



Australian Government
Department of Defence
Defence Materiel Organisation

DMO

REPORT OF THE
**REVIEW OF THE POLICY FRAMEWORK
FOR CLOTHING PROCUREMENT**

September 2010

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REPORT ON THE POLICY FRAMEWORK FOR CLOTHING PROCUREMENT

SUMMARY OF KEY FINDINGS AND RECOMMENDATIONS:

1. After major changes to the Clothing Systems Project Office (SPO) management and business processes following the implementation of the 2006 Harding Report recommendations, SPO staff understand their business and work diligently, properly and effectively to do their job.
2. The Minister's decision in February 2010, not to proceed with the Restricted Tender contract option to source the combat uniform fabric from China, was made because of uncertainty about three issues – the reliability of the tender evaluation process, the appropriate interpretation and application of the Priority Industry Capability (PIC) policy, and the uncertain impact of the option on Australian industry.
3. The Minister's intervention does not imply necessarily that the wrong decision was made originally by the Clothing SPO - rather, there was insufficient evidentiary basis for it. It is still an open question as to whether the Chinese-sourced fabric would have been compliant, on schedule and on cost, and therefore best value for money.
4. There is a need to clarify the policy framework and its application to combat clothing, in order both to inform industry and to assist those officials required to make rigorous and complex procurement decisions based on it.
5. There are no significant conflicts or inconsistencies in the policy framework applying to the procurement of combat clothing and personal equipment. Rather, there are various major principles which need to be considered and reconciled, in terms of their relative importance and priority, in their application to different procurements.
6. There is one principal source of ambiguity or uncertainty related to the policy framework – namely the Priority Industry Capability and its specific application to combat clothing and personal equipment.
7. A revised definition of the PICs should be adopted, in the following terms:
 - “PICs are those industry capabilities that confer such a strategic advantage by being available within Australia that their absence would undermine significantly defence self-reliance and Australian Defence Force operational capability”.
8. A revised definition of the Combat Clothing and Personal Equipment PIC should be adopted, in the following terms:
 - “This is the capability to undertake further technical development and subsequent manufacture of clothing and personal equipment, to enhance the protection and survivability of ADF personnel in combat. It applies particularly to leading-edge technical developments which Australia is concerned to protect. It does not require combat clothing and personal equipment to be manufactured solely or even principally in Australia, and does not apply to clothing or personal equipment worn outside combat”.
9. Strategic Policy Division should develop, for consideration by Government, a clear basis and criteria for assessing the relative priority of the PICs and, therefore, the relative priority of any proposals for government intervention in the market.
10. In terms of the priority between the PICs [both in relation to the capabilities which confer the greatest strategic advantage by being available in Australia and in relation to any additional costs or premiums to be paid for that local capability], the PIC for combat clothing and personal equipment itself does not appear to be a high priority, compared to some other PICs, and, within the PIC, personal equipment appears to be a higher priority than combat clothing.
11. There are currently no intellectual property, unique technologies or unique industrial capabilities in the manufacture of the existing fabric for the combat uniform, and there are no compelling grounds currently under the PIC to limit the manufacture of the existing fabric solely to Australia.
12. In relation to the combat uniform jacket and trousers, the Combat Clothing and Personal Equipment PIC appears to have relevance only to the ongoing development of the fabric used – and the case for the retention within Australia of that capability rests on the prospects of sufficiently significant technological enhancements.
13. Further work should be undertaken, in consultation with DSTO, to assess the potential for successful further development of the combat clothing – and, in particular, the relative potential and priority for further technical development of both the fabric and the combat uniform itself (jacket and trousers) compared to that for other items worn or carried in combat, such as combat protective equipment.
14. Strategic Policy Division should develop, for consideration by Government, advice on those specific countries whose industry capabilities might also support Australian defence capability identified in the PICs.
15. Industry Division should undertake further research into the dynamics of the clothing market and industry, particularly its specialised components, and the likely trends in industry structure, vertical integration and market concentration. This will provide a better understanding of the relative weight and influence of Defence in the market, and the degree of reliance by both fabric and garment manufacturers

- in Australia on Defence as a customer for the viability of their entire business or specialised parts of it. This will inform future Government consideration of any possible PIC-based interventions in the market.
16. The Clothing SPO should develop, and maintain, a comprehensive picture of the sourcing of Australian combat clothing and personal equipment, including the raw materials, refined materials and finished products.
 17. The Clothing SPO, in consultation with Industry Division, should develop a more detailed understanding of the practices of other countries in relation to the procurement of combat clothing and personal equipment.
 18. An agreed and consistent terminology should be developed for the different elements of combat clothing, with the combat uniform defined more carefully, in two ways – firstly, to distinguish between the combat jacket and trousers and other items worn or carried in combat (such as footwear, headwear, outerwear, protective equipment and personal equipment); and, secondly, to distinguish between the uniform worn in combat and the uniform worn outside combat.
 19. Army should expedite its work on refining its future uniform requirements, particularly in relation to the appropriate uniform to wear in different functions and locations and to the development of a new mid-point camouflage uniform, to inform the forthcoming Open Tender, and ensure that the requirements for signature reduction are applied consistently to different items of clothing and personal equipment.
 20. In conjunction with the Army review of its requirements and the Air Force investigation of a DP uniform for its personnel, the Clothing SPO should investigate the costs of different uniform options, so that the Army and Air Force decisions are informed by a full understanding of the resource impact and the potential for resource savings.
 21. The Clothing SPO should develop enhanced information on the past performance of the Textile, Clothing and Footwear (TCF) industry sector in compliance with standards and quality requirements. The SPO should also investigate further the industry suggestion that there be an accreditation or pre-tender registration process for companies with a proven track record and capacity to meet specific requirements. This should operate on a panel basis, with companies able to seek and gain a renewable compliance certificate, and thereby avoid inclusion of extensive documentation on these compliance areas in each tender response they make. This compliance would be subject to agreed conditions, such as audit and random testing by DMO.
 22. The broad principles of the DMO Assurance Processes are:
 - (1) Assurance relates not only to the quality of the product but also to broader workforce, social, ethical and environmental responsibilities.
 - (2) The cost of assurance should be broadly commensurate with the value of the product and the likelihood and significance or impact of any shortcomings in compliance.
 - (3) The stringency of the assurance processes used should be proportionate to the assessed risk [likelihood and significance] of shortcomings in compliance.
 - (4) There should be cascading, complementary and mutually-supporting responsibilities for assurance. The first and principal responsibility for assurance rests with the supplier – DMO's assurance processes should complement and validate those of the supplier. Within DMO, enterprise-wide assurance processes should be complemented by SPO processes.
 - (5) DMO must either retain the capacity to be a well-informed buyer or customer [the preferred option], with an in-house capability to undertake assurance activities; or buy in such independent services from the market.
 23. The following are the key elements or parameters of a comprehensive assurance process:
 - (1) Careful identification and promulgation of the product sought.
 - (2) Inclusion in the tender requirements of the assurance processes required [both about the product and about the company, its manufacturing processes and its financial situation]; and the right of DMO to investigate and audit those processes, and the means by which DMO will exercise that right.
 - (3) Rigour in the selection of the preferred tenderer.
 - (4) Careful translation of the tender requirements into the contract documentation – including any warranties or guarantees, testing program, or quality plans.
 - (5) Appropriate accreditation, registration and certification of suppliers, with domestic and international bodies and standards.
 - (6) Effective Quality Assurance (QA) and audit processes, both by the company and by DMO [or its agent], involving the testing of the product, the manufacturing facilities and the company itself.
 - (7) Careful contract management, to ensure maintenance of performance to specification and within tolerances and ongoing compliance with relevant contract requirements and standards.
 - (8) Maintenance of records of supplier performance, including on assurance and quality management.
 24. DMO General Manager Commercial should review the policy and advice on intellectual property contained within the Defence Procurement Policy Manual

- (DPPM), including the relevant clauses in the tender and contract documentation, to ensure that they are sufficiently clear and rigorous to protect Defence's position.
25. Further advice should be sought, from technical experts, on the technical and practical feasibility of formally qualifying the general export control on signature suppression. Experts should advise whether it is possible to identify a certain technical level of signature suppression in a uniform fabric above which export should be controlled and below which export would be allowed.
 26. Subject to that technical advice, Defence, through the Defence Exports Control Office, should seek international support for an amendment to the control on signature suppression equipment and material.
 27. Within broader advice provided by the Defence Exports Control Office, DMO should provide clear and helpful advice to companies on export control issues, including a general warning about export permits in any tender, contract or other documentation which involves products which are or might be subject to the DSGL. This should apply particularly to any materiel or other GFM provided to companies.
 28. The Clothing SPO, in consultation with Procurement and Contracting Branch, should identify additional ways to inform industry about the major principles and processes followed in making procurement decisions, including greater detail on the processes and criteria to be used in selecting a preferred tenderer; and to provide more detailed de-briefings to unsuccessful tenderers.
 29. The forthcoming Open Tender for the supply of disruptive pattern uniforms should seek supply options unconstrained by country of manufacture of fabric or garment. But it should also require each tenderer to submit an option for the manufacture of both the fabric and the garment in Australia, to allow the evaluation of the tender responses to assess fully the Australian industry and strategic implications of the options over the full life of the contract. The tender evaluation will be informed by:
 - (1) the dynamics and state of the TCF industry
 - (2) any development work, and associated Intellectual Property (IP) or technology, on the combat uniform
 - (3) the relative costs of different fabric and garment options
 - (4) the detailed uniform requirements of the three Services
 - (5) the nature and volume of work for, and its potential impact on the viability of, industry
 - (6) policy advice on the relative priority of the PICs, competing proposals for intervention in the market and Strategic Reform Program (SRP) savings proposals.
 30. DMO should begin a broad campaign to inform the media and the public about the overall approach to procurement of combat clothing and personal equipment, with its relative priority within the PIC program; the numerous sources for raw materials, refined materials and finished products; relevant international comparisons; and the importance of value for money considerations in delivering the most effective defence force possible within a constrained budget. The objective of that campaign is to ensure that future decisions on the sourcing of combat clothing and personal equipment can be made, and sustained, in a less politically-charged environment.
 31. Based on the lessons learned from the tender evaluation process for the Restricted Disruptive Pattern Combat Uniform Tender, DMO [Procurement and Contracting Branch] should develop additional advice on the assessment of risk and value for money over the whole life of the contract for inclusion in the Defence Procurement and Policy Manual.

INTRODUCTION

TASKING:

1. On 29 January 2010, Mr David Mortimer advised Dr Stephen Gumley, CEO DMO, of concerns about DMO and clothing procurement raised with him by an industry representative. Dr Gumley decided that further investigation was required of the issues raised with him. He met with Mr Frank Lewincamp on 2 February 2010 to discuss the proposed review, and formally commissioned it on 12 February.
2. On Wednesday, 10 February, Minister Combet decided to rule out an option, proposed by Australian Defence Apparel (ADA) in its successful bid for the Restricted Disruptive Pattern Camouflage Uniform (DPCU) Tender, for the use for the combat uniform of a fabric manufactured in China. That decision was made because of uncertainty about three issues – the reliability of the tender evaluation process, the appropriate interpretation and application of the Priority Industry Capability (PIC) policy, and the potential and uncertain impact of the option on Australian industry.
3. The initial task for the Review, commissioned in February, was to analyse the extant Commonwealth policy framework relevant to DMO procurement of combat clothing, to determine whether there is any overlap, conflict or ambiguity within that policy framework and, if so, to provide advice on possible actions and strategies to resolve those issues. A draft report was completed in early May 2010.
4. In early June, the Review was tasked to address additional terms of reference relating to the processes and procedures that DMO could use to gain assurance about the supply of textiles, clothing and footwear from overseas sources. It was also tasked to investigate further some of the matters raised in the first draft report. The terms of reference for the Review are at Attachment A.
 - The Review did not address issues associated with ADF personnel's assessment of, or satisfaction with, the clothing and personal equipment procured by the DMO. These issues are the subject of a separate review being conducted by Mr Jeff Whalan.
5. This Report presents the findings of both parts of the Review.

