

Section 2 Initiatives for Improving the Contract System and Other Related Matters

1 Improving the Contract System and other Related Matters

1 Long-term Contracts, etc.

The production of the equipment, ships and aircraft of the SDF requires a significant amount of time. Therefore, if a certain set amount is to be acquired by the integrated procurement method, in many cases a contract for more than five years is needed. With regard to the equipment etc., and services used by the SDF, economies of scale tend not to exist due to the following reasons: (1) the annual procurement quantity is small; (2) procurement is handled only by the MOD; (3) companies that provide such equipment etc., are limited. In addition, for companies, it is particularly difficult to systematically move forward with their businesses with a high degree of predictability.

In light of such unique characteristics of the equipment etc., and services that the SDF use, if long-term contracts are introduced, then stable procurement will become possible, leading to the realization of the systematic improvement of defense capability. At the same time, for companies, given that the procurement amount will be assured, the systematic use of personnel and equipment as well as cost reductions are made possible by the receiving of bulk orders. Furthermore, this will contribute to the prevention of subcontractors from withdrawing from the

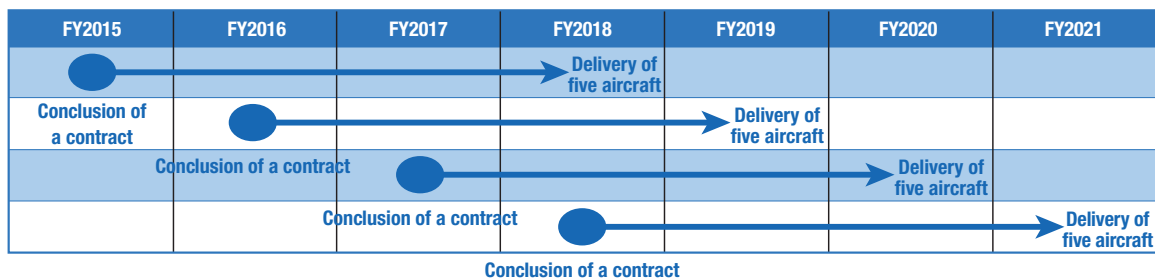
defense industries.

For this reason, the 189th extraordinary session of the Diet saw the enactment of the “Special Measures Law Concerning the Term of Expenditure Based on the Obligatory Assurance of National Subsidization for Specific Defense Procurement,” which stipulates changes to the upper limit of acts that incur national debt from 5 years in principle, as prescribed in the Public Finance Act, to 10 years for specific equipment. As for the FY2015 budget, this includes the procurement cost for 20 fixed-wing patrol aircraft (P-1) through a long-term contract based on this Act resulting in an expected cost reduction of approximately 41.7 billion yen.

See Fig. III-2-2-1 (Image of Long-term Contracts and the Cost Reduction Effect)

In addition, by realizing long-term multiple-year contracts through active utilization of the PFI Act¹ and the Public Service Reform Act², it is anticipated that the planned acquisition and execution of budgets through the standardization of investment amounts will be realized. It is also anticipated that the realization of long-term multiple-year contracts will give rise to such benefits as cutting equipment procurement costs by reducing risks for those accepting orders and by promoting the entry of new suppliers. To that

Fig. III-2-2-1 Image of Long-term Contracts and the Cost Reduction Effect

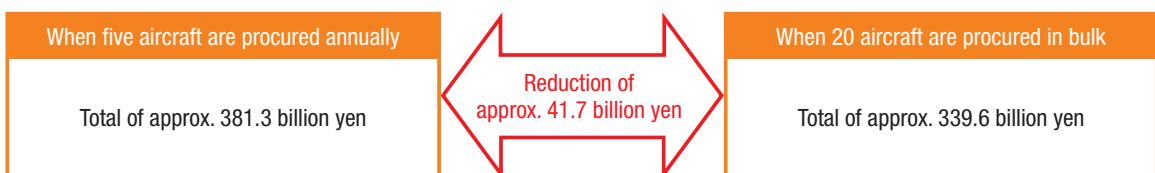


(Image of a long-term contract)



[Cost reduction effect in comparison with previous contracts]

(Comparison with a case in which five P-1 aircraft are procured annually from FY2015 to FY2018)



⇒ Reduction of approx. 41.7 billion yen realized due to long-term contracts with periods lasting over five fiscal years

1 Act on Promotion of Private Finance Initiative
 2 Act on Reform of Public Services by Introduction of Competitive Bidding

end, in regard to the project focused on the enhancement and operation of the X-band communications satellite, which makes use of the PFI Act, the MOD concluded the contract for the project in January 2013.



