

Chapter 7

The awarding and performance of the 2010 contract

7.1 Between 6 September 2010 and 15 September 2010, the Source Evaluation Report (SER) and subordinate documents raised during the original tender evaluation process were re-validated and the re-validated SER approved. Defence then finalised its arrangements with the preferred tender, Adagold.¹

7.2 In this chapter, the committee looks at the awarding and performance of the contract, and considers Defence's reflections on lessons learned from the procurement in relation to governance and procedure.

Awarding of contract

7.3 Following Ministerial approval on 20–21 October 2010, the contract was signed by Adagold and Defence on 22 October 2010.² The 2008 contract expired the following day, and Strategic performed the interim contract between 26 October and 18 November 2010.³

7.4 On 26 October 2010, shortly after the signing of the 2010 contract, CASA issued a FAAOC to Hi Fly for the period from 1 November 2010 to 31 October 2011. The FAAOC includes two Airbus A340-300 aircraft.⁴

Performance of contract

7.5 The 2010 contract commenced on 23 November 2010 and Adagold performed its first flight on this date. Defence informed the committee of its satisfaction with services rendered to date.⁵

Contractual performance management

7.6 The Air Transport Deed of Standing Offer and the Request make provision for periodic performance assessment and reporting. The deed provides for:

- internal assessments of the contractor's performance without obligation to disclose the results to the contractor;⁶

1 Defence, *Submission 5*, Annex A and Dr Ian Watt, *Proof Committee Hansard*, Estimates, 19 October 2010, p. 11.

2 Department of Defence, *Submission 5*, Attachment A, Annexure A.

3 Department of Defence, *Submission 5*, Attachment A, Annexure A.

4 Air Operator's Certificate AOC # 1-BOV6-09, issued 26 October 2010.

5 Department of Defence, *Submission 5*, Attachment A, p. 15; Dr Ian Watt, *Proof Committee Hansard*, 29 March 2011, p. 46.

- the issuing of directions to the contractor to remedy performance that is, in the opinion of the Commonwealth, determined to be unsatisfactory;⁷
- the calling of performance review meetings at the Commonwealth's discretion;⁸
- on receipt of notice of a performance review meeting, provision by the contractor of a report detailing its performance;⁹ and
- the rectification by the contractor of areas for improvement identified by the Commonwealth at the performance review meeting, within 30 days of the meeting.¹⁰

7.7 The terms of the request also require the contractor to provide the Commonwealth with monthly reports detailing the number of services provided, the number of personnel moved, the weight of equipment and baggage moved on each service, and the total flight time for each service.¹¹

7.8 Defence further informed the committee that, in the first four months of the contract, all of the ten available pallet spaces had been utilised on all flights performed to date. It stated that an average of 20,033 kg had been moved per flight, 'representing about 80 per cent of the maximum contracted payload and an increase of 37 per cent over that moved in the last five months of the previous contract with Strategic'.¹² Defence stated that the 2010 contract has resulted in 'significant financial savings' on the 2008 contract. It quantified these savings as approximately \$16 million per annum, representing a 32 per cent saving compared to exercising an option to extend the 2008 contract.¹³

Compliance with tender specifications

7.9 In its evidence to the committee, Strategic alleged that Adagold's contractual performance may be non-compliant with the minimum tender specifications on volumetric capacity. Mr Aisen stated that:

The successful Airbus A340-300 series is equipped with 11 pallets and bulk hold for just over 150m³—just meeting the specified criteria of the

6 Clause 16.5(a).

7 Clause 16.5(b).

8 Clauses 16.6(a),(b), (d), (e).

9 Clause 16.6(c).

10 Clause 16.6(f).

11 Item 7.16.

12 Dr Ian Watt, Secretary's opening remarks to the Senate Foreign Affairs Defence and Trade References Committee, tabled 29 March 2011, p.17.

13 Dr Ian Watt, Secretary's opening remarks to the Senate Foreign Affairs Defence and Trade References Committee, tabled 29 March 2011, pp. 1–2.

Commonwealth...Strategic is aware that the current contract is now being provided by a Portuguese A340-300, of which only 10 pallets and loose cargo is being made available due to the carrier's need to fly a maintenance kit on its aircraft—known as a fly-away kit. The ramifications of this are that the current tender response would appear to be non-compliant. The reduction of one pallet position from the Commonwealth reduces available capacity by approximately 10.5 to 11m³, to approximately 142m³.