CONDUCT OF THE REVIEW

6. The Review involved two key elements:
 - interviews with Minister Combet and his staff, the Chief of Army (as the principal user or customer), senior DMO personnel, Land Systems Division and Clothing Systems Program Office (SPO) personnel, DSTO personnel, industry and union representatives, and staff of the Department of Industry Innovation Science and Research; and
 - an analysis of relevant documents, relating to strategic and defence policy, defence industry policy, procurement policy and clothing procurement.

Full details on those interviewed and the documents analysed are provided at Attachment B. A summary of public statements made in February by Ministers and officials about the Restricted DPCU Tender is at Attachment C.

7. The analysis was conducted over a relatively short period of time, with relatively limited consultation. Key issues have been followed up, to check or reconcile conflicting views and accounts of situations, but that has not been done for all issues. Areas in which further information should be sought or further examination is warranted, and areas of conflicting views, have been identified in this Report.

BACKGROUND

The Australian Textiles, Clothing and Footwear Industry

8. That part of the Textiles, Clothing and Footwear (TCF) sector engaged in the supply of clothing and personal equipment to Defence is relatively small. A limited number of companies manufacture the goods, using a mixture of local and overseas sites. Only one company currently manufactures the DPCU fabric for the combat uniform (jacket and trousers) and does so in Australia. Two companies, currently manufacture the combat uniform garments (jacket and trousers) in Australia, using fabric supplied by the Australian company. Other companies make a DPC material for equipment such as webbing, and a non-signature reduction DPC fabric for outerwear.
9. The company representatives themselves describe an industry sector in which there is a deal of rivalry, suspicion and tension.
 - The TCF industry in Australia is shrinking rapidly. The Clothing SPO advised that employment levels in the industry have fallen 50 per cent in the past 10 years, with corresponding falls in investment. Substantial levels of assistance are being provided by Government, including tariffs and funding for innovation and restructuring.
10. There is limited reliable information available about the dynamics of the specialised clothing market, and, in particular, the extent to which both fabric and garment manufacturers in Australia are reliant on Defence as a customer for the viability of their entire business or specialised parts of it. This is a critical issue in any consideration of government intervention under the Priority Industry Capabilities (PICs). The companies themselves present a mixed and at times confusing story.
11. It is not sufficiently clear at present how different the production demands are for Defence uniforms compared to those required by other services and companies – for example, the police, fire services and paramedics, or combat uniforms for other countries - and the extent to which production for Defence, especially of the high technology fabric, involves significantly different manufacturing facilities

or equipment. Nor is it clear what volume of business is required to maintain the technological and manufacturing capabilities, or what the relevant lead time and start-up times would be if the local capability closed temporarily.

- Garment manufacturers in Australia are not dependent solely on Defence orders in order to receive the volume of business required to maintain a commercially viable capability to make close tolerance uniforms – there is much other work in specialised uniforms (for example, fire and emergency services and police forces).
 - » However, specific garment manufacturing facilities are currently dependent heavily on Defence orders.
 - » Several companies expressed concern about the future viability of specific facilities without ongoing Defence work.
 - High technology fabric manufacture for Defence appears to be qualitatively different to the manufacture of fabrics with other properties (even, for example, fire retardancy). Therefore, the maintenance of a commercially viable specialised capability for high technology fabric manufacture appears to be highly dependent (perhaps solely) on the volume and assurance of Defence business.
12. The Review was informed of pressures for vertical integration and market concentration within this industry sector. Existing companies are investigating an expansion into other elements of clothing manufacture (for example, from garment manufacture into specialised fabric manufacture and vice versa). If pursued successfully, such moves would have significant implications for competition within the Australian industry, and the ongoing viability of particular local facilities.
13. A specific concern in relation to combat clothing is the potential market power of a sector-dominating or monopoly supplier, particularly in high technology fabric manufacture, and the consequent lack of market leverage over that supplier. Greater competition is more likely in garment manufacture, where the skill set is not so specialised, and lead times for development or expansion of the capability are less.
14. Further research into the local industry and market is, therefore, a high priority. Industry Division should undertake research into the dynamics of the clothing market and industry, particularly its specialised components and the likely trends in industry structure, vertical integration and market concentration, in order to gain a better understanding of the relative weight and influence of Defence in the market, and the degree of reliance by both fabric and garment manufacturers in Australia on Defence as a customer for the viability of their entire business or specialised parts of it. This will inform any subsequent judgments on possible PIC-based interventions in the market.

Current Sourcing of Combat Clothing and Personal Equipment

15. The current sourcing of combat clothing and personal equipment is a complex mixture of local and overseas supply and manufacture – of raw materials, refined materials and finished products.
- In some cases, there is overseas supply of fabric and local garment manufacture.
 - In other cases, there is local supply of fabric and overseas manufacture of the garment.
 - Some items are sourced entirely overseas.
 - But all fabric for the DPCU, the Disruptive Pattern Desert Uniform (DPDU) and Disruptive Pattern Naval Uniform (DPNU) is currently sourced from Australia.
16. Additional advice was obtained from the Clothing SPO about the current sourcing of combat clothing and personal equipment. There is, through the DMO, a globalised supply chain for ADF clothing. All combat uniform fabric is manufactured in Australia, while some of the garments (but not the DPCU jacket and trousers) are manufactured overseas, in China, Laos, Vietnam, the UK and Italy. A range of combat protective equipment is manufactured overseas, in Israel, the US, Germany, Vietnam, China and Latin America. Personal field equipment is sourced from China, the US, the UK, Italy and Israel.
- In this regard, Australia is little different to most other countries. There is a large, dynamic and highly competitive global supply chain for military clothing and personal equipment.
17. Further work should be undertaken by the Clothing SPO to develop, and maintain, a comprehensive picture of the sourcing of combat clothing and personal equipment, including the raw materials, refined materials and finished products.

International Comparisons

18. It has been difficult to get accurate information on the practice of other countries such as the US, UK and Canada in relation to the procurement of combat clothing. Conflicting reports were presented to the Review. Such information is relevant to the public discussion of sourcing decisions made in Australia.
- For example, during the Senate Estimates hearing of 10 February 2010, Senator Johnston stated that “I wouldn’t have thought any one of our allies would have entrusted that specification and knowledge [of Near Infra-Red signature management] to a foreign manufacturer”.
19. The following limited information has been provided to the Review:
- A press report indicates that the UK is developing a new multi-terrain pattern (MTP) camouflage uniform, to replace both the desert camouflage and the

traditional temperate or woodland camouflage worn by troops stationed in Europe (Telegraph, 20 December 2009). The uniform is designed for all types of terrain, and was to be used in Afghanistan from March 2010. The Ministry of Defence paid a US company an undisclosed sum for the new design, and has secured intellectual property rights over the MTP camouflage to prevent others from using it without permission. The report states that “the kit is to be produced by a Northern Irish company but will be made in China”. Australian industry representatives advise that the UK has sourced the fabric for its uniform for some years from Eastern Europe and China.

- The Canadian camouflage fabric and combat garments are manufactured in Canada, which is reported to have a competitive domestic textile industry.
 - Industry Division reported that the French, German and Italian uniforms are each manufactured locally at a very high cost premium.
20. Further work should be undertaken by the Clothing SPO, in consultation with Industry Division, to develop a more detailed understanding of the practices of other countries in relation to the procurement of combat clothing.

Clothing SPO

21. The Clothing SPO is predominantly concerned with the sustainment function, rather than acquisition projects. It manages approximately 20,000 lines of clothing, headwear, footwear and accoutrements. Each year, approximately 1,800 purchase orders are raised, there are around one million demands for clothing in the supply chain, and around 7 million items are issued.
22. The Clothing SPO has been the subject of numerous reviews and audits in recent years, many arising from specific complaints from clothing and equipment suppliers about partiality or bias in procurement decisions or the lack of adherence to the required procurement processes. In 2006, a report of a major review, *The Report of the ADF Clothing Review* [Harding Report], made numerous recommendations to address governance, management, business process and cultural issues within the then Clothing Group within the Soldier Support SPO.
23. The recommendations of the Harding Report were accepted. New structural arrangements were implemented, with Clothing established as a discrete SPO, and management oversight strengthened. The then Director, COL Simon Welsh, revamped the SPO business model and introduced new business processes. This gave greater direction and clarity to the overall procurement strategy and specific contracting. Significant effort was also expended on staff training, and enhancing internal supervisory and clearance processes. In the past two years, the SPO has sought to establish a greater number of long term standing offers and contracts, in order to reduce the workload associated with procurement action. In FY 2009-09, 15 such contracts and standing offers were established, and in FY 2009-10 a further 19 were established.
24. In parallel, the Procurement and Contracting Branch, under the Special Counsel DMO, updated the Defence Procurement Policy Manual [DPPM], and strengthened the review, oversight and promulgation of changes in procurement policies arising from new legislation or government decisions. Departmental Procurement Policy Instructions (DPPIs) are designed to provide timely advice of changes to policy or legislation. A new DMO-wide process guide, Defence Material Instruction (Procurement), was developed in 2009, and replaced an internal process within Land Systems Division of promulgating Standard Operating Procedures (SOPs).
25. These changes have had a dramatic effect on the Clothing SPO. Both Land Systems and Clothing SPO managers are confident (a confidence that appears to be soundly based) that there is a clear policy framework; updated guidance is received in a timely manner; there are sound internal business arrangements, based on probity and proper processes, clearly understood by staff; and that there are appropriate processes, based on levels of risk and complexity, for clearance of procurement decisions by senior, experienced practitioners. The overall impression is of a SPO staff who understand their business and work diligently, properly and effectively to do their job.
- Notwithstanding this, the workload pressures, public scrutiny, allegations and inquiries and reviews over recent years continue to challenge the morale and focus of the SPO, and to threaten the attraction and retention of staff. SPO management and staff have faced an onerous burden in investigating complaints and assisting inquiries, in addition to their demanding procurement work.
26. In relation to the Restricted DPCU Tender, the Clothing SPO did apply the extant policy framework properly. In relation to the interpretation of the Priority Industry Capabilities (PICs) and the issue of overseas supply of clothing, it relied on advice from Industry Division of DMO.
27. However, there are some aspects of the Restricted DPCU Tender evaluation process that cause concern. After the contract was signed, reservations were expressed by two companies about the value for money outcome and the treatment of risk. Whilst the Review did not examine the tender evaluation process or documentation, it did not receive a fully satisfactory explanation from the SPO of the judgments made on risk and value for money. There appeared to be uncertainty about dealing with the risk of supply from an unproven manufacturer, and at what point in the tender or contracting process assurance about the management of that risk needed to be obtained. Specifically:
- The SPO awarded the contract on value for money across the whole contract, including both the initial phase and the follow-on option which proposed to source the fabric from China;

- But the SPO did this without sufficient evidence of the technical compliance or assurance of supply of that follow-on option;
- There was not, therefore, a fully comprehensive, whole-of-contract review of risk and value for money;
- This does not imply necessarily that the wrong decision was made – rather, that there was insufficient evidentiary basis for it;
- It is still an open question as to whether the Chinese-sourced fabric would have been compliant, on schedule and on cost, and therefore best value for money.

Further details on the tender process are at Attachment D.

28. There has been some public comment [for example, in the media and during the Estimates hearings of the Foreign Affairs, Defence and Trade Legislation Committee in February and June, 2010] about the supposed inferior quality of any fabric sourced from China. In that context, the Review must note that Chinese suppliers are able to meet successfully the combat uniform requirements,

including signature reduction, of countries such as the United Kingdom. It should not be assumed that an overseas-sourced product is necessarily inferior to one produced in Australia. In addition, it should not be concluded that the supplier associated with this contract would not have been able to provide a fully compliant product for the ADF.

- The Chinese supplier provided two fabric swatches, in January and February 2010, before its development work ceased. Neither met the technical specification, although the second was closer to it with progress being made.
- It would be useful for the Clothing SPO to seek further information about the capability of specific Chinese suppliers to produce a fully compliant high technology fabric, such as that being procured by the UK.

