

Chapter 1

Introduction

1.1 On 25 June 2014, the Senate referred the matter of the future of Australia's naval shipbuilding industry to the Senate Economics References Committee for inquiry and report by 1 July 2015. The term of reference for the inquiry is straightforward yet comprehensive in its coverage—the future sustainability of Australia's strategically vital naval ship building industry.

1.2 As part of this broad inquiry into Australia's naval shipbuilding industry, the committee resolved to inquire into the tender process for the Royal Australian Navy's (RAN) new supply ships as its first order of business. On 10 July 2014, the committee adopted the following terms of reference for the first part of its inquiry:

1.3 The tender process for the RAN's new supply ships and, given the significant impact that this decision will have on the Australian shipbuilding industry, in particular:

- the reasons for the Government's decision in June 2014 to exclude Australian-based defence industry from tendering for the replacement of HMAS *Success* and HMAS *Sirius*, and instead have a restricted tender for Spanish and South Korean shipbuilders;
- the capacity of Australian shipbuilding to carry out, in part or in full, the construction and fit-out of two auxiliary ships to replace the Navy's HMAS *Success* and HMAS *Sirius*;
- the role of the Department of Finance and/or Department of Treasury and/or Department of Defence, the Finance Minister and/or the Treasurer and/or the Defence Minister, in the Government's decision to exclude Australian defence industry from tendering for the auxiliary ship replacement project;
- the feasibility of including Australian industry participants in the tender process for the replacement auxiliary ships;
- the management and performance of DMO that contributed to the Government's decision to exclude Australian industry from tendering for the replacement auxiliary ships; and
- any related matters.

1.4 The committee determined that it would report on this first part of its inquiry by 27 August 2014. With regard to Part 1 of this inquiry, the committee called for submissions to be lodged by 17 July 2014 in time for its public hearing on 21 July 2014. For the second part of the inquiry, the committee set down 1 December 2014 as the closing date for submissions.

Conduct of inquiry

1.5 The committee advertised its inquiry on its website and in the *Australian*. The committee sought views directly from a range of people interested in the future of Australia's naval shipbuilding and repair industry. In particular, it wrote to, and invited, submissions from shipbuilders, suppliers, unions, professional associations and individuals engaged in the shipbuilding industry such as engineers and architects as well as academics including economists. The committee also invited state governments and relevant Commonwealth government departments to lodge written submissions. In drawing attention to the inquiry, the committee noted its intention to examine the tender process for the supply ships as a priority. Although this report deals only with the tender process for the supply ships, it lays the foundations for the committee's broader inquiry into the sustainability of Australia's naval ship building industry.

Submissions

1.6 The committee received 15 submissions for its inquiry into the tender process for the two supply ships, as well as additional information, listed at Appendix 1. On 21 July 2014, the committee held a public hearing in Canberra. A list of witnesses is at Appendix 2.

Background to inquiry

1.7 Over many years, Defence procurement has been subjected to regular, extensive and in-depth examinations that have revealed deficiencies in the processes for acquiring major military equipment. These revelations have often been followed by a period of reform to rectify perceived inadequacies. Indeed, in December 2011, the Senate Foreign Affairs, Defence and Trade References Committee, which was inquiring into procurement procedures for Defence capital projects, spoke of Defence being caught in an 'endless merry-go-round of reviews and implementation programs'.¹ In its 2014 report, the Commission of Audit also noted that the efficiency and effectiveness of Defence capability development and procurement processes had been 'a long standing issue, commented on by previous reviews'.² The numerous independent reviews undertaken over recent years into Defence procurement involving naval acquisitions include:

- *Report of the Defence Procurement Review*, 15 August 2003 (Kinnaird Review);

1 Foreign Affairs, Defence and Trade References Committee, *Procurement procedures for Defence capital projects*, Preliminary report, December 2011, p. xiii.

2 National Commission of Audit, *Towards responsible government*, Appendix to the report of the national commission of audit—volume 1, 9.8 Defence and national security, p. 9 of 21, <http://www.ncoa.gov.au/report/appendix-vol-1/9-8-defence-and-national-security.html> (accessed 8 August 2014).

