

OPINION: DEFENCE PROCUREMENT

Feds should apply lessons learned from AG's report on CF-18s to F-35s

By ALAN WILLIAMS

OTTAWA—The objective of this analysis is to highlight some important trends from the auditor general's recent report dealing with the helicopter acquisitions and apply them to the Joint Strike Fighter (JSF) and other large, complex defence procurements. I propose to examine the AG's comments from three perspectives—the procurement process, governance/accountability and cost.

At the outset, let me disclose that I was the senior official in National Defence accountable for the acquisition of the Cyclones. As such, some may challenge my objectivity in commenting on the auditor general's (AG's) latest report that dealt with the acquisition of the Cyclones and the Chinooks. That being said, I do not dispute her findings. I was also pleased that in the case of the Cyclone program she pointed out that a fair, open and transparent process was followed to select the winner and that with respect to the approval framework, appropriate oversight was provided at the preliminary project and effective project approval stages. These findings were in direct contrast to the Chinook program that was launched after I retired in 2005.

The Procurement Process

The AG is quite explicit in stating that the Cyclones were acquired in an open, fair and transparent manner. Here is a riddle. In procurement, what is worse than unnecessarily sole-sourcing? Answer: sole-sourcing under the guise of a competition. That is, undertaking a sham competition while all along knowing who was to win the contract. This is what the AG says happened in the acquisition of the Chinooks. It is a very serious observation because doing business this way undermines the whole integrity of the process.

Now, if we turn our attention to the Joint Strike Fighter, the government is following the Chinook script all over again but with a wrinkle. Now the government is claiming that sole-sourcing the jets to Lockheed Martin is okay because Canada was part of a prior competition to determine which company should build these jets.

Unfortunately for the government, repeating this argument over and over will not cause the argument to morph into a truth. The government is referring to the competition run by the United States and the United Kingdom that in October 2001 selected Lockheed Martin over Boeing as the winning contractor for the JSF.

However, the 2001 competition had everything to do with selecting an aircraft to meet the needs of the U.S. and U.K. and absolutely nothing to do with meeting Canada's

needs. The United Kingdom and only the United Kingdom, signed an MOU with the United States allowing British participation in the JSF program as a collaborative partner in the definition of requirements and aircraft design. This MOU, signed on Dec. 20, 1995, committed the British government to contribute \$200-million towards the cost of the Concept Demonstration Phase. On Jan. 17, 2001, the U.S. and U.K. governments signed a second MOU finalizing the U.K.'s participation as a partner in the next phase with a commitment to spend a further \$2-billion. For comparison purposes, Canada spent \$10-million in the first phase for "observer" status and \$150-million in the second phase as a "level III" participant. To suggest that for our relatively minor contribution we had the same kind of influence as the U.K. defies logic.

Furthermore, for the government's claim to be true, Canada would have had to determine its requirements and ensure that they were incorporated into the specifications of these new jets.

However, in the early 2000s replacing Canada's CF-18s was, pardon the pun, not on our radar. Instead, our focus was on upgrading our existing fleet of CF-18s to ensure they could last to 2017-18. Accordingly, we had not determined our future requirements and therefore we were not in a position to ensure that they were incorporated into the 2001 competition. This reality is acknowledged by Col. Dave Burt, Canada's director for air requirements, at that time. In 2006, after Canada signed on to the third phase of the JSF program and more than five years after Lockheed Martin was selected to build the F-35, he is quoted as saying, "Up until this point, a very large part of Canada's program has been about industrial issues and technology transfer issues. We have done a relatively modest operational analysis of this program." The truth is Canada entered the JSF program to benefit its industry and without any commitment to purchase this aircraft.

Equally alarming is the bizarre process actually followed by the government to select the JSF. As reported in *Le Devoir* on Nov. 4, 2010 (F-35: les conservateurs ont négligé la concurrence), as early as September 2006 recommendations were made by Dan Ross, assistant deputy minister (materiel) to Gordon O'Connor, the minister of National Defence at that time, that the JSF was the preferred option to meet Canada's needs. Yet on CBC's *Power and Politics*, also aired on Nov. 4, 2010, Lt.-Gen. André Deschamps, chief of the air staff, revealed that the "statement of requirements" for the new jet aircrafts was only finalized in the spring of 2010. In other words, before deciding on their

requirements, DND had already selected the JSF to replace the CF-18s. In my opinion, it is quite clear the procurement process was hijacked, distorted and manipulated in order to sole source for the JSF. What is still not clear is why.

The attempt to sole-source the JSF reflects a clear and alarming trend by this government to avoid competition. Table 1 below presents data for DND over the past decade, extracted from the Treasury Board and Contracts Canada websites.

As is quite apparent, there is a dramatic increase in all aspects from 2000-2004 to 2005-2009. Furthermore, while the average percentage increase is large at 57 per cent, it becomes even more alarming when the trend over the 10 years is examined.

Table 2 and Graph 1 below show these figures for each year.

As you can see the trend is essentially "V" shaped—a sharp decline, especially from 2001 through 2004, with an equally sharp rise from 2005 through 2009. For example, in 2004 for each dollar contracted over \$25,000, 8.8 cents were contracted non-competitively and 91.2 cents were contracted competitively. In 2009, for every dollar contracted over \$25,000, 42 cents were contracted non-competitively and 58 cents were contracted competitively. This represents nearly a five-fold percentage increase in the value of non-competitive contracts issued between 2004 and 2009. It should also be noted that these figures do not reflect the de facto sole-source contracts like the Chinooks.