Having had a relationship with Hi Fly previously, Strategic is aware of the fly-away kit and Hi Fly's need to carry [one]. We knew that this aircraft type, with this fly-away kit, would not be compliant.¹⁴

7.10 Defence responded that the aircraft provided by Adagold is compliant with the minimum volumetric capacity requirements. Rear Admiral Griggs stated that the primary aircraft has a total capacity of 162m³, and that its useable capacity is dependent upon how the aircraft is stacked on individual flights. He noted that the aircraft does not carry a fly-away kit, as Adagold has pre-positioned its maintenance equipment at various ports. Rear Admiral Griggs stated that the alternative aircraft used by Adagold when the primary aircraft is unavailable carries a fly-away kit of 5m³, which reduces the volumetric capacity to 157m³.¹⁵

7.11 Strategic further submitted that Adagold's contract price—which it estimated was \$10 million lower than the Strategic A340-300 proposal—may indicate that Adagold's response did not factor in all necessary contingencies.¹⁶ Mr Aisen stated that:

Ultimately, it begs the question of just how this respondent could be so significantly lower than any respondent elsewhere on the panel. It begs the question of whether there was the depth of knowledge with the decision makers to understand whether all aspects of the tender response were provided and appropriately considered.¹⁷

7.12 Defence did not respond expressly to this submission. However, as noted above, the Deloitte review examined documentary evidence—including Adagold's tender response and the evaluation criteria in the TEP¹⁸—and concluded that it had not identified any evidence suggesting that Adagold lacked capacity to 'meet the quality and standard required by the Commonwealth to provide the contracted services'.¹⁹ The AGS review also concluded that the selection of Adagold as preferred

14 Mr Shaun Aisen, *Proof Committee Hansard*, 29 March 2011, p. 2.

15 Rear Admiral Ray Griggs, *Proof Committee Hansard*, 29 March 2011, p. 51.

16 Mr Shaun Aisen, *Proof Committee Hansard*, 29 March 2011, pp. 3–4.

17 Mr Shaun Aisen, *Proof Committee Hansard*, 29 March 2011, p. 4.

18 The TEP included criteria assessing: overall compliance with the requirements; the respondent's understanding of the requirements; compliance with specific performance requirements; and demonstrated technical and managerial capacity to meet the requirements: AFCD Review, p. 9.

19 Deloitte Review, pp. 28–29.

tenderer was fair and defensible—including in respect of compliance with the tender evaluation methodology, and the provision in the SER of a defensible and clear justification for the ranking of tenders.²⁰

Lessons learned

7.13 During the inquiry, Defence officials acknowledged that the tender process 'could have been improved'.²¹ As mentioned previously, Defence indicated that it is working on several reforms to its procurement practices and policies on managing conflicts of interest. It identified these initiatives as having arisen from the 2009 Defence White Paper, and its reflections on the MEAO procurement process, including analysis of the findings of the independent reviews.²²

Reforms to Defence procurement practices

7.14 Defence has already started the process of implementing several initiatives to improve the governance of non-equipment procurement (NEP) arising from the White Paper. It stated that the following initiatives have been implemented:

- appointing independent probity advisors for all significant, complex procurements;
- establishing a Centre of Excellence to support a more robust and consistent commercial approach to NEP;
- establishing the position of Non-Equipment Chief Procurement Officer (NECPO) on 1 July 2010. The NECPO provides high-level advice and assistance to all groups and services, and is required to endorse all Defence NEP spending proposals valued over \$1 million as a pre-requisite to proposal approval;
- scoping a whole-of-portfolio sourcing approach for various categories of NEP (for example, travel, garrison support, building maintenance, advertising and health);
- establishing a working group of NEP stakeholders to coordinate and resolve issues arising from the implementation of the new arrangements;
- launching a new NEP website on 17 August 2010, providing a single access point for policy and process guidance; and

20 AGS Review, p. 9. See further, Department of Defence, *Submission 5*, Attachment A, pp. 27–28.

21 Vice Admiral Griggs and Dr Watt, *Proof Committee Hansard*, 28 June 2011, p. 17.

22 Department of Defence, *Submission 5*, Attachment A, pp. 32–35; Dr Ian Watt, Secretary's opening remarks to the Senate Foreign Affairs Defence and Trade References Committee, tabled 29 March 2011, pp. 18–22.

- establishing a single simple procurement business centre on 1 February 2011, into which all simple procurements will be transitioned over the next two years.²³
- 7.15 Defence identified the following initiatives to be implemented in 2011:
- the application of a gate review process for major acquisition projects across Defence, focussing on important procurement process and probity issues relevant to a particular 'gate';
 - the engagement of expert procurement teams with lead responsibility for major acquisition projects;
 - the agreement and implementation of a NEP category management model for specific types of NEP;
 - the introduction of implementation status reporting requirements for all major NEPs;
 - improved stakeholder advice and assistance services, including publication of the Defence annual procurement plan on AusTender to provide greater transparency of planned NEPs, and an advisory role for the NECPO in the drafting of tender documentation, publishing on AusTender and evaluating tenders; and
 - implementing strategies for the recruitment and retention of suitably skilled procurement professionals.²⁴

Reforms to conflict of interest management policies

7.16 Defence stated that, in light of the committee's inquiry, it had reviewed its post-separation policy regime and its policy on the engagement of Reservists.²⁵ It identified the following four action areas for implementation in mid to late 2011:

