

Executive Summary

On 6 June 2014, the government announced that it had given approval for Defence to conduct a limited competitive tender between Navantia of Spain and Daewoo Shipbuilding and Marine Engineering of South Korea for the construction of two replacement Auxiliary Oiler Replenishment ships (AOR). The Minister for Defence claimed that the decision to exclude Australian companies from the tender and involve only two overseas companies was due to: the urgent need to replace the vessels and avoid a capability gap; the current low productivity of shipbuilders involved with the Air Warfare Destroyer (AWD) project; and value for money considerations.¹

Although the committee has only started its inquiry into the future sustainability of Australia's strategically vital naval ship building industry, its consideration of the proposed tender process for the supply ships has highlighted a number of concerns.

They relate to the lack of contestability and competition in the limited tender, the level of industry engagement in the process so far and the absence of long-term strategic planning that led to the decision.

As such, the committee recommends that:

- the tender process for the two replacement replenishment ships be reopened to include Australian companies;
- the government undertakes open tender processes for any future naval acquisition.
- the tender must make clear that a high value will be placed on Australian content in the project.

Capacity

The committee heard that local major shipyards could be upgraded to build the supply ships in Australia. Furthermore, the relatively small upfront costs for the improvements should not be considered in isolation but with a view to the long term benefits, especially when such infrastructure is regarded as a fundamental input to capability. The committee has heard that such an investment would support the construction in Australia of large vessels, including the supply ships, and that long term dividends would result from such investment. By excluding Australian companies from the tender, the government has not allowed these matters, including the amount of investment required to upgrade current facilities and the long-term benefits of this investment, to be fully explored and contested.

It should be noted that investment in infrastructure in Australian shipyards becomes a permanent asset and builds on the considerable infrastructure that already exists. Defence, in collaboration with industry, should consider undertaking a complete and

1 'Minister for Defence—Boosting Australia's maritime capabilities', 6 June 2014, <http://www.minister.defence.gov.au/2014/06/06/minister-for-defence-boosting-australias-maritime-capabilities/>

thorough audit or stocktake of Australia's shipyard infrastructure and incorporate the findings into a strategic plan for future naval shipbuilding.

Urgency

A number of witnesses put forward proposals that could address the urgency of the purchase, without having to resort to a limited tender that excludes Australian ship builders. They include a modular build for the supply ships in Australia or a hybrid build to include both Australian and overseas ship builders. The committee is concerned that the government's delay in making a decision to acquire the vessels following the election has led it to select a tender process that prevents an open, competitive and indeed, fairer process.

Productivity

Evidence provided to the committee indicates that the government has an overly simplistic understanding of the factors driving productivity in the ship building industry. The committee heard that the productive performance on the Air Warfare Destroyer (AWD) project was well within what was expected to be world's best practice. As the work on the AWD vessels progresses and the skills base and experience continues to develop, further productivity gains could be anticipated.

The committee heard that the Defence Minister used the findings of the independent, but not publically available, review of the AWD program undertaken by Professor Don Winter and Dr John White as justification for excluding Australian companies from the supply ship tender.

Given the strategic importance of the naval ship building industry to Australia and the importance of the analysis contained within that report to the future of the industry, the committee recommends that the government release this report in full.

National security

National security concerns are central to any consideration of Australia's naval shipbuilding industry, as well as the priority that should be given to developing and retaining the skill base and experience to support that industry.

The committee looked at the much broader economic benefits that accrue from a local build or Australian involvement in the production of a naval vessel. They include the development and maintenance of a highly skilled workforce, the benefits that innovation brings to the wider economy and the economic and employment growth that flow from investment in research and development.

The committee also recognises the importance of having the skills base, experience and local know-how necessary to support the Royal Australian Navy's vessels through their operational life. This self-reliance is central to Australia's interests.

Defence industry policy and decision to conduct limited tender

The Department of Defence has a defence industry policy that recognises the vital contribution Australian industry makes to Australia's security. Among other things, the policy seeks to increase opportunities for Australia's defence industry to identify and make the most of business opportunities and to compete for acquisition projects.

The procurement process for the supply ships shows no evidence that Defence consulted with industry or encouraged open discussion about possible Australian engagement with the project.

Indeed, it appears as though local shipyards were shut out of all consideration.

The committee is of the view that Defence should have consulted with local shipyards and allowed them to present their case when it comes to building the supply ships in Australia.

The way in which the decision for a limited tender was taken and announced was a significant blow to Australian industry. The lack of consultation was at odds with Defence's stated industry policy objectives, which seek to promote competitive, collaborative and innovative industry.

Decisions, such as the acquisition of the supply ships, are extremely important for both Defence capability and for the sustainability of Defence industry in Australia. They involve huge amounts of taxpayers' money and have long-term implications for Navy's future procurement strategies and, importantly, its capability. Such decisions should be well considered and based on sound research and analysis.

A local vibrant and sustainable industry able to support navy vessels throughout their operational lives is critical to Australia's national interest. In this regard, the prime contractors in Australia and the many SMEs engaged in naval shipbuilding need to have certainty and the confidence to continue to invest and participate in the industry.

The way in which the tender process was announced and the exclusion of Australian industry from this process has clearly undermined this confidence.

The committee is not convinced that a limited tender involving only two companies is the best way to obtain the necessary information to proceed to second pass.

The committee makes the following recommendations:

Recommendation 1

9.16 The committee recommends that the tender process for the two replacement replenishment ships:

- **be opened up to allow all companies, including Australian companies, to compete in the process; and**
- **make clear that a high value will be placed on Australian content in the project.**

Recommendation 2

9.17 The committee recommends further that the government require that an open tender process be used for any future naval acquisitions.

Recommendation 3

9.18 The committee notes that Defence has identified areas where potential exists for Australian industry to become involved as sub contractors in the replenishment ship project. In this regard, the committee recommends that Defence become actively involved in encouraging and supporting Australian industry to explore such opportunities.

Recommendation 4

- 9.19 The committee recommends that the government release the report of the independent review of the AWD program undertaken by Professor Don Winter and Dr John White.**