

# Chapter 2

## Tender process

### Recommendation 1

**The committee recommends that the government not enter into a contract for the future submarine project without conducting a competitive tender for the future submarines, including a funded project definition study.**

**The tender should invite at least two bidders, preferably up to four, to participate.**

**The tender for the future submarine project should be conducted in line with the committee's recommendations and the guidelines set out in the Defence Policy Procurement Manual.**

**A request for tender should invite the bidders to provide the Commonwealth with:**

- **a Project Definition Study and preliminary design that meets Top Level Requirements; and**
- **a pricing arrangement to build a certain number of submarines and provide ten vessel years of integrated logistics support, post commissioning.**

2.1 In this chapter, the committee looks at the arguments for and against a competitive tender and at the schedule for the process and considers whether there is sufficient time to conduct a competitive process.

2.2 Without doubt, the choice of the designer and builder for Australia's future submarines is a critically important decision. Not only is the future submarine an expensive acquisition but the fleet of highly-capable modern submarines is a vital part of Australia's Defence force. The safety and well-being of its crew is also paramount. In this context, Commander Frank Owen (Rtd) highlighted the importance of Defence making an informed and timely decision. He stated:

We need a national program that delivers a sustainable and affordable capability for the long term and not just a quick-fix replacement of the Collins-class submarines. Indeed, there are no quick fixes, just as there are no MOTS options. Even the most capable of available overseas submarines will require modification. They will rely on Australian industrial capability.<sup>1</sup>

---

1 *Committee Hansard*, 30 September 2014, p. 3.

2.3 Rear Admiral Peter Briggs (Rtd) and Commodore Terence Roach (Rtd) also placed a heavy emphasis on the need for 'careful and measured consideration of risks'.<sup>2</sup> Likewise, Professor Goran Roos noted the importance of the decision to acquire Australia's future submarines. He acknowledged that submarine systems were one of the most important advanced complex defence systems the ADF operates and recognised the vital role they play in protecting Australia's trade routes.<sup>3</sup> Rear Admiral Briggs similarly advised:

...we do need to make the right decision and we do need to start with the right process to allow us to make the right decision.<sup>4</sup>

### **Speculation regarding limited tender**

2.4 A number of witnesses thought that the government was not on course to deliver the best submarine. During the inquiry, they expressed concern that the government may be intending, as it did with the new supply ships, to proceed with a limited tender.<sup>5</sup> For example, the Hon Martin Hamilton-Smith was of the view that the federal government appeared to 'have softened up' the Australian public by criticising Australia's current naval shipbuilding projects, including the AWD and Collins, in order to push through an off-shore build of supply ships and possibly future submarines.<sup>6</sup>

2.5 Mr Malcolm Jackman, Defence SA, harboured the same apprehension. As far as he was aware, DMO was not following the normal procedure for large-scale acquisitions, which was to run a 'comparative and competitive' project definition study process. He told the committee:

In terms of reading the tea leaves, so to speak, we are seeing a process that does not appear to conform to what we would expect out of DMO.<sup>7</sup>

2.6 Likewise, Mr Chris Burns, Defence Teaming Centre, indicated that there appeared to be a strong push towards the Japanese submarine. He observed:

Prior to the election, we were extremely confident, for instance, that the submarines were going to be built in South Australia. It is undeniable that, since that time, there seems to be a walking-away from the commitment to building those submarines in South Australia.<sup>8</sup>

---

2 *Submission 17*, p. 8.

3 *Submission 25*, p. 21.

4 *Committee Hansard*, 30 September 2014, p. 9.

5 See for example, Mr Hamilton-Smith who raised his concern that the government may again use exemption from the Commonwealth Procurement rules to proceed with a limited tender: that Mr King would not rule out a limited tender. *Committee Hansard*, 14 October 2014, p. 3.

6 *Committee Hansard*, 14 October 2014, p. 3.

7 *Committee Hansard*, 14 October 2014, p. 8.

8 *Committee Hansard*, 14 October 2014, p. 18.

---

## Competitive process

2.7 Witness after witness gave emphatic and overwhelming evidence in support of Defence conducting a competitive process.