29. Based on the lessons learned from the tender evaluation process for the Restricted DPCU Tender, DMO [Procurement and Contracting Branch] should develop additional advice on the assessment of risk and value for money over the whole life of the contract for inclusion in the DPPM.

DISCUSSION

COMMONWEALTH POLICY FRAMEWORK RELEVANT TO CLOTHING PROCUREMENT

30. There are various elements of the legislative and policy framework within which the Clothing SPO operates. Most directly, they are the relevant Defence strategic and industry policies and overall government procurement policy. But there is also whole-of-government policy on industry, trade, employment and workplace relations that is relevant to government procurement.
31. The Review found no major conflicts or inconsistencies in the policy framework applying to the procurement of combat clothing and personal equipment. Rather, there are various major principles which need to be considered and reconciled, in terms of their relative importance and priority, in their application to different procurements.
32. The principal or primary policy document for all Defence officials involved in the procurement process is the DPPM. It seeks to provide up to date guidance on all relevant policy across government. The DPPM states clearly [p3] that it “incorporates mandatory procurement policy drawn from the higher level Commonwealth or Defence procurement guidance, in particular the CPGs [Commonwealth Procurement Guidelines]. These requirements are mandatory for all Defence officials”.
 - Figure 1 [page 1.1.4] outlines the broader sources of procurement policy from the wider legislative and policy environment – including policies which govern Australian Public Service actions.
 - Chapter 3.10 deals with interacting policies – that is, those broader government policies which also apply to procurement. They include financial management, accountability, legal, outsourcing, international, industrial relations, privacy, security and social policy considerations.
 - Chapter 3.12 deals with industry development and Australian Industry Capability considerations.
 - Chapter 3.14 deals with legislation affecting procurement, including consumer protection, superannuation, workers compensation, taxation, privacy, anti-discrimination, occupational health and safety, and environmental legislation.
 - Chapter 5.6 provides detailed advice on the evaluation of tenders, including assessing risk, determining value for money and evaluating whole of life costs.
33. Some developments and changes in broader government policy were foreshadowed in the Government’s Procurement Statement in July 2009. As these are formalised in policy or enacted in legislation, they will need to be adopted and implemented by DMO – for example, the Fair Work Principles whose associated Act took effect from 1 January 2010 [noting that these did not apply to the Restricted DPCU Tender, whose contract was signed in December 2009]. The Principles build on the existing provisions of the CPGs, with the following major relevant provisions:
 - Value for money is the core principle underpinning government procurement, with the Government committed to a fair, cooperative and productive workplace
 - Suppliers must comply with the Principles [particularly those relating to the workplace, workplace relations, workers’ compensation, and OH&S] and provide information in their tender responses as to how they do so, and must require subcontractors to comply with the Principles “as far as practicable”
 - Overseas suppliers must comply with all applicable laws in jurisdictions in which they are based
 - Clothing and footwear manufacturers which have a commercial presence in Australia must be accredited with the Homeworkers’ Code of Practice, or be seeking accreditation prior to signing a contract.
34. Procurement and Contracting Branch released DPPI 1/2010 on 19 February, to advise DMO personnel of these requirements and to provide updated tender and contract templates. These details were incorporated into the DPPM on 1 April. A revised DPPI, 11/2010 dated 1 July 2010, provided revised guidance.
35. The TCF Union of Australia believes both that the Government is committed more firmly to support for the local TCF industry and that DMO is not fully compliant with current policy requirements.
 - The union argues that Labor Government ministers are committed to maximising participation of Australian TCF suppliers, to extending the value-for-money consideration to include wider economic impact [for example, unemployment benefits and other social welfare costs arising from workers losing their jobs], and to applying ILO workforce principles and broader ethical considerations to all government procurement.
 - » However, Defence and all other government agencies must operate on the basis of existing government policy, rather than intentions or aspirations that have not yet been translated into policy. While there were world-wide trends towards greater concern about broader social, ethical and environmental issues associated with global supply chains which may lead in future to policy and legislative change, Defence will continue to implement endorsed or enacted government policy.
 - The union also stated that Defence is not yet implementing fully the requirements of the Fair Work Principles and its associated industrial awards,

citing the requirements to procure only from accredited suppliers, and the level of assurance Defence was seeking about the financial viability of suppliers for the whole life of contracts [for example, in relation to the capacity of suppliers to meet workers' entitlements and award conditions, and to continue to do so throughout the life of the contract].

- » The Clothing SPO acknowledges that it is still developing processes and procedures to undertake this additional scrutiny of tendering companies – and has not [due to workload pressure and lack of resources] examined all existing contracted suppliers to ensure they are meeting the expanded workforce obligations introduced on 1 January 2010.
 - » On the other hand, the Review was not given any evidence to indicate that existing contracted suppliers are not meeting these obligations.
36. The Department of Industry, Innovation, Science and Research advised the Review that a number of initiatives and proposals are being considered, through innovation programs, projects and reviews [such as an ethical quality mark], but that these are yet to be considered by government. DIISR is currently providing financial support to the TCF industry through structural adjustment and innovation grants.
37. Clothing SPO staff report that there are some minor areas in which the CPGs and the DPPM impose different requirements – for example, in relation to the number of delegates that need to sign off on procurement decisions. But the SPO staff indicate that these differences relate to process only, and are confident that they do not affect decisions or outcomes.
- It is recommended that these minor differences be examined, to determine whether the DPPM processes need to remain different from the CPG processes.
38. The only other area identified by this Review for further guidance and discussion in the DPPM is that of PICs, which are not currently covered in the Manual. They are described briefly in a separate Australian Industry Capability manual. It is recommended that Procurement and Contracting Branch, in consultation with Industry Division and drawing on the Defence White Paper, promulgate advice on the definition and application of Priority Industry Capabilities, for inclusion in the DPPM.
39. There is **one major source of ambiguity or uncertainty related to the policy framework**, identified by all parties - that is the PICs and their specific application to combat clothing and personal equipment.
- The Clothing SPO advised that, consequently, the applicability of the PICs to specific procurements was a judgment exercised by the Program Manager level within the SPO, with the advice of DMO Industry Division.
40. That uncertainty was the major reason for the Minister's decision to rule out the contract extension option of acquiring fabric from a Chinese supplier. Pending the outcomes of this Review and further clarification of the PIC, the Clothing SPO then ceased action on both finalising related tenders and negotiations with preferred tenderers for already released tenders.
- Since the commencement of the Review, the Clothing SPO has sought to remove some of the uncertainty for industry and ensure ongoing workload, by notifying ADA and Pacific Brands [CTE] that it will direct source the DPCU equally from the two companies for the 24 months following the current 12 month Restricted Tender contract period, with the fabric sourced from the fabric supplier in Australia. The contracts were signed on 26 May 2010.
 - During this time, the Clothing SPO intends to release an Open Tender for the further supply of disruptive pattern uniforms and award the contract.
41. Industry representatives are divided about the clarity and consistency of the policy framework, with contention about the interpretation of the PIC and the definition of combat clothing.
- ### **Analysis of the PIC**
42. The concept of PICs was introduced in the *Defence and Industry Policy Statement 2007*, and taken up in *Defending Australia in the Asia Pacific Century: Force 2030* [Defence White Paper 2009], 2009. Further advice on the PICs was provided in a Fact Sheet published in July 2009. The recent Defence Industry Policy Statement [*Building Defence Capability: A Policy for a Smaller and More Agile Defence Industry Base*], released in July 2010, did not elaborate further on the PIC concept, and left the definitions of PICs in general and the Combat Uniform and Personal Equipment PIC unchanged.
43. The general aim of the PICs is clear – to ensure that certain strategically important industry capabilities continue to be available in Australia. *"PICs are ... those capabilities that confer an essential strategic advantage by being available from within Australia and which, if not available, would significantly undermine defence self reliance and Australian Defence Force (ADF) operational capability"* [Fact Sheet, July 2009].
- The Fact Sheet states that the National Security Committee of Cabinet will make decisions about whether and how to provide support to PICs based on a robust business case. Support will only be provided in cases where market failure would be so detrimental to Australia's strategic interests as to justify intervention.
 - This of course allows the possibility of a judgment that market failure would not be so detrimental to Australia's strategic interests, and that some undermining of defence self-reliance would be acceptable - and hence that overseas

- supply is acceptable (even if local supply is preferred or there is some strategic advantage from the availability of the industry capability in Australia).
- » Such a possibility would call into question the word “essential” in the definition. Is it sensible to suggest that an essential strategic advantage not be maintained because the market failure would not be so detrimental? That would indicate that the strategic advantage is not essential.
 - » If the strategic advantage was truly essential, the government would have to intervene. The robust business case would relate only to how to intervene, not whether.
- This issue would be clarified, at least in part, by simply removing the word “essential” from the definition of the PIC. The definition might be recast in the following terms:
 - » “PICs are those industry capabilities that confer such a strategic advantage by being available within Australia that their absence would undermine significantly defence self-reliance and Australian Defence Force operational capability”.
44. The Combat Clothing and Personal Equipment PIC states: “This capability relates to the ability to undertake ongoing development of the combat uniform, especially multi-spectral and other signature reducing characteristics, and enhancements to personal survivability (such as ballistic, blast and flash protection). It does not include non-combat clothing nor imply that local manufacturing is always necessary”. This definition contains uncertainties. While some scope for interpretation, judgment or flexibility is clearly desirable, to allow responsiveness to changing circumstances, there is also merit in providing some clearer guidance on the meaning and interpretation of the PIC, in order to assist both industry and those officials required to make rigorous and complex procurement decisions based on it.
45. The PIC explicitly relates to the ongoing development of the combat uniform, not to the production of the current combat uniform. This implies that the sole concern is to retain in Australia an industry capability, either independently or in concert with DSTO and other research and development bodies, to test, produce and commercialise new technology related to the combat uniform, and, if necessary, to protect such technology through local manufacture.
46. There are a number of issues with the Combat Clothing and Personal Equipment PIC. Firstly, there is ambiguity in the term “combat uniform”.
- What is implied or intended by the use of the term “combat clothing” in the title of the PIC, compared to the term “combat uniform” used in the description of the PIC?
 - On some interpretations, the combat uniform is the current Australian camouflage or Disruptive Pattern uniform – the DPCU. On others, it includes additional items worn with the jacket and trousers, such as headwear, footwear and webbing.
- It would be helpful to develop an agreed and consistent terminology for the different elements of the combat clothing – the jacket and trousers; other items worn as part of the uniform in combat, such as footwear, headwear, webbing and protective equipment; outerwear for specific purposes; and other personal equipment.
 - At its simplest, the term should mean the uniform worn in combat - and that appears to be the most appropriate and useful definition. In that case, the term does not apply to a uniform worn in offices or barracks, in much training or in other non-combat circumstances, even if it is very similar to the uniform worn in combat.
47. Secondly, the manufacture and supply of the combat clothing and personal equipment involves several stages – the sourcing of raw materials, the manufacture of the fabric or refined materials, and the manufacture of the garment or final product - and the PIC currently provides little guidance on those stages.
- Raw materials are predominantly sourced overseas. In general, these are widely available and generic, so assurance of supply is not an issue. In some specific cases (for example, for ballistic protection in protective equipment), ingredients or raw materials may be scarce, especially in major conflicts, and steps would need to be taken to assure supply for manufacturers of Australian garments and equipment.
 - In relation to the combat jacket and trousers, the PIC does not seem to apply to the manufacture of the garment – except perhaps in circumstances in which Australia is seeking to protect some unique technology in or applied to the fabric, or some aspect of the design of the garment (although it is difficult to see how garment design would have such advantage that it required strong protection).
 - » There may be other strategic reasons, related to the assurance of supply and short-term responsiveness to changing demands, for maintaining at least some garment manufacturing capability within Australia – but that is not currently envisaged or encompassed by the PIC statement.
 - » Assurance of supply of garments might also be met by other means, including stockholding and using a number of manufacturers.
 - » Industry representatives concede that there is nothing about garment manufacture that qualifies as a PIC. But they argue that some Australian garment manufacturing capability should be retained for assurance of supply and responsiveness to changing operational demands.
 - The PIC, in relation to the combat jacket and trousers, appears to have relevance then only to the ongoing development of the fabric used – the technology and industrial capability to apply dyes and chemicals to the fabric to give it specific properties – such as visual reduction and signature reduction (NIR, thermal).