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- *Going to the Next Level: The Report of the Defence Procurement and Sustainment Review*, 2008 (Mortimer Review);
 - 2008 Audit of the Defence Budget, 3 April 2009 (Pappas Report);
 - *Review of the Defence Accountability Framework*, January 2011 (Black Review);
 - *Plan to Reform Support Ship Repair and Management Practices*, July 2011 (Rizzo Report);
 - *Collins Class Sustainment Review*, Phase 1 Report, 4 November 2011 (Coles Review); and
 - *Study into the Business of Sustaining Australia's Strategic Collins Class Submarine Capability*, November 2012, report issued by Mr John Cole.

1.8 The Senate Foreign Affairs, Defence and Trade Committee undertook a comprehensive inquiry into Australia's naval shipbuilding industry in 2006 and more broadly into defence procurement, which included the acquisition of naval ships, in 2011–12. The Australian National Audit Office (ANAO) also regularly conducts performance audits into major defence acquisitions, including.

- ANAO Major Projects reports; and
- ANAO Performance Audit reports, including the recent audit of the Air Warfare Destroyer (AWDs)—Audit Report No. 22 2013–14 Performance Audit, *Air Warfare Destroyer Program*, March 2014.

Decision to inquire into the limited tender for two replenishment vessels

1.9 Australia's naval shipbuilding history has witnessed the delivery of large, complex and technically difficult projects with varying degrees of success. HMAS *Success* was built in Australia but when finally commissioned in 1986, was well over budget and late. The Australian Frigate Project was also constructed locally and after initial difficulties succeeded in its prime objective of re-establishing a major warship capability in Australia during the early 1990s. The Collins-class submarines and the ANZAC class frigates, commissioned between March 1996 and June 2006, were also built in Australia. The latter project involved the design, construction, testing and trialling of ten vessels which were delivered on time and on budget with some frigates delivered ahead of schedule.³

1.10 Overall, Defence's programs for the procurement of major capital equipment, including important naval acquisitions, have been dogged by delays and cost overruns and in some cases projects have been abandoned. Problem projects involving naval projects have involved acquisitions from overseas and from Australia. For example:

3 See Foreign Affairs, Defence and Trade Committee, *Blue water ships: consolidating past achievements*, December 2006. Chapters 3 and 4 provide a brief history of Australia's naval shipbuilding industry.

- The Super Seasprite project was intended to acquire helicopters for the Navy's ANZAC ships. Having failed to deliver the required capability, the project was ultimately cancelled in March 2008 with a total expenditure of \$1.4 billion.
- The LCM 2000 project was intended to purchase six landing watercraft that would transfer personnel and supplies from Navy's Landing Platform Ships (LPA) to shore. Originally approved in 1997, the watercraft project was placed on the projects of concern list in 2010 and eventually cancelled.
- The Guided Missile Frigate Upgrade project commenced in 1999 and was subsequently re-baselined in 2004 and 2006 due to delays. Also, the project scope was reduced from six to four ships. The operational release of the four ships was successfully completed in July 2011, representing delays of between 67 and 84 months. The Foreign Affairs, Defence and Trade References Committee suspected that 'the full story of incompetence on this project, including that of the contractor, will never be discovered'.⁴
- The Lightweight Torpedo Replacement project had a long history of project management difficulties.
- The Collins Class Submarine Reliability and Sustainability project designed to upgrade the Collins Class platform systems has exposed problems, some of which can be traced back to the initial acquisition phase.⁵

1.11 A number of recent developments have once again posed serious questions about the performance of major naval acquisitions, but more importantly about Australia's shipbuilding industry.

1.12 On 6 March 2014, the ANAO released its performance audit on the Australian Warfare Destroyers (AWDs) which was highly critical of the project. The public response to the ANAO report tended to focus on the project's poor performance. Media headlines spoke of cost blowouts, the bleak future facing Australian shipyards, with some referring to the looming 'valley of death' for the industry. At that time, the Minister for Defence also announced that the AWD program was to be added to the projects of concern list and would join five other ADF projects including the Collins Class Submarine Sustainment Program, which had been on the list since 2008.⁶

4 See Foreign Affairs, Defence and Trade References Committee, *Procurement procedures for Defence capital projects*, Final report, August 2012, paragraph 2.34.