Patrol aircraft P-1, which procurement method is bulk procurement based on a long-term contract in order to reduce the procurement cost

2 Decrease Procurement Cost and Improve Companies' Incentives to Reduce Cost

With regard to the procurement of defense equipment, based on the special fact that there exists a variety of equipment without a market price, it is necessary to achieve both the reduction of procurement cost and improvement of companies' incentives to reduce cost simultaneously. Thus, the MOD has been striving to achieve the reduction of procurement prices by requiring companies to return any excessive profit after the execution of the contract, through cost audit contracts with a special provision stipulating that an audit of the actual costs incurred will be conducted and that the final amount paid will be established based on this (audit contracts incorporating a provision requiring the return of excessive profit).

Meanwhile, regarding the provision requiring the return of excessive profit, it is also noted that particular conditions, such as the request that this be returned after the completion of the contract payment during the end of the fiscal year, diminish the effectiveness of cost reduction

incentives for the company. Therefore, the MOD will carry out a review of contract methods in which the cost reduction incentives for companies work more effectively, taking into consideration the perspective of realizing the efficient procurement of defense equipment.

Furthermore, the MOD will conduct independent estimates of more appropriate acquisition prices and, with the cooperation of companies, will also review the development of a cost database related to the acquisition of defense equipment, which is required in order to account for the validity of contract prices. The MOD will also examine the mechanism for discontinuing a project if the primary estimate and the results differ when proceeding with the project management.

3 Strengthening of Project Management throughout Its Life Cycle

In order to ensure the performance of defense equipment required by the MOD and SDF with appropriate costs and without a delay in schedule throughout the life cycle of the equipment, a cross-functional Integrated Project Team (IPT) headed by a Project Manager (PM) has been established for the acquisition of primary defense equipment, and the development of a system in which projects can be managed in a unified way from conception to disposal is in progress.

As a leading example, currently, in the project to develop a new multi-purpose helicopter (UH-X)³, where a Parliamentary Vice-Minister is the group leader in charge of project management, this initiative is being promoted cross-organizationally by establishing an IPT under a neutral PM who does not have a stake in the development and also under a management system with enhanced objectivity and fairness⁴. This development project advances the development of SDF aircraft in parallel with the development of private aircraft, which are implemented jointly by domestic and overseas companies, and promotes the project under a system with enhanced project management function, such as aiming to realize a cost reduction through the standardization of the platform.

2 Initiatives Aimed at Increasing the Efficiency of Procurement, and Other Related Initiatives

1 Achieving Further Efficiency in the Acquisition of Equipment

For the purpose of promoting acquisition reform, the MOD has continuously been holding meetings of the Comprehensive Acquisition Reform Committee since October 2007 and the Contractual Systems Study Groups since 2010, reflecting acquisition efficiency policies that

incorporate approximately 153 billion yen of cost reduction in the FY2015 budget.

Specifically, the MOD has implemented the following measures: a bulk purchase, which seeks greater efficiency by budgeting and entering into contracts for equipment, supplies and components based on the approach of consolidating the quantities required for several years into a single specific fiscal year; and integrated procurement,

³ As a successor of the GSDF helicopter UH-1J, this is the development of a new multi-purpose helicopter to be used for air operations in various situations and lifesaving activities in large-scale disasters. In order to undertake the development during the 2015 fiscal year, currently the process of selecting the developer is in progress.