- » There are currently *no intellectual property, unique technologies or unique industrial capabilities* in the manufacture of the existing fabric for the DPCU. Given the widespread availability of current NIR technology around the world, there is not a compelling argument on those grounds to limit manufacture of that fabric to Australia.
 - » There may however be an argument for some local manufacturing capability to assist with further development, testing and commercialisation.
 - ◆ Some TCF companies argue that a local manufacturing capability is essential to undertaking local research and development. Others suggest that the R&D could be undertaken offshore, in countries such as NZ, the UK or the US.
 - ◆ If a local capability is needed for this purpose, the critical issue is how much capability.
 - » The argument then for the retention within Australia of the capability represented by fabric manufacture rests on the prospects of sufficiently significant technological enhancements (see section below).
48. The description of the Combat Clothing and Personal Equipment PIC should be revised. The following draft is suggested:
- “This is the capability to undertake further technical development and subsequent manufacture of clothing and personal equipment, to enhance the protection and survivability of ADF personnel in combat. It applies particularly to leading-edge technical developments which Australia is concerned to protect. It does not require combat clothing and personal equipment to be manufactured solely or even principally in Australia, and does not apply to clothing or personal equipment worn outside combat”.
49. More broadly, there is an issue of priority between the PICs – both in relation to the capabilities which confer the greatest strategic advantage by being available in Australia and in relation to any additional costs or premiums to be paid for that local capability.
- This becomes particularly relevant in the context of the affordability of the Defence Capability Plan (DCP) and the achievement of the Strategic Reform Program (SRP).
 - Part of the SRP identified savings for DMO was to be achieved in clothing procurement.
 - » The Audit of the Defence Budget identified savings and productivity gains of \$13-19m per annum in clothing procurement through the consolidation of suppliers, greater standardisation of uniforms, and moving to lower cost suppliers [p215]. It goes on to state that two of the biggest opportunities for savings are the use of global sourcing and consolidating the local supplier base [p216]. It says that these are “examples of a potential saving where Defence personnel believe they are constrained by Government policy or direction, and do not feel able to fully pursue the opportunities” [p217].
- » The intent of these findings is clear – reduce local sourcing, consolidate local suppliers, and increase global sourcing.
 - These findings, and the specific means of achieving the savings in the supply of ADF clothing, were endorsed by Government.
 - Anticipated savings of approximately \$1.5m will now not be made from the Restricted DPCU Tender contract.
 - Both CEO DMO and the Chief of Army are concerned that, if identified savings cannot be made in clothing procurement, they will be required to find offsetting savings elsewhere, possibly from higher priority capability requirements.
50. There is currently no advice available, to either DMO or industry, on the relative priority between the PICs. Strategic Policy Division should develop, for consideration by Government, a clear basis and criteria for assessing the relative priority of the PICs, and, therefore, the relative priority of proposals for any government intervention in the market.
- An appropriate starting point for those criteria is the discussion of the PICs in the 2009 Defence White Paper [paragraphs 16.22-23].
 - The annual Planning Guidance provided by Defence to Government should also include judgments on what should, and should not, be included as a PIC.
51. On the grounds of both those capabilities which confer the greatest strategic advantage by being available in Australia and the additional costs or premiums to be paid for that local capability, the PIC for combat clothing and personal equipment itself does not appear to be a high priority, compared to some other PICs - and, within the PIC, personal equipment appears to be a higher priority than combat clothing.
52. PIC policy does not currently address whether there are other countries whose supply of raw materials, fabric or garments and further development of the combat clothing would not be seen as contrary to Australia’s strategic interests – or which might be seen as equivalent to local supply. This applies particularly to New Zealand, but close allies such as the United States, the United Kingdom and Canada might be included.
- Industry representatives suggested strongly that research and testing could be coordinated by a prime with extensive knowledge of the textile industry, working with DSTO but using an overseas fabric manufacturer. They are confident that appropriate protections could be given to the technology and associated intellectual property.

- Industry representatives advise that they could work, for example, with a UK fabric supplier and NZ garment manufacturer on further technical development of the uniform.
 - The major issues would then be an assurance of the ready availability of such a capability, and which specific countries might be acceptable.
 - It is unlikely, however, that the Australian Government would wish to invest in the development of technology, through DSTO, which would then be commercialised in an overseas country. The Government would likely wish to ensure that the benefits of its investment were reaped in Australia.
53. Strategic Policy Division should develop, for consideration by Government in the ongoing refinement of defence industry policy and the PICs and in accordance with broader trade policy, advice about those specific countries whose industry capabilities might also support Australian defence capability identified in the PICs.
54. There is opportunity to clarify and refine the description of the PICs in the annual review of PICs as part of Defence Planning Guidance [a process set out in the Defence White Paper 2009, para 16.25]. Following Government consideration and endorsement of the Defence Planning Guidance, more detailed guidance on the PICs should be developed and distributed for procurement staff.

PROSPECTS OF FURTHER DEVELOPMENT OF THE COMBAT UNIFORM

55. It is not possible at this stage to make an accurate assessment of the possibilities for further development of the combat uniform, over what timeframe and at what research cost. It is not possible, therefore, to provide definitive advice on the relative priority, feasibility and likelihood of success of further development work on different aspects of combat clothing and personal equipment.
- The Review assesses that, prima facie, there are better prospects of proportionately greater development success in areas such as combat protective equipment [for example, in ballistic protection], rather than in simply the fabric of the jacket and trousers of the uniform.
 - DSTO is working with industry and international partners on the protective capabilities of fabrics, materials, and equipment, including ceramics and textile-based “soft armour”. It retains strong interest in the ongoing technical development of combat clothing and equipment, a major component of which involves working with the textile industry.
56. It is recommended that DMO and Strategic Policy Division, in consultation with DSTO, assess the potential for successful further development of combat clothing – and, in particular, the relative potential and priority for further technical development of both the fabric and the combat uniform itself (jacket and trousers), compared to that for items worn or carried in combat, such as combat protective equipment.

ARMY CLOTHING REQUIREMENTS

57. The Chief of Army stated that he simply wants the best gear at the best price. There are no emotional or other issues about the country of supply of the combat uniform, of either the fabric or the garments. He is very confident that that is not, and would not be, an issue amongst Army personnel. Much combat clothing and personal equipment is already sourced from overseas. The principal concern is to get the right gear for the task at the best price.
58. LTGEN Gillespie also indicated that the cost of combat clothing could be reduced with a more sophisticated approach to risk management. A high technology uniform was needed for situations of real risk, but a cheaper, lower technology uniform could be used in less risky operational circumstances and in non-operational situations.
59. The Chief of Army has recently directed that the daily work dress to be worn in Army headquarters be the DPCU, and has given discretion to local Army commanders to determine the day-to-day dress in their units. He reported to Senate Estimates in February that many commands are wearing the DPCU. This represents a significant cost saving if Army personnel are able to avoid buying the more expensive polyester uniforms previously worn. However, many Army personnel are not able to do so, because they are still required to use the “more presentable” polyesters for representational duties, such as appearance at Senate Estimates.
60. Army has commenced an overall review of its uniform. This will involve extensive consultation with Army personnel. There will likely be an opportunity in that review to consider the costs of different uniform options, including the potential for savings from much wider use of a camouflage uniform that does not have NIR or other signature reduction properties. Such use might include office and barracks use, and training and operations that do not involve a sophisticated adversary. Air Force is apparently planning a similar review of its uniform, including the development of a new and unique camouflage pattern.
61. Army has also commissioned work on a mid-point camouflage uniform, between the greener colours of the DPCU and the lighter colours of the DPDU. This would be an all-purpose uniform for most operating environments, as is the UK MTP uniform. The Clothing SPO is overseeing the development and trial of this new uniform.
62. Army should expedite its work on refining its future uniform requirements, particularly in relation to the appropriate uniform to wear in different functions and locations. and to the development of a new mid-point camouflage uniform. It should also review its overall policy in relation to NIR, to ensure that the requirements for signature reduction are applied consistently to different items of clothing and personal equipment. This information is needed for the forthcoming Open DPCU Tender.

COMBAT UNIFORM COSTS

63. Two aspects of the cost of combat uniform are relevant:

- The cost savings identified in the Defence Budget Audit and approved in the Strategic Reform Program that would be foregone if overseas supply is precluded, and the cost premiums associated with any broader application of the PIC [not only to the DPCU fabric but also to other elements of the combat uniform if local sourcing was mandated for them].
- The relative costs of uniforms made of different fabrics and materials, and worn in different functions and locations.

64. Of the total Clothing SPO annual budget of approximately \$90m, approximately 70 per cent (\$63m) is expended on combat clothing – of that amount, some \$50m is expended in Australia and \$13m overseas. Advice from the SPO indicates that items currently produced overseas [at a total annual cost of \$13m] would cost on average around 40 per cent more to be produced in Australia - a cost premium of \$5-6m (although not all of the items under combat clothing could be manufactured in Australia).

- Savings in the range of \$13m-\$19m per annum were identified in the Defence Budget Audit for the Clothing SPO, primarily by moving from current local sourcing to overseas suppliers.
- There is, therefore, an \$18-25m cost differential annually between achieving the savings planned under the Strategic Reform Program and the costs arising from any decision to source all of the combat clothing in Australia.

65. There are differing assessments of the proportion of the combat uniform costs represented by the fabric manufacture and the garment manufacture.

- An analysis of the costs of the uniforms to be provided under the Restricted DPU Tender suggests that the cost of the fabric manufacture (from raw materials through weaving to the fabric with the desired camouflage pattern and signature reduction properties) is about 50 per cent of the total cost, with the remaining 50 per cent being the garment manufacture (alternatively called cut, make and trim (CMT) or stitching).
- However, the relative costs of the fabric and garment manufacture depend on the nature of the fabric used in the garment and the sourcing of the garment manufacture.
- If overseas supply is allowed for the fabric for uniforms not used in combat, there is significant potential for savings. On the basis that the estimated savings from the Chinese DPCU fabric would have been of the order of 40 per cent, a higher saving would be expected for Chinese-sourced non-signature

reduction fabric – of the order of 50 per cent or higher. If overseas garment manufacture was also used, higher savings would be achievable.

- The Clothing SPO advises that further savings are possible if other items of clothing are included – for example, if the boots worn in non-combat situations were not the combat uniform boots. There would also be additional savings in inventory and supply chain costs from a rationalisation of clothing requirements.

66. If Australian procurement of fabric for the combat jacket and trousers was mandated under the PIC, a particular issue would be how to put reasonable constraints on the cost, especially in a situation in which a supplier is in a monopoly situation. No straightforward mechanism for doing so was reported to the Review. Garment manufacturers expressed concern about being hostage to the fabric manufacturer's price, if they were required to source the fabric within Australia.

- This issue might be addressed by the Clothing SPO negotiating an extension to the current Standing Offer for fabric manufacture in order to provide price assurance – this would mean, in effect, that the fabric would be provided to the garment manufacturer as Government Furnished Material (GFM).
- Apart from DMO taking responsibility for controlling the price of the fabric in this way, three broad options were presented to the Review – having an open book on the fabric supplier's costs; paying a specified per cent premium on top of the cost of overseas supply; or paying a product price plus an agreed management overhead.
- An additional complication would arise if the current fabric manufacturing company also developed or acquired a garment manufacturing capability, and competed as a prime tenderer. Other tenderers would be required to use that company's fabric. In such circumstances, companies indicated that they would not be able to compete, with the fabric manufacturer having a natural advantage, being able to play with two margins (on the manufacture of both the fabric and the garment), and would likely win any open tender for the combat jacket and trousers.
- Such a situation would be mitigated if other companies developed a fabric manufacture capability within Australia. But that would require significant investment of resources, which companies would be unlikely to make unless there was a long-term assurance of a continuing requirement for local fabric manufacture.