5 See Foreign Affairs, Defence and Trade References Committee, *Procurement procedures for Defence capital projects*, Final report, August 2012. Chapter 2 gives a detailed account of the Super Seasprite, Landing Watercraft, Guided Missile Frigate Upgrade, Lightweight Torpedo Replacement and the Collins Class Submarine Reliability and Sustainability projects.

6 The projects of concern list was established in 2008 to focus the attention of the highest levels of government, Defence and industry on remediating problem projects. The Hon Stephen Smith, Minister for Defence, and the Hon Jason Clare MP, Minister for Defence Materiel, 'Projects of Concern—Update', 15 October 2010.

1.13 That same day, Senator the Hon Don Farrell, at the request of Senator the Hon Kim Carr, moved a motion in the Senate to recognise 'the vital contribution of the Australian shipbuilding industry as an employer, a storehouse of advanced manufacturing capabilities and a strategic asset'.⁷ On 17 March 2014, members of the House of Representatives also spoke to a similar motion to recognise 'the proud naval shipbuilding history of Australia and to note that the ability to build and maintain naval ships was essential to Australia's defence capability'.⁸

1.14 Almost three months later, on 4 June 2014, the Minister for Finance made a public statement raising further concerns about the AWD project. He stated that when the Coalition came into government, both he and the Minister for Defence were confronted with advice that the AWD program was in 'serious trouble'. Noting the critical importance of this program to national security, he explained that the project was experiencing significant delays in its delivery and considerable cost overruns. In his view, the government had inherited a deteriorating position and the project was about 21 months behind schedule. The Minister indicated that the problems encountered with the AWDs could have far-reaching implications for Australia's naval shipbuilding industry. He stated that everyone involved in this project was 'on notice':

Unless we can get this back on track, unless we can demonstrate that we can build these sorts of ships competitively here in Australia, then we have problems for the shipbuilding industry for these sorts of ships here in Australia as a whole and we don't want to get into that situation. We want the industry as a whole to have the best possible opportunity to be successful in building and delivering these sorts of ships in the future on time and on budget.⁹

1.15 The Minister for Finance made clear that this was 'the final opportunity to get this right, there's no two ways about it'.¹⁰

1.16 Within days, the government announced that it had given approval for Defence to conduct a limited competitive tender process between Navantia of Spain and Daewoo Shipbuilding and Marine Engineering of South Korea for the construction of two replacement replenishment vessels based on existing designs. The Minister for Defence explained that the decision to conduct a limited tender involving 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

7 *Senate Hansard*, 6 March 2014, p. 1089.

8 *House of Representatives Hansard*, 17 March 2014, pp. 1987–1995.

9 'Minister for Finance and Minister for Defence—Joint Press Conference—Review of the Air Warfare Destroyer program', 4 June 2014, p. 10, <http://www.minister.defence.gov.au/2014/06/04/minister-for-defence-and-minister-for-finance-joint-press-conference-review-of-the-air-warfare-destroyer-program/> (accessed 4 August 2014).

10 'Minister for Finance and Minister for Defence—Joint Press Conference—Review of the Air Warfare Destroyer program', 4 June 2014, p. 10.

involved with the AWD project; and value for money considerations.¹¹ During his announcement, the Minister stated:

Demonstrating that the AWD Program is able to provide value for money will be a crucial test for the Australian shipbuilding industry. No responsible Government could consider providing further work to an industry that is performing so poorly.¹²

1.17 It was in this context of mounting concern not only about the performance of the AWDs but more broadly about the future prospects for Australia's shipbuilding industry that the Senate referred the matter of Australia's naval shipbuilding to the committee.

1.18 As noted earlier, the committee resolved to inquire into the tender process for the new supply ships as a priority. In this report, the committee considers the need and importance of the supply ships to the Australian Navy, the capacity of Australian industry to build the ships and the contribution that such construction could make to sustaining Australia's naval shipbuilding industry.

Acknowledgements

1.19 The committee thanks all those who assisted with the inquiry, especially those who made written submissions and appeared before the committee at such short notice.

11 '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/> (accessed 4 August 2014).

12 'Minister for Defence—Boosting Australia's maritime capabilities', 6 June 2014.