⁴ In order to ensure the adequacy of the formulation of a specification and a request for proposal, efforts are being made to increase the transparency and clarity of the process by collecting information equally from multiple companies through the invitation of open information provision using public notification.

which involves the consolidated implementation of budgets for equipment used across multiple different organizations, or for components that are common to different types of equipment. For example, in the FY2015 budget, the bulk purchase of Aegis-Equipped Destroyers will save approximately ¥35 billion on a contract base.

In addition, the Ministry is striving to reduce development, acquisition and maintenance expenses through (1) procuring common equipment and supplies, (2) standardizing some components, and (3) development of product families, etc⁵.

2 Effective and Efficient Maintenance and Replenishment

Having made every effort to securely ensure safety, the MOD has been endeavoring to achieve greater efficiency by extending the interval between periodic maintenance checks of defense equipment. During FY2014, cost reductions have been achieved, for example, by extending the interval between the regular maintenance of P-3C maritime patrol aircraft (P-3C) from 48 to 60 months. In addition, the MOD embarks on the introduction of Performance Based Logistics (PBL)⁶ from the perspective of improving the equipment availability ratio and long-term cost reductions. In FY2015, PBL contracts are due to be concluded on the aircraft maintenance of the MSDF minesweeper and transporter (MSH-101).

3 Efforts to Increase Fairness and Transparency

The MOD aims to increase fairness and transparency in relation to the acquisition of equipment and materials, and has thus far implemented a variety of measures from the perspective of making contracts more appropriate and strengthening checking functions.

Recently, as a part of the effort to make public procurement more appropriate across the whole government, the MOD has been working on a number of measures, including the introduction and expansion of a comprehensive evaluation bidding system⁷, the increase of multiple-year contracts, making bidding procedures more efficient, and reviews of single-tendering contracts. Alongside these measures, a deputy chief in charge of auditing was assigned at the Equipment Procurement



PBL will be newly introduced for the minesweeping /transport helicopter (MCH-101)

and Construction Office, and an auditing division was established in the Internal Bureau, showing that the MOD is working toward strengthening its checking functions.

However, because it was revealed that Mitsubishi Electric and four of its subsidiaries and affiliates, and Sumitomo Heavy Industries and its subsidiary⁸ had engaged in overcharging, in December 2012, the MOD announced measures to prevent recurrence, centering on the strengthening of system investigation, the revision of penalties, and the establishment of guidelines concerning bidding suspensions.

These measures to prevent recurrences seek to enhance and strengthen measures to alleviate the closed nature of those involved in defense production and increase transparency, as well as reviewing measures toward the impartial evaluation of the costs and risks borne by companies. In March 2013, the Investigative Committee on Cases of Overcharging, chaired by the Parliamentary Vice-Minister of Defense, began deliberations concerning the specific ways to implement these measures, and some of these measures have entered into force since April of the same year.

Furthermore, in June 2013, Sumitomo Heavy Industries reported to the Equipment Procurement and Construction Office that they had delivered “12.7-mm heavy machine guns” having falsified the results of product testing on them. The MOD is working to prevent recurrence, while at the same time implementing five months of bidding suspension measures against Sumitomo Heavy Industries.

5 Examples of each of these include, (1) small arms, vehicles, and chemical supplies in the GSDF, MSDF, and ASDF; (2) short-range surface-to-air missiles used by the GSDF and ASDF; and (3) anti-ship missiles used by all three branches of the SDF.

6 PBL is a contract method that involves payment of compensation relative to the level of equipment performance achieved, in terms of availability ratio and stable stock. It has achieved positive outcomes upon application to the maintenance and servicing of equipment in Western countries.

7 Unlike the automatic bid system, which focuses only on price, this is a system in which the successful bidder is determined on the basis of a comprehensive evaluation that includes both the price and other elements, which is used in cases in which it is appropriate to carry out such procedures as evaluating the technological elements.

8 Mitsubishi Electric, Mitsubishi Space Software, Mitsubishi Precision, Mitsubishi Electric TOKKI Systems, Taiyo Musen, Sumitomo Heavy Industries, and Sumiju Tokki Service