2.8 The Hon Martin Hamilton-Smith stated that his government would like to see due process that would involve an open project definition study (PDS), 'an open process, where all the contenders put their offers on the table'.<sup>9</sup> He argued that a fair and open tender was the way to achieve the best outcome for Australia.<sup>10</sup> In his words:

It just beggars belief that you would go with one provider without testing the market.<sup>11</sup>

2.9 Mr Jackman stated that anybody that has deep knowledge of Defence acquisition would say that a competitive comparative PDS was clearly the process to go through.<sup>12</sup>

2.10 Mr Burns similarly argued that a competitive tender was the only way to validate claims made by industry contractors. He explained that you cannot test how much a project is going to cost, including whole-of-life cost benefits, until you go to a fully open and transparent tendering process.<sup>13</sup> In his view:

When I say 'open and transparent tendering processes', I specifically exclude the sole source and limited tenders being suggested for the future submarines or the farcical situation of Australian industry being specifically excluded from tendering for the replacement of replenishment ships. You will never know the true potential cost of a project until you get multiple companies to put their names to dollar figures on firm tender bids.<sup>14</sup>

2.11 He underlined the fact that it was not just a question of price but 'the capacity to actually do the job'.<sup>15</sup>

2.12 Mr Brice Pacey also favoured a competitive tender, suggesting that deep consultation with other players would be worthwhile.<sup>16</sup> In 2012, Mr Pacey recommended that the next generation submarine should be an evolution of the Collins design. Since then, however, he has formed the view that if there were new options, they should be considered. He thought that the best way to do that would be

---

9 *Committee Hansard*, 14 October 2014, p. 13.

10 *Committee Hansard*, 14 October 2014, p. 4.

11 *Committee Hansard*, 14 October 2014, p. 8.

12 *Committee Hansard*, 14 October 2014, p. 9.

13 *Committee Hansard*, 14 October 2014, p. 18.

14 *Committee Hansard*, 14 October 2014, p. 16.

15 *Committee Hansard*, 14 October 2014, p. 18.

16 Mr Pacey authored Kokoda Paper No. 17, *Sub Judice: Australia's Future Submarine*, January 2012.

through a competitive tender process of some sort, which would be 'entirely consistent with this government's philosophy'.<sup>17</sup> He explained that he had been working in the private sector a long time and thought that potential suppliers need to be put under pressure in order to come up with the optimal solution.<sup>18</sup> He stated:

I think that any alternative, any new opportunity, should be put under the same sort of scrutiny the Collins was in the original competitive process. The exact form of that competition is open for negotiation.<sup>19</sup>

2.13 In essence, Mr Pacey agreed with the view that an open, transparent tender process with competitive tension would be good for both the design and the taxpayer and would be the only way to proceed.<sup>20</sup>

2.14 Dr John White, who participated in the 2014 independent review of the performance of the AWD program, explained the need for funded, competitive PDS to properly and rigorously form up the future submarine project.<sup>21</sup> In his view, it was appropriate to explore all options—Japanese, Korean, German or Spanish options. He insisted that there was a definite need to have an open process where claims are stress tested and certainty obtained about Australia achieving value for money and maximising the strategic, employment or industrial benefits for the Australian public.<sup>22</sup>

2.15 Dr White repeated his contention that the various claims of the contractors who can build submarines suitable for Australian conditions can be best tested by a competitive tender process. He suggested that the claims 'need to be put under some tension, some pressure'. Furthermore, that it was not only the company, the designer, which should be scrutinised but also 'the industry base of that country, the support of the military and the government of that nation'. Put succinctly, he stated:

Unless there is a prize at the end and some competitive tension, the experience is that you really do not get the best offer.<sup>23</sup>

2.16 Drawing on the Collins class experience, he explained that under competitive pressure from other countries, the German bidders agreed to comply 'with the

---

17 *Committee Hansard*, 30 September 2014, p. 30.

18 *Committee Hansard*, 30 September 2014, p. 32.

19 *Committee Hansard*, 30 September 2014, p. 32.

20 *Committee Hansard*, 30 September 2014, p. 32.

21 *Committee Hansard*, 13 October 2014, p. 27. Dr White conducted the review with Professor Winter, former Secretary of the US Navy. For further details on Dr White's extensive experience in the area of major construction programs including the acquisition of naval vessels see *Committee Hansard*, 13 October 2014, pp. 25–26.

22 *Committee Hansard*, 13 October 2014, p. 32.

23 *Committee Hansard*, 13 October 2014, p. 28.