67. The fabric manufacturer's representatives understand concerns about the future cost of its fabric. They say that the company is open to negotiations about the cost of its fabric, and that it may be open to an independent audit of its costs or other means to validate costs and identify productivity savings. The more that

DMO is able to provide a reasonable, longer term forecast of likely or possible fabric procurement, the more open the representatives are to such arrangements.

68. The Clothing SPO should investigate further the cost of different uniform options, so that Army and Air Force (and possibly Navy) decisions on their future uniform requirements are informed by a full understanding of the resource impact and the potential for resource savings.

LOCAL INDUSTRY VIABILITY ISSUES

69. There would remain, however, a very significant practical difficulty in applying the PIC policy on Combat Clothing and Personal Equipment. It relates to the issue of the critical mass needed to maintain a viable local industry capability.

- **If** it was decided that the PIC related to the further technical development of the fabric for the combat uniform, and hence a local fabric manufacturing capability needed to be retained; **and if** it was agreed that the high technology fabric would only be used in the uniform to be worn in combat against a sophisticated adversary, with a different uniform worn by Army personnel for other functions; **then** there may not be a sufficient volume of business to ensure a viable local capability – particularly on a full-time, ongoing basis.
- If so, Defence would need **either** to provide additional work in specialised fabric manufacture to provide the minimum volume needed to maintain the capability, **or** to be prepared to accept temporary closure of the capability when the manufacturer ran out of orders, with its political ramifications, and accept the risk and cost of start-up once more fabric was needed.
 - » Defence could provide the additional work only by ordering more high technology fabric than was strictly needed under the ADF's requirements.
 - » Defence would then either retain greater stockholdings of fabric or completed garments (which would only serve to defer the date of the local manufacturing capability running out of orders) or use the fabric in uniforms worn more widely than just in combat or training for combat. That in turn would mean that the use of a cheaper, low technology fabric uniform would be more limited.
- This would mean a significant cost premium associated with retention of the local fabric manufacturing capability.
- DMO and the Government would still be exposed to the risk of public and media comment by manufacturers about the volume of business needed to maintain a commercially viable capability, and the possibility of plant closures and staff lay-offs.
- The issue would be complicated further if there was more than one local supplier of fabric competing for a limited volume of business.

70. The issue of maintaining basically a standing industry capability becomes more complex when looking across all of the PICs. In circumstances in which the SRP requires significant savings, and the Audit identified such savings through overseas supply of clothing, the key judgment to be made is the relative priority of the PICs and the associated premiums for local supply. The Government would not wish to set a precedent now, in maintaining a local capability in combat uniform fabric manufacture at a cost premium, which could then be invoked by companies in other PIC areas which are, or are thought to be, of higher priority.

- There is also potential utility in some more explicit guidance on the premium or margin allowable, in value for money assessments, of Australian compliance and other costs.

71. The optimum solution to this conundrum is for the local Australian industry to be cost-competitive with overseas suppliers. If that was not the case, DMO would need to apply a stringent test of the relative strategic priority for local manufacture and supply, with the associated cost premiums, across all the PICs.

ASSURANCE ABOUT SUPPLIERS

72. Until now, assurance activity within the DMO has related predominantly to the quality of the finished product being supplied [through measures such as contract requirements, accreditation of companies with particular quality standards, product testing and site visits]. Some attention has been given to broader factors such as the financial viability and future of supplying companies [through financial investigations], but this has largely been only for major procurement contracts. Very little attention appears to have been given to issues related to the workforce, social, ethical or environmental responsibilities of the companies.

- It appears that DMO procurement staff [at least in the Clothing area] have largely relied on, and trusted, companies themselves to comply with all relevant national and local laws, with little explicit audit or checking of that compliance.
 - » Such a “low-regulation” approach appears to have worked well in the overwhelming majority of DMO's business – it has been an entirely reasonable risk management approach, and has meant lower DMO and lower industry costs.
- But with new measures such as the Fair Work Principles, and as the growing focus on the ethical, social and environmental responsibilities of companies is translated into government procurement policies, DMO procurement staff will need to devote more attention to these issues – and assurance will be seen to apply to compliance with all relevant laws and standards, not just product quality.

73. While the Review was tasked particularly to look at assurance issues related to overseas suppliers, it must be noted that many assurance issues relate also to Australian suppliers in the TCF industry.

- There is some additional assurance within Australia arising from initiatives such as the Fair Work Principles, the Homeworkers Code of Practice, Ethical Clothing Australia, and the proposed Ethical Quality Mark for the TCF industry; and the certification of many suppliers to international standards.
 - But both TCF companies and the TCF Union report that there are still significant breaches of the required working conditions, OH&S and wages within the TCF industry in Australia, especially in relation to piecework done outside factories.
 - It is not clear, on the limited investigation done by this Review, to what extent these concerns apply to the work done within Australia under Defence contracts.
 - » The major companies involved in fabric and garment manufacture for the combat uniform state that they do not commission any work outside their factories [notwithstanding this, there was one allegation made to the Review that one company has manufactured DPCU garments using workers outside its factory – this was denied by the company concerned, and there is no evidence available to support the allegation].
 - » Other Defence clothing [that is, non combat] may be produced in less transparent, or assured, conditions.
74. Broadly, the main areas in which assurance is, or may be, needed are:
- Product quality and compliance with specification – including product safety, chemical treatments and residues;
 - Social accountability - labour or workforce conditions, labour rights, fair wages;
 - Environmental impact – water use, greenhouse impact, environmental sustainability, product and manufacturing emissions, waste management; and
 - Animal welfare.

Assurance Processes beyond Defence

75. The principal mechanisms used in the government and commercial sectors for assurance about both quality and broader social and environmental factors are:
- Company [and manufacturing facility] participation in, and compliance with, relevant international and national standards and agreements, including:
 - » Worldwide standards, such as International Standards Organisation [ISO] standards [including quality management and environmental management systems]; the Social Accountability Standard SA8000 [related to labour and working conditions]; Worldwide Responsible Accredited Production [WRAP, related to workplace standards, regulations and local laws]; and Oeko-Tex 100 [related to ecology and the health and safety of textile products].

- » Other international standards or agreements, such as International Labour Organisation conventions, European Union eco-label certification, NATO standards and Allied Quality Assurance Publications.
 - » International regulations related to specific industries and their supply chains – for example, aircraft spare parts.
 - » Overseas initiatives that are gaining wider acceptance, such as the UK's Ethical Trading Initiative, or the US's Fair Labor Association.
 - » National standards or agreements, such as ACCC guidelines, industry sector certification schemes [for example, the TCF Ethical Quality mark, Ethical Clothing Australia, and Good Environmental Choice Australia], or the Green Leader Program.
- Clear agreements and close working relationships with suppliers, including:
 - » Previous cooperation and proven performance
 - » Transparency of processes and arrangements
 - Carefully specified contracts for supply, including:
 - » Guarantees and warranties
 - » Regular manufacturer testing and demonstration of product compliance
 - » Manufacturer acceptance of unannounced visits and inspections by the purchaser – including possibly open-book accounting
 - Audit and review procedures, including:
 - » Independent product testing, initially and periodically, both at the manufacturing site and at delivery
 - » Manufacturing site visits
 - » Periodic independent audits – of production, quality management systems, product, and finances.
76. With an increasingly global supply chain in many industry sectors, there is growing recognition of the importance and value of multi-stakeholder schemes [involving government, industry and unions/workforce] for negotiating and agreeing regulations and standards.
77. There are, however, concerns, on the part of industry, the union and DMO, about the reliability of international standards and testing to them – at least in some overseas locations. There are unverified reports of suppliers or factories “buying” accreditation, even to international standards, without ongoing assurance about their products or processes or whether the products are actually made in the certified facility.

Assurance Processes used by Australian Suppliers:

78. The Review did not examine the full range of current clothing suppliers to Defence in order to assess their assurance processes. Interviews were conducted with major combat uniform suppliers which all have in place comprehensive quality

systems, which extend beyond systems related to the quality of products to those encompassing broader social and ethical responsibilities. Such suppliers could respond readily to any developments in government assurance processes or requirements. The Review did not examine the assurance processes used by smaller suppliers of non-combat clothing.

DMO-Wide Arrangements:

79. DMO [and Defence more broadly] has in place tiered arrangements, involving centrally developed and promulgated policy and procedural advice; intermediate management layers; and devolved procurement authority and responsibility resting with program and project offices.
80. The principal current source of advice within Defence is the DPPM, the responsibility of General Manager Commercial staff. However, the DPPM deals predominantly with ensuring product or service quality, and it is not easy to identify quickly all the sections related to assurance about quality and wider issues.
- DPPM, Chapter 3.5 deals with Quality Assurance. Its language is almost entirely about supplies – for example, being fit for purpose and posing no hazard [paragraph 5], reducing the risk of receiving non-compliant supplies [paragraph 8], and managing sub-contractors' quality [paragraph 12]. While other chapters deal with other aspects of assurance, none appears to do so in a comprehensive manner.
 - DPPI 11/2010, of 1 July 2010, provided updated tender and contract templates to implement changes arising from the Fair Work Principles.
 - General Manager Commercial staff are currently reviewing the DPPM, and its associated tender and contract templates, to ensure that they cover assurance issues comprehensively.
81. There are additional sources of advice and direction on assurance matters within Defence and the DMO:
- Defence promulgates a suite of QA instructions, under the sponsorship of CJLOG. The overwhelming focus of the instructions is on the quality of products, supplies and services.
 - » However, the extant instructions appear to be limited and incomplete in scope. Many are related to process and procedures, rather than practical advice for staff.
 - DMO [General Manager Commercial staff] is developing additional guidance on Supplier QA, including a Defence Materiel Instruction, a draft DIG, a draft new section for the DPPM, an options paper on DMO training, and a draft paper on the Supplier/Contractor QA Lifecycle.

- » This work represents an acknowledgement that, overall, there is a gap in the quality of advice available to DMO staff on QA issues.

- The Director Supplier QA Services is also responsible for international QA arrangements and processes, including multilateral agreements.
 - » Australia has government QA arrangements with 26 countries, 21 of them through the NATO framework. MOUs are in place with several of these countries, with additional MOUs being negotiated. These arrangements allow mutual access to QA services and both supplier and product information. Such services may be used to audit suppliers in those countries, thereby avoiding the need for visits from Australia.
 - ♦ Currently, however, there is no systematic collection of supplier and product information, and no database maintained. NATO is apparently investigating such an initiative.
- DMO Industry Division manages some relevant initiatives, which might be a source of useful information. These include the Company Scorecard – although this doesn't cover all relevant issues, or overseas suppliers and products.

Clothing SPO Arrangements

82. The Clothing SPO operates within this broad framework. The principal reference available [as it should be] is the DPPM.
83. Clothing SPO staff are not confident that assurance is done sufficiently well – and understand that it will be more difficult with the demands for assurance about broader social and ethical responsibilities. SPO staff do not believe that there are sufficient staff, skills and/or time to determine the additional levels of assurance on social responsibility and financial matters.
- For example, considering aspects of suppliers' longer term financial viability will require assistance from the central DMO Financial Investigation Services. With other SPOs also likely to need more FIS assistance, it is likely that FIS's limited resources will be in great demand – careful decisions will be needed on those areas requiring priority attention, based on a risk assessment, and full financial assurance may not be possible.
 - The extent of ongoing product testing, after the initial assurance that the product meets the contract specification, varies significantly across the numerous contracts. In some contracts, suppliers are asked to provide regular test results from accredited test agencies demonstrating continuing compliance of the product. In other contracts, especially those relating to low-value clothing items, there is limited ongoing testing undertaken.
 - » Until now, there has also been limited testing of the ongoing compliance of the product after its introduction into use with the ADF.

- A specific concern is the realistic options available to the SPO if a product no longer meets the precise terms of the specification, especially if the supplier has a monopoly or an alternate supplier would take some time to come on line. Given the limited amount of testing currently conducted, the user may not be aware that the product no longer meets the specification [for example, the breathability of a garment, or the NIR properties of a fabric].
 - » How much tolerance should be given for small variations from specification? If there is initially some tolerance for variations, how are further variations to be handled?
 - » The SPO is planning changes to its testing program, to introduce additional periodic testing of the products, but it is not currently resourced to do this extensively.
- It may not be straightforward to build assurance process costs into the tender evaluation. For example, as a general principle, it is valid and appropriate to include assurance costs into the value for money assessment during the tender evaluation of competing bids, with higher assurance cost for an untested overseas supplier compared to a proven domestic supplier. But it is very difficult to determine, ahead of the contract and its implementation, precisely what those costs would be.