Governance/Accountability

In exhibit 6.1 of her report, the AG lays out the roles of the federal organizations involved in acquiring equipment for National Defence. However, there is a critical omission by the AG. Within DND, she neglects to distinguish the responsibilities of the military from those of the civilians. In National Defence, the military is accountable for defining their requirements not for seeking out and recommending the preferred platform. That job is the responsibility of the civilian authorities within National Defence, with support from officials in Public Works and Government Services Canada and Industry Canada. It is this split in responsibility, this critical check and balance that helps ensure that the procurement process is conducted in an open, fair and transparent manner. When Industry Minister Tony Clement says that the F-35 is

the best plane because "the military experts said so" he is undermining the accountability framework. Rather than learning from the helicopter acquisitions the government is perpetuating the oversight neglect highlighted by the AG.

Costs

In her report the AG makes three very pertinent observations. First, she observes that ministers must be informed of not just the procurement costs and not just the "out of pocket costs" but even the internal costs such as salaries of personnel. In other words, ministers must be aware of all the costs associated with a program. Second, she observes that there is a tendency to underestimate the complexity of the acquisition, to believe that acquisitions are "off-the-shelf" when in fact there remains considerable developmental work. Consequently, project risks and associated costs are understated. Third, with respect to the Chinooks she highlights the huge impact on costs and schedule when requirements change because the operational roles and missions are not clearly defined.

As a result of these mistakes, the cost estimates provided to Treasury Board ministers for effective project approval (the last opportunity for ministers to see the expected costs and approve the acquisition before a contract is signed) were understated. Table 3 below presents these findings.

I should also point out that the AG also observed that in the TB submission for the Cyclones, ministers were also informed that the total operations and maintenance costs would be \$900-million more between the fiscal years 2011-12 and 2022-23 than they would have been for the Sea King.

With respect to the Joint Strike Fighter, at the present time we do not know the acquisition cost, nor do we know the long-term support cost. We do know that the program is experiencing huge cost overruns and that the developmental phase of this program has been extended by four years thru 2016-17. We also

know that the acquisition price will be directly affected by the number sold and that, since the inception of the program, the U.S. has cut their requirement by over 400, Canada has cut its number from 80 to 65 and that reports from the U.K. indicate that they may reduce their requirement from 138 to 40. Interestingly, the U.K. has indicated that it will defer this decision until 2015. Makes you wonder why we have to commit to it now!

Conclusion

Defence procurement is complex and difficult. We may never get it perfect but we should always strive for that result. To do so, we should be willing to learn from our mistakes. It remains to be seen whether this government is willing to apply the lessons learned from the AG's report to the replacement of our CF-18s. Before spending billions of the taxpayers' money it makes sense to implement the following actions. First, publish the aircraft requirements ensuring that they are linked to the operational role and mission of the military. Second, undertake an open, fair and transparent competitive process to determine which platform best meets Canada's needs at the best price while providing robust industrial and regional benefits equal to or greater than the value of the acquisition and life cycle contracts. Third, in conducting this process, ensure all applicable boards and committees fulfill their respective roles and responsibilities. Fourth, and finally, ensure all life cycle costs are disclosed. If the F-35 is indeed the best solution for Canada, it will win the competition.

Alan Williams retired in 2005 after enjoying a 33-year career in the federal public service. The last ten years of his career was spent in the business of defence procurement, five years as ADM Supply Operations Service in PWGSC followed by five years as ADM Materiel at DND. In 2002, he signed the memorandum of understanding committing Canada to the second phase of the Joint Strike Fighter program. He is now president of The Williams Group, providing expertise in the areas of policy, programs and procurement. In 2006, Mr. Williams authored *Reinventing Canadian Defence Procurement: A View From the Inside*. He can be reached at williamsgroup@rogers.com
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Graph 1: Average per cent of non-competitive contract values over \$25,000

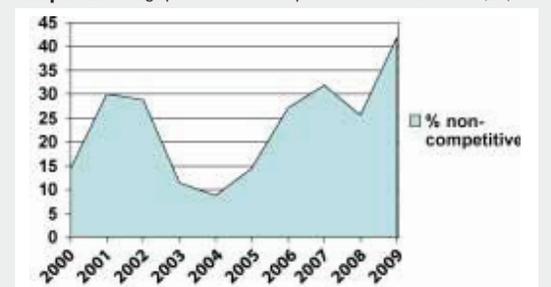


Table 2

| Year | Average % of Non-Competitive Contract Values Over \$25,000 |
|------|--|
| 2000 | 15.5% |
| 2001 | 30.1% |
| 2002 | 28.9% |
| 2003 | 11.5% |
| 2004 | 8.8% |
| 2005 | 14.6% |
| 2006 | 27.3% |
| 2007 | 31.9% |
| 2008 | 25.6% |
| 2009 | 42.0% |

Table 1

| Timeframe | Number Of Non-Competitive Contracts \$25,000 And Above | Value Of Non-Competitive Contracts \$25,000 And Above | Average % Of Contract Non-Competitive Values \$25,000 And Above |
|----------------|--|---|---|
| 2000-2004 | 2,274 | \$4.76-billion | 17.4% |
| 2005-2009 | 5,983 | \$8.98-billion | 27.4% |
| Difference (%) | +163% | +88% | +57% |

Table 3

| Program | Costs presented to TB ministers for Effective Project Approval (Billions) | Actual costs (Billions) | Difference (Billions) | Difference (%) |
|---------|---|-------------------------|-----------------------|----------------|
| Cyclone | \$5.52 | \$6.2 | \$0.680 | 12.3% |
| Chinook | \$4.886 | \$6.9 | \$2.014 | 41.2% |