---

Australian requirement for a fixed price bid to build all submarines in Australia'.<sup>24</sup> He informed the committee:

I can absolutely assure you that, if there had not been a competitive PDS with that as a subject of the competition, that bid for building in Australia would not have been forthcoming. It is every country's preference to keep the work at home. But in 1986 the Germans were able to offer a fixed price.<sup>25</sup>

2.17 He argued that a competitive tender would be in the government's interests to ensure and demonstrate that the best value for money was obtained in the future submarine project.<sup>26</sup> He warned against a sole-source supplier, saying further:

There are significant technical, commercial and capability gap risks invoked by prematurely and unilaterally committing to a preferred overseas, sole-source supplier. Well-established best procurement practice in Australia and many parts of the western world is to undertake a competitive project definition studies, or PDS, process involving the potential suppliers—including or in parallel to the preferred solution, if you have one. This should be done with a view to having a viable fallback option to proceed with should, for whatever reason, the preferred solution prove not to be executable. I understand that this has sometimes been done in parallel when a US foreign military sale, or FMS, is the preferred solution in this country. So this is not new territory.<sup>27</sup>

2.18 According to Dr White, choosing a sole-source supplier could lead to a capability gap for Australia's submarines. Referring to the Japanese option, he said that even if Japan were the preferred design solution, the government needs 'to develop one or two, preferably two, fallback options in parallel because we do not know for what reason the preferred option, if it is Japan's, may not be able to be brought to a contract'.<sup>28</sup> In this regard, he noted that Japan still had not approved the export of products such as the submarine. In his view, there was 'some risk in those processes going through their procedures in Japan'. He accepted that he was no expert in Japan's foreign policy, but would have thought that that process could be a year or two years.<sup>29</sup> He explained further:

If the Japanese design solution were the sole option, failure for whatever reason to achieve an acceptable contract over the next year or two—because that is how long it will take to define it—with no fully developed fallback would create significant project risk and lead to a gap, almost definitely, in Australian submarine capability.

---

24 *Committee Hansard*, 13 October 2014, p. 29.

25 *Committee Hansard*, 13 October 2014, p. 29.

26 *Committee Hansard*, 13 October 2014, p. 27.

27 *Committee Hansard*, 13 October 2014, p. 27.

28 *Committee Hansard*, 13 October 2014, p. 29.

29 *Committee Hansard*, 13 October 2014, p. 29.

That would be lost time. Overall this could lead to embarrassment for the respective governments and militaries. A separate PDS is therefore, I argue, required for each shortlisted submarine platform design option. This would be not only to finalise the existing design and details for the construction, build, specification, standards and testing regime required to validate the design but also to develop, in conjunction with the RAN the interface requirements for directed design changes, of which there will be many, including combat system control—because we are putting a US combat system in—weapons discharge, external communications, security equipment and of course Australian Navy habitability changes. Separately, those critical and sensor subsystems that may be purchased from third parties—which will definitely be the case—need to be agreed, to consider design options and their required interfaces.<sup>30</sup>

2.19 As noted earlier, Dr White made the point forcefully that Australia could not afford to go down the path with only one potential supplier; 'you need to take two or three down the path so that at all times you have competition and you have a fall-back'.<sup>31</sup>

2.20 Professor Roos agreed with the proposition that Australia should conduct an open tender. He recognised that competitive tension between contending builders was necessary to ensure there would be the appropriate and effective transfer of technology and a substantial Australian industry participation plan. He argued that such fundamental requirements must 'be built into the procurement process if you want to accomplish the defence objectives of self-reliance for an island continent, and achieve the optimal balance between value for money and sovereign capability'.<sup>32</sup>

2.21 He explained further that Defence would require a new class of submarine, no matter what direction was chosen because none of the existing classes in the world would meet Australia's requirements. He argued that in order to make an evaluation of the preferred submarine class, a contested project definition study was required. According to Professor Roos, this approach would be the normal way in which to 'enquire around the world for these type of complex systems that are one of a kind'. He argued that:

We should go to a contested definition study where we give each and every one of them \$10 million, we write down the problems that need to be solved—we do not need to specify anything; we just write down the problems—and we ask them to go away for 12 to 24 months and come back with a specific statement of how they intend to solve those problems, including the transfer of IP and data and so on, as well as how they intend to deal with training and associated issues to secure our sovereign capability. And we ask them what this is going to cost us. That will allow us to compare apples with apples, which at the moment we cannot do.

---

30 *Committee Hansard*, 13 October 2014, p. 27.

31 *Committee Hansard*, 13 October 2014, p. 30.

32 *Submission 25*, p. 21.