Recommended Approach:

84. A significant consideration in specifying the appropriate assurance processes is to ensure that the cost of compliance, for both industry and DMO, is commensurate with the value of the product and the significance or impact of any shortcomings in compliance.
85. The key to assurance is risk management – that is, where there is a higher risk of shortcomings in product quality or a supplier’s adherence to broader social or ethical responsibilities, there should be more stringent assurance processes in place. Additionally, the greater the value and the cost of the product being acquired, and the more significant or detrimental any shortcomings in product quality are, the more stringent the assurance processes should be and the higher the assurance should be.
- Such a statement is unexceptionable – but one uncertainty or variable is the different assessments which might be made of risk, and the associated risk appetite or tolerance, by different stakeholders.
 - » For example, would Ministers have a different assessment of acceptable risk in relation to reputation? Would DMO’s judgment on this be sustained during a political controversy about a company’s compliance – for example, a Chinese supplier?
86. An assessment of risk might begin with the jurisdiction within which the supplier is based. For example, if the supplier is based in Australia, or an allied or NATO

country, it will be subject to significant local regulation and will likely be compliant with certain national and international standards. Its home base can be taken as a reasonable initial guide to the level of assurance that might be assumed. But this is not definitive or absolute. – for example, note the earlier comments on the Australian TCF industry. On the other hand, if the supplier is based in Eastern Asia, there is currently a prima facie need for more stringent checking of its capacity to provide assured supply of the product.

87. This is another area in which DMO should develop greater awareness of industry performance. As well as the earlier recommendations on an enhanced understanding of industry dynamics, DMO should develop enhanced information on specific industry sectors, in this case TCF – including past performance, compliance with standards and quality requirements. This would best be done by the relevant SPO.
- A related point is the industry suggestion that there might be an accreditation or pre-tender registration process for companies with a proven track record and capacity to meet specific requirements. While there is general support for this among the companies consulted, there is also concern about the workload and resources involved and that this not become a barrier to entry for new suppliers.
 - CEO DMO is receptive to this suggestion. He envisages the accreditation operating on a panel basis, with companies able to seek and gain a renewable compliance certificate, and thereby avoid inclusion of extensive documentation on these compliance areas in each tender response they make. This compliance would be subject to agreed conditions, such as arrangements for audit and random testing by DMO.
 - This proposal should be investigated further by the Clothing SPO.
88. The following, then, are the broad principles of the DMO Assurance Processes:
- (1) Assurance relates not only to the quality of the product but also to broader workforce, social, ethical and environmental responsibilities.
 - (2) The cost of assurance should be broadly commensurate with the value of the product and the likelihood and significance/impact of any shortcomings in compliance.
 - (3) The stringency of the assurance processes used should be proportionate to the assessed risk [likelihood and significance] of shortcomings in compliance.
 - (4) There should be cascading, complementary and mutually-supporting responsibilities for assurance. The first and principal responsibility for assurance [and its associated costs] rests with the supplier – DMO’s assurance processes should complement and validate those of the supplier. Within DMO, enterprise-wide assurance processes should be complemented by SPO processes.

(5) DMO must either retain the capacity to be a well-informed buyer or customer [the preferred option], with an in-house capability to undertake assurance activities; or buy in such independent services from the market.

89. The following are the key elements or parameters of a comprehensive assurance process:

- Careful identification and promulgation of the product sought.
- Inclusion in the tender requirements of the assurance processes required [both about the product and about the company, its manufacturing processes and its financial situation]; and the right of DMO to investigate and audit those processes, and the means by which DMO will exercise that right.
- Rigour in the selection of the preferred tenderer.
- Careful translation of the tender requirements into the contract documentation – including any warranties or guarantees, testing program, quality plans, and audit arrangements.
- Appropriate accreditation, registration and certification of suppliers, with domestic and international bodies and standards.
- Effective QA and audit processes, both by the company and by DMO [or its agent], involving the testing of the product, the manufacturing facilities and the company itself.
- Careful contract management, to ensure maintenance of performance to specification and within tolerances and ongoing compliance with relevant contract requirements and standards.
- Maintenance of records of supplier performance, including on assurance and quality management.

INTELLECTUAL PROPERTY ISSUES

90. As noted earlier in this Report there are currently no intellectual property, unique technologies or unique industrial capabilities in the manufacture of the existing fabric for the DPCU. Given the widespread availability of current NIR technology around the world, there is not a compelling argument on those grounds to limit manufacture of that fabric to Australia.

- This judgment is supported by advice from DSTO that information relating to the NIR specifications of the DPCU fabric is publicly available and that the printing technology is freely available; and by advice that the proliferation risk is negligible.
- DSTO also advises that it is relatively easy to manufacture a signature-managed uniform without the need for a fabric sample, if the manufacturer has the

specification and generally-available textile and dyeing knowledge. From the specification and industry knowledge, the manufacturer can readily do colour coordination, NIR reflectance, base fabric specification, dyes and dyeing method.

91. There are different aspects of the intellectual property associated with the current DPCU fabric:

- DSTO retains IP ownership over the specification [the colours, patterns and NIR reflectance requirements], but this is unclassified and has been put into the public domain.
 - An Australian company has IP ownership of the specific manufacturing process it uses to manufacture its DPCU fabric. However, this IP is not unique. Other suppliers can achieve the same [or better] results against the specification using their own processes.
 - » There is no evidence available to this Review that the company's manufacturing process IP has been compromised.
 - Any IP in the finished garment should lie with Defence/DMO as the purchaser, with relevant contract clauses allowing Defence/DMO unfettered use of the fabric and garment.
 - It is important also that there be consistency across the different parts of the Defence organisation in the approach to IP. The lead in this area, in relation to arrangements with industry, should be provided by CEO DMO.
92. Any IP issues should be distinguished from export control issues, which relate to proliferation, not IP [see below].
93. DMO General Manager Commercial should review the policy and advice on intellectual property contained within the DPPM, including the relevant clauses in the tender and contract documentation, to ensure that they are sufficiently clear and rigorous to protect Defence's position.

EXPORT CONTROL ISSUES

94. The Defence Strategic Goods List [DGSL], 2010 version, includes a general control on "equipment and material, coated or treated for signature suppression, specifically designed for military use" [p52: ML 17 c, h]. This is a necessary control, and should not be removed completely – it is easy to comprehend the possibility of high technology signature suppression materiel which requires protection. The challenge therefore is how to describe those aspects of signature suppression which are widely available and do not require protection, and distinguish them from those that do.
95. Further advice should be sought, from technical experts, on the technical and practical feasibility of formally qualifying the general control on signature suppression. Experts should advise whether it is possible to identify a certain

technical level of signature suppression in a uniform fabric above which export should be controlled and below which export would be allowed.

- If this was feasible, Australia would then have to undertake the lengthy process of seeking and gaining the required international agreement [in this case, under the Wassenaar Agreement] for change to the DSGL.
 - Subsequent export control on this basis might still be complex, with careful testing required to ensure that the signature suppression fell within levels allowed for export.
96. If this approach is not feasible, then the only alternative would be to retain the general control on signature suppression goods and materiel, but with a straightforward and quick permit approval process by the Defence Export Control Office [DECO] of those goods and materiel known not to involve technology which needs to be protected [for example, the current fabric for the DPCU] and satisfaction about the end-user.
- Strategic Policy Division [Murray Perks] agrees with this approach, and indicated that export permits could be given readily and speedily for the current DPCU fabric.
 - However, several companies reported to the Review that the permit process through DECO is not speedy or straightforward. They cited very recent examples of lengthy delays in obtaining both advice and approvals from DECO for the export of DPCU fabric – and noted that there was an unnecessary two stage process [firstly, to seek advice whether an export permit was required, and then to submit the permit], each involving up to 35 days for DECO processing and longer, if consultation with other agencies was required.
97. While the responsibility for seeking export permits, and thereby avoiding breaches of the Customs Act, rests firmly with the company or agent undertaking the export, Defence should ensure that it provides clear and helpful advice to those companies. Broad export control advice is the responsibility of DECO. Within that, it would be advisable for DMO to include a general warning about export permits in any tender, contract or other documentation which involves products which are or might be subject to the DSGL. This should apply particularly to any materiel or other GFM provided to companies.
- Several TCF companies advised that they did not have a detailed knowledge of the DSGL and its contents, and had not been aware, for example, that it included a general control on signature suppression goods and materiel.
 - The Clothing SPO had also been unaware that the signature reduction DPCU fabric was a controlled item.

98. The difficulty of compliance with the DGS� is exacerbated both by its length and complexity and by rapid developments in technology. The capacity of either DMO staff or Defence suppliers to understand, interpret and comply with the provisions of the DGS� is questionable. Further technical developments are likely to result in an increase of referrals from companies to DECO.

- This casts some doubt on the effectiveness of the DECO Outreach Program. It appears to have been focussed more on process, rather than the content or subject matter of the export controls.
- DECO also advised that currently, under the Customs Act, only physical goods are subject to export control. Officials are seeking an amendment to the Act in order to gain export control over intellectual property and other intangibles. This would only increase the complexity of the export controls, and both industry's difficulty in understanding them and officials' difficulty in administering them.

PUBLIC INFORMATION ON THE POLICY

99. The principal area for clarification in the policy framework related to clothing procurement is the PIC. Other elements of the framework appear to be sufficiently clear and well-understood within the Clothing SPO, and need no further refinement.

- However, on the limited evidence available to this Review, it is not apparent that the framework is as well understood throughout the clothing industry.
 - » In particular, SPO staff reported that they often had to deal with repeated complaints from unsuccessful tenderers who clearly did not understand the processes followed and the criteria used to assess the competing offers. This was an onerous part of their work which consumed significant time.
- There would be merit in seeking additional ways to inform industry about the major principles and processes followed in making procurement decisions.
 - » To supplement the briefs and presentations now given at the regular forums with industry, succinct written advice might be prepared about the key principles of the policy framework and some greater detail on the processes and criteria to be used in selecting a preferred tenderer. That advice should be available on a website, but it might also be distributed directly with the tender documentation.
 - » Admittedly, this lack of understanding might well be the result of a failure to access already available advice and information. But the Procurement and Contracting Branch might review what is available, to determine whether it might be enhanced or supplemented.

100. The DMO should develop information and material to inform industry, the media and the public about the overall approach to procurement of combat clothing and personal equipment, with its relative priority within the PIC program; the numerous sources for raw materials, refined materials and finished products; relevant international comparisons; and the importance of value for money considerations in delivering the most effective defence force possible within a constrained budget. The objective of this information is to ensure that future decisions on the sourcing of combat clothing and personal equipment can be made, and sustained, in a less politically-charged environment.
101. A range of arguments or principles has been used in the political debate, in the media and by industry in relation to the sourcing of the combat uniform – both in support of the development, maintenance and retention of industry capabilities within Australia, and in support of sourcing unconstrained by origin or supplier. Much of the commentary has confused or conflated these arguments, and has involved an evident lack of clarity of thinking. At Attachment E is an outline of the different possible arguments for the sourcing of the uniform. At Attachment F is a preliminary, draft narrative that might be used as the basis for talking points for public discussion of clothing procurement policy.

