money.

Mr Bonighton—Understood.

Mr BROADBENT—Look back on the comments that have been made. People in your position have said exactly those same words: 'We believe we have now a clear way'. They said it to two previous ministers, probably. They said, 'This is fixed and we have a clear way ahead.'

Mr Gordon—Arrangements have been put in place in the last few days. I have been involved for a long time. I am much more heartened that the new management team from next Monday knows what they are doing. I have not had that comfortable feeling before. They have been there before and done it. Unfortunately, Telstra had not been there before and they had not done it.

Mr Bonighton—While we do not know the cost and the date, we now have a mechanism which will give us those and will tell us what we should be doing when we know what they are.

CHAIR—All right. There being nothing else, we thank you very much for your appearance.

Mr Bonighton—Mr Chairman, could we leave you a copy of the briefing notes. Would that be of some help?

CHAIR—Yes.

Committee adjourned at 10.59 a.m.