---

Whoever we choose to move forward with will then be asked to move forward with an Australian industry partner—which is likely to be the one who knows how to build submarines in this domain. That is the logical way to do it.<sup>33</sup>

2.22 Supporting Dr White's stance against sole-sourcing, Professor Roos similarly warned about the risks of undertaking a limited tender. He was also concerned about the lack of certainty with Japan's long term commitment:

If the Government were to make it known that it was sole-sourcing a contract e.g. through indicating a 'limited tender' which indicates a unilateral sole-source approach to one submarine designer only, then it would place that Government in a negotiating position where it would be difficult, if not impossible, to get a good deal on both price and terms and conditions. This would de facto expose Australia to an unacceptable level of risk in the national security domain; the political domain; the operating domain; and as previously stated the commercial domain. All this would also take place at an unusually early phase in what is a complex evaluation and procurement process.

It will be impossible if the best option was chosen unless at least one other option was pursued in parallel—also as a back-up in case the Japanese option for some reason is taken off the table by the Japanese themselves for political, performance, commercial or national security reasons. This seems unacceptable given that the submarine project is likely to be Australia's largest defence program for at least the coming 40 years.<sup>34</sup>

2.23 Commodore Paul Greenfield (Rtd) reinforced the view that a designer should be selected through 'a due diligence process to ensure the right decision is made'. In his view, this process could be:

...through a funded project definition study or a funded concept design. You could have a competition if you wanted to, but the outcome must be acceptable in the capability, technical and total cost sense, not just politically attractive.<sup>35</sup>

2.24 Rear Admiral Briggs and Commodore Roach supported the view that selecting the most appropriate design partner should be done by undertaking a competitive PDS. They suggested that the study would provide costed, fixed price bids for the design and construction of the submarines in Australia.<sup>36</sup> As noted earlier, most witnesses generally accepted that there were four valid starting points—the French, Swedish, German or Japanese designs. Rear Admiral Briggs strongly urged

---

33 *Committee Hansard*, 8 October 2014, pp. 17–18.

34 *Submission 25*, p. 5.

35 *Committee Hansard*, 30 September 2014, p. 24. Commodore Greenfield has more than 40 years' experience, 30 of which were in the technical side of Navy's operations, maintenance and acquisition programs. See *Committee Hansard*, 30 September 2014, p. 21.

36 *Submission 17*, paragraph 56.

the government to conduct a competitive project definitions study and to invite all four bidders to participate. They would be required to meet the same criteria, including the date of completion; the required performance; and the fact that 'you want them built in Australia'.<sup>37</sup> He said:

The only way to pick it is to conduct a competitive project definition study where you can get the answers back to your top-level requirements and, frankly, these can go on two sheets of paper. From that basis you have an informed point to be able to make a decision on what is the starting point and who is going to come with you on the journey.<sup>38</sup>

2.25 After which the government should make a sensible, informed choice and then get on with the acquisition process because, in his words, the clock was running:

...we know the date; we ought to go out with a competitive PDS which nominates the date and says, 'We want your answers for a submarine in the water on that date'.<sup>39</sup>

2.26 This approach would allow for the two year transition from the Collins: that March gives two years of capacity that was found to be necessary for the Collins.<sup>40</sup>

2.27 Rear Admiral Briggs reminded the committee about the importance of acquiring the best possible submarine:

It is a fact that in a submarine-on-submarine battle the difference is so fine; and it comes down to the sonar superiority, the training superiority and the weapon. This is a knife fight in a dark alley. If you make the first sweep and miss, you are going to cop it right between the eyes. You have to get it right the first time.<sup>41</sup>

2.28 Thus, he reasoned, the only way to ensure that Australia obtains this cutting edge technology was through a competitive PDS. He stressed that 'You will not get it unless you are forcing those four companies into a competition where they have to stump up a promise and a real price'. Commodore Roach endorse this view.

### **Committee view**

2.29 The committee is concerned that many assumptions have been made about the various contenders for the future submarine but these assumptions remain untested.

---

37 *Committee Hansard*, 30 September 2014, p. 19.

38 *Committee Hansard*, 30 September 2014, p. 9.

39 *Committee Hansard*, 30 September 2014, p. 16.

40 *Committee Hansard*, 30 September 2014, p. 16.

41 *Committee Hansard*, 30 September 2014, p. 10.

2.30 The committee has highlighted the vital importance of making the right decisions at this critical stage of the project and before Defence takes Australia down a path from which it cannot turn back.

2.31 The process of selecting the designer of Australia's future submarine—a highly complex, expensive, safety-critical asset central to Defence's capability—is far too important to opt for an inferior selection process.

2.32 The committee understands that a competitive process may require additional time, but the committee is confident that such a process can be achieved without a gap in capability for Australia's submarines.