RECOMMENDATION FOR THE OPEN TENDER FOR DISRUPTIVE PATTERN UNIFORMS

102. The Clothing SPO has advised industry that it will source the DPCU directly from ADA and Pacific Brands to meet ADF requirements over the 24 months from the end of 2010. During this period, the SPO will release an Open Tender for the further supply of disruptive pattern uniforms.
103. In order to allow the decision on the Open Tender source selection and contract to be informed fully by all relevant issues, the following information is needed:
- (1) The dynamics and state of the specialised TCF sector, including its structure and vertical integration, and the degree of its reliance on Defence as a customer.
 - (2) Any development work being undertaken on the combat uniform, and the prospects of its commercialisation during the life of the contract.
 - (3) Any IP or technology issues associated with the available fabric and uniform.
 - (4) The relative costs of different fabric and garment options for ADF uniforms.
 - (5) The detailed uniform requirements of the three Services, particularly for high technology combat, for other combat and operations, and for non-combat purposes.
 - (6) The consequential nature and volume of work for industry, especially for high technology or close tolerance manufacture, and its likely impact on the viability of local industry.

- (7) Policy advice on the acceptability of fabric or garment supply for the high-technology combat uniform from other countries.
 - (8) Policy advice on the relative priority between the PICs, the relative priority of competing proposals across the PICs for government intervention in the market, and the relative priority of the savings proposals included in the SRP.
104. The Open Tender should seek options for the supply of uniforms unconstrained by country of manufacture of fabric or garment. But it should also require each tenderer to submit an option for the manufacture of both the fabric and the garment in Australia. The evaluation of the tender responses will be on the basis of value for money over the full life of the contract.
- The mandatory inclusion of an Australian sourcing option, together with the information identified in the preceding paragraph, will allow the evaluation to assess fully the Australian industry and strategic implications of the options.

PRIME VENDOR MODEL

105. While this was not a focus of the Review, mixed views were presented from industry and DMO about the utility and broad applicability of the prime vendor model.
- On the one hand, the model simplifies the DMO contract management and oversight task, and reduces the DMO workload. It gives responsibility to the prime vendor to manage the various suppliers and subcontractors, and to ensure assurance of all products and processes. There will likely be an overall additional cost, captured in the project cost.
 - » DMO would, of course, have to retain sufficient expertise to be an informed customer and effective contract manager.
 - On the other hand, there are risks associated with this approach. The prime vendor may not be DMO's principal customer, which may impact on its responsiveness to DMO requirements or in meeting contracted deliverables. With a monopoly or dominant supplier, DMO may be held hostage on service quality. The prime vendor arrangement, if widely applied, may also force further rationalisation of local industry and lead to reduced competition.
 - These considerations should be taken into account in any decision to implement the model more widely.

Attachments:

A: Review Terms of Reference

B: Conduct of the Review

C: Public Comments by Officials on the Contract and the Policy/PIC

D: The Clothing SPO and the Restricted Tender Process

E: Possible Arguments for Sourcing of Combat Clothing

F: Draft Narrative

TERMS OF REFERENCE FOR THE REVIEW:

Extract from the Original Contract, dated 15 February 2010:

DMO buys goods and associated services from suppliers in the textiles, clothing and footwear industry sector. The existing Commonwealth policy framework associated with the DMO's procurement of goods from this sector for the ADF has been subject to change and some uncertainty.

Urgent advice is now required by the CEO DMO to precisely identify the areas of key policy concern and to recommend actions and strategies for the Commonwealth and DMO to take to reduce the policy uncertainty in this area and to ensure continuity of supply of products from this industry sector to the ADF.

The consultant shall provide the following:

- a) an analysis of the current Commonwealth policy framework relating to the DMO procurement of textiles, clothing and footwear;
- b) from this analysis, the identification of areas of policy overlap and conflict;
- c) the delivery of a draft report for CEO DMO's consideration by 26 February 2010; and
- d) a final report delivered prior to the expiry of the agreement.

Extract from the Additional Contract, dated 18 June 2010:

Following receipt of the initial report, CEO DMO identified the need for further analysis and advice, specifically to:

- a) identify practical methods by which DMO can obtain quality assurance on its overseas suppliers, particularly those from Asia;
- b) identify processes and procedures through which DMO can be assured that its overseas suppliers abide by the laws of their countries and relevant international obligations, such as those of the International Labour Organisation;
- c) consider how an Australian company acting as a prime contractor to DMO can enforce quality obligations on its suppliers, and ensure that subcontractors abide by the laws of their countries and relevant international obligations;
- d) consider further the relevance and impact of broader government industry and procurement policies on Defence; and
- e) investigate further intellectual property issues associated with combat clothing.

CONDUCT OF THE REVIEW

Interviews:

The following people were interviewed, in February/March and August, with many key individuals interviewed on both occasions:

- The Hon Greg Combet, Minister for Defence Personnel, Materiel and Science
 - » and staff: Allan Behm, Pat Conroy and Rod Hilton
- Dr Stephen Gumley, CEO DMO
 - » Dan Fankhauser, Chief of Staff to the CEO
- LTGEN Ken Gillespie, Chief of Army
 - » with MAJGEN John Caligari and BRIG Dave Mulhall
- Mark Reynolds, Head Commercial and Industry Programs DMO
 - » Glenn Wahlert and Peter Moorhouse
- MAJGEN Grant Cavenagh, Head Land Systems Division DMO
 - » John Wiseman, Director of Audit, Land Systems Division
- BRIG Bill Horrocks, then Director General Land Combat Systems, DMO
- BRIG Mike Phelps, Director General Integrated Soldier Systems, DMO
- COL Roy Bird, Director Clothing Systems Program Office, DMO
- Clothing SPO staff:
 - » LTCOL Sanja Cvijanovic, Deputy Director Clothing SPO
 - » Ben Murphy, Sustainment Program Manager, Future Clothing Acquisition
 - » Tom Traynor, Sustainment Manager, Combat Clothing
 - » other SPO staff
- COL Simon Welsh, previous Director Clothing SPO
- Key personnel from companies involved in the supply of combat clothing, from the TFC Union of Australia, and from the Council of Textile and Fashion Industries of Australia
- Relevant DSTO personnel

Major Documents Reviewed:

The following documents were reviewed:

Strategic and Defence Policy, and Defence Industry Policy

- *Defence and Industry Policy Statement 2007*
- *Priority Industry Capabilities Fact Sheet*, 2009
- *Defending Australia in the Asia Pacific Century: Force 2030* [Defence White Paper 2009], 2009
- *Going to the Next Level: The Report of the Defence Procurement and Sustainment Review* [Mortimer Review], 2008
- *The Response to the Report of the Defence Procurement and Sustainment Review* [Mortimer Review], 2009
- *2008 Audit of the Defence Budget*, 2009 [public version], 2009
- *The Strategic Reform Program: Delivering Force 2030*, 2009
- *Defence Capability Plan 2009* [public version], 2009
- Defence and Industry Conference July 2009 – Speeches by Ministers Faulkner and Combet
- Draft Defence Industry Policy Statement 2010 – *Building and Sustaining Force 2030*, DMO Industry Division, Feb 2010
- The Defence Industry Policy Statement, *Building Defence Capability: A Policy for a Smarter and More Agile Defence Industry Base*, June 2010
- *DMO Doing Business with Defence 2007*, Industry Division, 2007

Procurement Policy

- *Commonwealth Procurement Guidelines* Dec 2008 – and fact sheets
- *Australian Government Procurement Statement*, July 2009
- *Fair Work Principles: User Guide*, January 2010
- *Defence Procurement Policy Manual*, October 2009
 - » And relevant subsequent Procurement Policy Instructions
- *DMO Acquisition and Sustainment Manual*, 2007
- ASDEFCON Suite of Tendering and Contracting Templates
- *DMO Australian Industry Capability Toolkit* [Version 1.2], undated

Clothing Procurement

- *Report of the ADF Clothing Review* [Harding Report], 2006
- *ADF Clothing and Personal Equipment Procurement Plan 2008-2012*
- *Textile Clothing and Footwear Innovation Package*, May 2009, DISSR
- *Non-Disclosure Agreement: DSTO and Bruck Textiles*, Sept 2002
- *Outcomes of the Combat Clothing Priority Industry Capability Risk Assessment – July 2009*, Paladin Risk Management Services, 2009 [Commercial-in-Confidence]
- Land Systems Division Standard Operating Procedures for Procurement
- Relevant Ministerial Submissions, 2009-2010 [Commercial-in-Confidence]
- Relevant emails between Industry Division and the Clothing SPO, 2009-2010
- Clothing SPO Clothing Business Model and Supply Concepts diagrams
- Relevant media transcripts, February-April 2010
- Capability Development Group advice to DECO [incorporating DSTO and DIO advice] regarding the export of DPCU fabric, July 2010 [Confidential]

Documents from Industry

- Relevant briefing papers, letters and emails, from the companies to DMO and between the companies

Other Documents:

- Proof Hansard of the Foreign Affairs, Defence and Trade Legislation Committee Hearing of the Budget Estimates, 1 June 2010
- Various documents and letters relating to the alleged breach of export controls and its investigation by COL McCullagh
- Relevant internal Defence correspondence related to export controls and DECO Outreach

ATTACHMENT C

PUBLIC COMMENTS BY OFFICIALS IN FEBRUARY ON THE CONTRACT AND POLICY/PIC

1. The following statements have been made publicly by Minister Combat:

Press Release, 10 Feb:

- No Australian troops are currently employed, or in training, wearing combat uniforms made from Chinese fabric.
- There was never a requirement to use Chinese fabric on combat clothing.
- Under the contract ADA put forward an option to supply additional uniforms if required. For these uniforms ADA said they would source the fabric from a Chinese company. This option has not been exercised by the Department of Defence and it will not be exercised.
- The Government is committed to giving Australian products a fair go, as long as local industry is competitive on schedule, cost and capability.

Sky News Interview, 10 Feb:

- There is no fabric used in combat clothing for the ADF that comes from a Chinese supplier.
- In the second year of that contract, there has been an option put forward by that company to source fabric from China. But Defence has never exercised that option and does not intend to exercise that option.
- Defence is not going to exercise any option to source the material in the second year of this particular contract from China.
- There are many different items that members of the Defence Force wear, from shoes and sock and right through the whole array of uniforms, and some of those things are sourced from overseas.
- The Government identified the development of combat clothing fabric as an important capability within the country, and we're very mindful of it.
- [In response to a question "So there are no jobs at risk because of any decisions made by the Defence Department over clothing, and none of this

material is coming from China] In relation to this specific issue, I think that's right.

2. The following comments were made at the Estimates hearing on 10 February 2010:

- Dr Gumley: My understanding is that the Commonwealth owns the intellectual property [in DPCU] [Senator Johnston: Solely?] A company owns some of the intellectual property of how to apply our intellectual property to the uniform, but certainly the background intellectual property is owned by the Commonwealth. [p43]
- BRIG Horrocks: The Commonwealth owns the intellectual property in terms of how to provide that camouflage in the near infrared. The commercial application of that is not owned by the Commonwealth.
- SEN Johnston: I wouldn't have thought any one of our allies would have entrusted that specification and knowledge [of technology in the near infrared] to a foreign manufacturer.
- Dr Gumley: There was an option in that contract for a second year of supply where the fabric would come from China. We will not be going ahead with that particular part of the contract. It has an option in the contract and we will not be going ahead with that. [p44]
- Dr Gumley: It was a performance specification. We did not give away any technology. [p45]
- BRIG Horrocks: The contractor ... has to demonstrate to us, if we were to exercise that option, that the product meets our needs. Hence, in that process, samples have been provided for our assessment, but there was no requirement to do that. We have not asked for that to occur. [p46]
- SEN Faulkner: The option has not been exercised by the Department of Defence. ... Let me go further to say that it will not be exercised.
- Dr Gumley: I initiated an internal review of aspects of this case. I have engaged someone to have a look at the various policy aspects and what has happened here because I was uncomfortable. It is one of those issues where when you here an allegation you sense that there is a bit of smoke and you wonder whether there is a bit of fire, so about 10 days ago I initiated an inquiry into this. [p47]

THE CLOTHING SPO AND THE RESTRICTED TENDER PROCESS

1. SPO staff advised that it was near impossible to make a mistake on high level procurements, because of the strengthened business processes and the level of management oversight. But senior industry personnel continue to have concerns about SPO processes.
 - SPO staff have responded to previous allegations about bias or improper procurement processes by ensuring a higher level of formality and rigour in their processes. SPO staff seek to be fair and even-handed in their dealings with companies, especially during tender periods in which probity and formality are required.
2. Some specific elements of the new SPO business model are worth noting, because they impact on the CTF sector companies which compete for DMO business. Firstly, the SPO is moving far more to the use of prime contractors, rather than contracting itself for each element of the procurement. In relation to the combat uniform, that means contracting for a prime to deliver the finished product, rather than separate DMO contracts with a fabric manufacturer and a garment manufacturer. This will, very quickly, change the dynamics of this industry sector.
 - In relation to contracts for the supply of the combat uniform, the prime contractor could be either the fabric manufacturer or the garment manufacturer.
 - There are evident tensions between the companies involved in the Restricted Tender work, despite their assurances that they will continue to work effectively together. An obvious response would be for individual companies to seek to move also into the other element of clothing procurement that they are not currently in [fabric manufacture and garment manufacture respectively], so that each can compete for future contracts without any partners or sub-contractors.
3. Secondly, the SPO has introduced measures to smooth out the peaks and troughs of the supply chain, by better forecasting of demand, and to provide greater predictability for warehousing by defining fixed periods for the delivery of stock. But industry representatives have a different perspective on the success of these measures.
 - Some companies cite the “current lack of certainty and predictability associated with the procurement of combat uniforms by DMO”. Company representatives reported that DMO orders still went through peaks and troughs, which did not allow the company to predict future workflows sufficiently to drive productivity in its process. There had been occasions on which orders had been placed by DMO with insufficient lead time to order fabric and meet garment delivery dates.