- (a) Creating greater awareness within Defence of existing policy and practice requirements, particularly for Reservists, including:
 - (i) establishing a Defence post-separation employment intranet page; and
 - (ii) ensuring that Reservists are made aware of their obligations in relation to conflict of interest.
- (b) Reviewing ASDEFCON [the suite of tendering and contracting templates used within Defence] provisions to further clarify and strengthen probity arrangements in Defence and Defence Industry, and reinforce the education in

23 Department of Defence, *Submission 5*, Attachment A, pp. 32–33.

24 Department of Defence, *Submission 5*, Attachment A, pp. 33–45.

25 Department of Defence, *Submission 5*, Attachment A, pp. 34–35; Dr Ian Watt, Secretary's opening remarks to the Senate Foreign Affairs, Defence and Trade References Committee, tabled 29 March 2011, pp. 19–22.

Defence and Defence Industry of these provisions. In particular, the ASDEFCON review will focus on:

- (i) reviewing the application of the 'Use of Former Defence Personnel' and 'Post Defence Separation Employment' provisions in the conditions of tender and contract respectively; and
 - (ii) whether provisions need to be strengthened to ensure application to Reservists.
- (c) Strengthening the policy around employing Reservists on continuous full-time service to require that potential conflicts of interest are declared prior to contract commencement.
- (d) Updating the Defence policy framework to include additional requirements on post-separation employment mitigation measures, drawing on those detailed guidelines that are already included in the Defence Materiel Organisation policy [Defence Materiel Instruction (PERS) 1/2007].²⁶

7.17 Defence advised the committee that as at 29 March 2011 it had made the following progress:

- commenced the revision of the relevant Defence Instruction on post separation employment;
- identified two new policy measures in relation to the employment of reservists, which are:
 - requiring Reservists on full-time or part-time service employed in procurement and contract management activity to complete a conflict of interest declaration prior to their engagement for duty; and
 - requiring commanding officers or supervisors to make a risk-based assessment as to which other Reserve personnel must complete a conflict of interest declaration and which personnel do not, and to document this decision; and
- on 24 March 2011, launched a Defence intranet page consolidating conflict of interest policies.

7.18 Defence acknowledged that the process of reviewing the 2010 tender has been an 'expensive exercise'.²⁷ It submitted, however, that this cost has been justified by the 'significant changes to the way we do business to ensure the robustness and the independence of the processes, and the governance around them'.²⁸ The committee provides its views on lessons learned in chapters 8–12.

26 Department of Defence, *Submission 5*, Attachment A, pp. 34–35.

27 Mr Geoffrey Brown, *Proof Committee Hansard*, 29 March 2011, pp. 88–89.

28 Mr Geoffrey Brown, *Proof Committee Hansard*, 29 March 2011, pp. 88–89.

Conclusion

7.19 This and the previous four chapters have outlined the factual narrative of events occurring in the lead-up to, during and on the completion of the 2010 tender process. Several issues emerge from this evidence, namely:

- The tender was conducted in circumstances which suggested that significant probity risks were present—in particular, those pertaining to perceived conflicts of interest, breaches of confidentiality and proponent grievances about these matters.
- Defence was aware, or ought to have been aware, of these circumstances during the lead-up to the tender, the approach to market and during the tender evaluation stage.
- However, this awareness (actual or constructive) was not reflected significantly in governance arrangements for probity risk management, particularly during the procurement planning stage.
- Probity risks materialised during the course of the procurement.
- Defence made no substantial attempts to re-consider probity risk management strategies as these risks materialised.
- Proponent grievances about the outcome of the tender processes prompted multiple reviews of the procurement. While concluding that there were no compliance grounds requiring the discontinuation of the procurement, two broad issues arose from their findings:
 - the reviews identified a number of shortcomings in the procurement process—including in respect of probity risk management; and
 - due to limitations in their scope and methodology, the reviews did not quell the disquiet that some proponents felt towards the procurement process.
- In the course of the reviews, allegations of impropriety arising from the 2005 tender process were referred to the AFP for investigation.
- In response to the findings of the reviews of the 2010 tender process Defence:
 - determined to proceed to contract with Adagold;
 - made retrospective corrections to aspects of the tender process; and
 - initiated a program of broader policy and procedural reforms.

7.20 In the following five chapters, the committee identifies specific matters of concern arising from the tender process and makes its findings and recommendations on those matters.

Part III

Committee's consideration of the evidence

In this part of the report, the committee analyses the evidence outlined in the preceding chapters to provide its findings and recommendations about the integrity of the 2010 tender process.

Chapters 8–12 look at three particular aspects of the tender—governance arrangements, which go to issues such as the integrity of the tender preparation and evaluation stages, conflicts of interest; tender design and due diligence. Chapter 10 also considers the suggestion in the terms of reference regarding the appointment of a permanent, independent probity adviser to oversee the awarding of all Commonwealth aviation contracts.