- They also noted the lack of advice about forward demand, and the continuing peaks and troughs in the orders.

Tender Evaluation Process for the Restricted DPCU Tender

4. In relation to the Restricted DPCU Tender, the Clothing SPO did apply the existing policy framework properly.
 - During the consideration of the responses to this tender, and to another, competitive tender for the Disruptive Pattern Field Outerwear Ensemble, the Clothing SPO consulted with DMO Industry Division specifically on the interpretation of the Priority Industry Capability (PIC) and the issue of overseas supply of some elements, or all, of the clothing.
 - In relation to the Field Outerwear Ensemble, Industry Division advised that “the proposed overseas manufacture of the garments ... does not breach the intent of the Combat Clothing PIC”, and that “there are no limitations in awarding the contract based on garments being manufactured overseas using Australian made fabric”.
 - Unfortunately, there is not similar documentary evidence in relation to the advice provided by Industry Division on the Restricted DPCU Tender. There is an email dated 7 October 2009 seeking further information from the SPO and indicating that advice would be given after consultation with the Head Industry Division, Mark Reynolds. However, COL Bird informed the Review that he spoke in February 2010 to Industry Division staff (Nick Paxman and Peter Moorhouse) who confirmed that there had been no PIC-related issue with the overseas sourcing of the fabric, and that such advice had been given by Industry Division at the time (noting that COL Bird did not take up his position as Director of the Clothing SPO until late December 2009).
5. The Review was informed of a number of concerns about the tender evaluation process (noting, again, that the Review did not examine the tender evaluation process or documentation), and whether the decision actually represented a soundly based judgment of best value for money overall.
6. Further advice on the tender evaluation process was sought on 2 March 2010 from BRIG Horrocks and the Clothing SPO, specifically on: the requirement in the tender response to provide test results or fabric samples; and the treatment in the tender evaluation of the risk of the various fabric supply options. The Clothing SPO subsequently provided the following advice:
 - There was no requirement in the original tender documentation for either test results or samples to be provided. The clarification sent to tenderers in early October sought test results, which were provided by both tenderers. No fabric samples were sought or required in the tender process.

- The contract signed with the successful tenderer, required that fabric samples only be required if the contract option (of supply of fabric from China) was exercised. As a measure of good faith, the tenderer provided Chinese-sourced fabric swatches to Clothing SPO in January and February 2010. Neither met the technical specification, although the second was closer to it.
 - In the tender evaluation process, the Chinese-sourced fabric option was rated as “Deficient Significant and Medium Risk”. SPO advice on 4 March 2010 to the Review went on to say “This was however mitigated through the provision of test results and fabric samples. Ultimately all companies were considered technically suitable subject to successful resolution of identified negotiation points”.
7. The Review posed further questions to the SPO on 11 March, indicating that these responses were unclear. If there were no fabric samples available at the time of tender evaluation, and only preliminary test results, how were the Chinese-sourced fabric options rated as technically suitable? COL Bird responded on 11 March, providing the following advice:
- All tenderers were required to provide test results for essential requirements (NIR capability) for the initial quantity only - not the follow-on option.
 - The Chinese-source option was going to be evaluated technically when the SPO intended to exercise the option for additional quantities.
 - In the meantime, the tenderer was keen to prove that the Chinese fabric would meet the specification, so that DMO would exercise the option.
 - Neither Chinese sample provided by the tenderer was technically compliant, but progress was being made.
8. This explanation is incomplete, and leaves a significant concern about the tender evaluation process – namely, that the value for money decision was made on the basis of both the initial quantity and the follow-on quantity, but it was made without evidence of the technical compliance or assurance of supply of the follow-on option.
- It does not appear appropriate or adequate to leave the demonstration of technical compliance to the point at which the follow-on option was to be exercised. If the Chinese-sourced fabric was not compliant at that point, the only option for the tenderer would have been to source the fabric from Australia which would then have raised the total cost of supply to slightly higher than the tendered offer from a competing tenderer.
 - If the tender evaluation concern was only with the initial 12-month quantity,
- then another tenderer’s offer was lower and apparently better value for money than the winning tenderer.
9. There was apparent uncertainty about how and when to deal with the risk of supply from an unproven manufacturer, and at what point in the tendering or contracting process assurance about the management of that risk needed to be obtained.
10. It appears also that there may be insufficiently detailed guidance on these issues in the DPPM. DMO should consider whether more specific guidance should be included.

POSSIBLE ARGUMENTS FOR THE SOURCING OF THE COMBAT UNIFORM

The following arguments have been advanced in the political debate, in the media and by industry in relation to the sourcing of the combat uniform – both those in support of the development, maintenance and retention of industry capabilities within Australia, and those in support of sourcing unconstrained by origin or supplier. Much of the commentary involves an evident lack of clarity of thinking about these different arguments, often confusing or conflating them.

Possible Arguments In Support of the Retention of Capabilities within Australia

- Strategic/Priority Industry Capability
 - » Required for defence self-reliance
 - » Required to support ADF operational capability
- Assured Source of (Quality) Supply
 - » Locally accredited/audited/assured for quality/timeliness
 - » Guaranteed supply in all circumstances
- Protect Technology or Intellectual Property
 - » Preserve capability edge
- Prevent Compromise or Illicit Use of Technology or the Product
 - » On-sale of product elsewhere
 - » Use of product by foreign militaries/violent groups
 - » Deliberate sabotage of the product [eg inclusion of foreign materials]
- Investment to Support the Australian Economy
 - » Multiplier effects in local communities
 - » Regional areas
 - » Employment – and forgone unemployment and social welfare costs
- Promotion of the Viability of an Australian Industry Sector
 - » Build and maintain sectoral capabilities
- Australian Made
 - » Symbolism/pride

Possible Arguments In Support of Unconstrained Sourcing

- Lowest Cost
 - » For a compliant product
- Open Competition
 - » Open approach to the market
 - » Non-discrimination and equitable treatment between suppliers
 - » Increase security of supply through diversity of suppliers
- Value for Money
 - » Consideration of all relevant costs and benefits for whole of life
 - » Optimal cost, based on quality, fitness for purpose, risk, assurance of supply, and performance history of the supplier
 - » Efficient, effective and ethical use of Commonwealth resources.

PRELIMINARY DRAFT: OVERALL NARRATIVE

Australia's government procurement market is open and competitive. On the one hand, there is no policy discrimination against foreign suppliers. On the other, government procurement must provide full, fair and reasonable opportunity for domestic suppliers to compete.

Government procurement is based on the following principles:

- best value for money over the whole life of the contract
- open and effective competition, with full and fair opportunity for domestic suppliers
- recognition of Australia's international trade obligations and interests
- recognition of Australia's international export control obligations
- support for innovation, research, the targeted skilling of staff, and the development of new products and processes.

In addition, procurement in the defence sector must consider the need for security and reliability of supply. This involves the identification of specific industry capabilities which are strategically important for defence capability and which, if not available, would undermine defence self-reliance and operational capability. But listing of a capability as a priority industry capability will not in itself lead to government financial assistance. The principal determinant of defence procurement remains best value for money over the whole of life of the contract – if local industry provides the best value for money solution, it will win the contract.

Government will make decisions about whether and how to provide support to a strategically important domestic industry capability, through payment of a premium for domestic supply, based on a robust business case for each specific procurement. Given a constrained defence budget, a key issue will be the relative priority between competing demands for investment of resources in support of domestic capability – available resources will be directed to the areas of highest priority.

Government defence industry policy states clearly that the Government does not intend to use the defence budget to subsidise uncompetitive sectors or firms within Australia. Moreover, with changing technology and changing defence capability requirements, Defence's support requirements from industry will continue to change – a priority industry capability today may not be one in the future.

The Government has indicated its broad priorities for support for local industry through its publication of the 2009 Defence White Paper, the 2008 Audit of the Defence Budget, and the 2009 Strategic Reform Program. These also identify specific areas in which resource savings are to be made – including in clothing procurement through

consolidation of suppliers, greater standardisation of uniforms and moving to lower cost suppliers. Specific savings were identified in the Strategic Reform Program, and budgeted, for procurement of the combat uniform from overseas.

There is, currently, no government-endorsed "buy Australian" policy in relation to defence procurement generally or clothing in particular. On the contrary, the Government has stated clearly that it is committed to an open and competitive defence marketplace. It expects local industry to become more resilient and self-reliant. The Government is assisting local industry to identify and make the most of business opportunities, both domestically and internationally, and to build skills, innovative capacity and productivity.

Defence would only apply a buy-Australian policy if it was explicitly endorsed and directed by Government. Similarly, the value for money assessment in a procurement would only include full economic impact [including factors such as foregone costs in unemployment benefits and social welfare, and multiplier effects of expenditure in local communities] if explicitly directed by Government. The Commonwealth Procurement Guidelines do not currently provide any mechanism to take such wider economic impact into account in the value for money decision. It would be inappropriate, and improper, for Defence/DMO to act contrary to endorsed government policy – and it would have no legal basis for doing so.

With an increasingly global supply chain, there is a growing focus on the wider workforce, social, ethical and environmental responsibilities of companies and suppliers, both within Australia and overseas. There is an increasing demand for assurance that suppliers are exercising such responsibilities appropriately. The minimum standard is that a supplier complies with the legal requirements of the jurisdiction within which it is based and with any wider, more detailed standards to which the supplier claims to adhere. Some people are also demanding a higher standard for overseas suppliers – that is, compliance with the requirements that would apply in Australia [whilst noting that, in some areas, some overseas countries have higher standards than apply in Australia].

It should not be assumed, however, that an overseas-sourced product will necessarily be inferior to one produced in Australia.

Currently, Government policy dictates that overseas suppliers must be compliant with the legal requirements of the jurisdiction within which they are based. There is nothing in the Fair Work Principles, for example, about suppliers meeting wider responsibilities. The Principles are not an instrument for procurement officers within Australia to force or demand a fairer, more cooperative workplace than local laws require.

There is also a growing focus on assurance that government procurement is being conducted in accordance with policy and, specifically, that suppliers are meeting

the required standards. One specific concern is that alternate [especially Australian] suppliers are not disadvantaged in a competitive procurement process by some companies gaining cost savings through non-compliance. Even within Australia, such concern is one of the principal causes of distrust between various local TCF companies.

The minimum standards expected of overseas suppliers are likely to continue to rise, to come more into line with Australian domestic standards [which are themselves rising], as a result of growing awareness amongst Western consumers and increasing pressure on non-Western suppliers to meet higher standards. This is becoming more of a modified or partial level playing field. Other countries may still have an advantage due to lower wage rates and other costs such as energy and transport, but increasingly they will not be able to gain advantage from non-compliance with certain workforce, social and environmental standards.