

Additional Comments by Senator Nick Xenophon

1.1 I welcome the Senate Economics References Committee's report, Part II, into the Future of Australia's naval shipbuilding industry and the Future Submarine project.

1.2 This inquiry was brought about due to serious concerns about the Government's record on Australian naval shipbuilding since coming to office in September 2013.

1.3 Naval shipbuilding in Australia in the past three decades has been a story of overall success, with the construction and delivery of several classes of heavy warships and submarines in Australia to a high standard and within reasonable budget and productivity expectations.

1.4 Much has been learned and much progress has been made in supporting an industry that has become an important strategic and economic asset to the nation.

1.5 When the Government launched a limited tender in June in relation to the \$1.5 billion supply ships procurement it was considered very out of the ordinary and this committee examined that decision in its first phase.

1.6 Before and since the committee reported on the limited supply ships tender debacle on 27 August, it emerged in the media that the Government was apparently starting on a course to consider acquiring the Japanese Soryu Class submarine.

1.7 The committee rightly resolved to focus on this issue and prepare a second interim report and has since conducted four further public hearings, on 30 September in Canberra, 8 October in Newcastle, 13 October in Melbourne, and 14 October in Adelaide, hearings largely focused on the SEA1000 project to acquire Australia's future fleet of submarines.

1.8 The Chair's majority report captures well the breadth and depth of evidence gathered by the committee on key aspects of SEA1000.

1.9 I strongly support all of the Chair's recommendations.

1.10 Additionally, I wish to amplify on some key points that will be crucial if the Government's wish is to properly deliver the Future Submarines.

A process that appears all at sea

1.11 Examining the SEA1000 project and establishing recommendations upon which the Government might proceed has been carried out against a backdrop of often

contradictory and speculative backgrounding of reporters, apparently by well-placed Government and/or Defence sources.

1.12 Based on media reporting in recent months, a number of contradictory positions have emerged from within Government, the bureaucracy and the ADF about how SEA1000 was proceeding. These statements were not only contradictory against one another but contradicted the stated public position of the Government.

1.13 As a result SEA1000 has taken on the appearance of a fraught and mismanaged acquisition and this represents a significant risk to the future of one of Australia's most important military acquisitions in the next half-century.

1.14 For example, on 8 September a news article appeared in some News Ltd publications and reported:

The next generation of Australian submariners will be put to sea in boats made in Japan ... [the Government] will select the Japanese-built Soryu Class submarine to replace locally built Collins Class boats.¹

1.15 On 2 November the Defence Minister gave a speech to the Submarine Institute of Australia conference in Fremantle and ruled out all current Military Off The Shelf (MOTS) options for SEA1000 and again asserted that no final decisions had been made.

1.16 But such stories have emerged regularly, raising questions about the level of reliability Australians can place in the stated position of the Government and the internal processes of Government in relation to SEA1000.

1.17 On 28 October a story appeared in the *Australian Financial Review* reporting that an 'international competition' would be staged to select the design of the Future Submarines,² the source for the story declined to identify themselves and no-one in the Government has since confirmed this on the record.

1.18 Last week at the Submarine Institute of Australia conference the Defence Minister talked about speculation about a competition, but did not commit to one.

1.19 So again, Australian and international industry and thousands of naval ship building workers were left with confusion and anxiety in relation to Future Submarines.

1 See: <http://www.news.com.au/national/new-japanese-submarines-to-cost-abbott-government-20-billion/story-fncynjr2-1227050682205>

2 See: http://www.afr.com/p/national/blow_builder_local_jobs_as_government_Sf6r98wHZPDJrrIDV340eK

1.20 The Australian head of German submarine designer TKMS, Philip Stanford, admitted to *ABC AM* in a story broadcast on 24 October that he wasn't aware of the process being followed.³

1.21 Mr Stanford said that he 'believed' a competition was going to be held, however this has not been confirmed by the Government publically and was contradicted in the same story by the reporter, who said she had received background information to that effect from a Government source who declined to be identified.

1.22 Defence Teaming Centre of South Australia chief executive Chris Burns told ABC Online, in a story published on 5 November, that industry remained confused about the SEA1000 process.⁴

1.23 The regular appearance of conflicting and unsourced reports, often with damning 'blind quotes' unfairly critical of Australian industry, purporting to reveal facts about SEA1000 only to be later disputed or ruled out by Government or Defence, has made the work of this committee more difficult than it otherwise might have been.

1.24 But for outside observers among Australian and international defence industry firms, the unions and organisations that represent expertise in the submarine field, the conduct of the Government in this process so far appears highly questionable and most disappointing.

1.25 Just what decisions have been made, by whom, upon what basis and what process is the Government following in relation to SEA1000, remains confused and clouded in needless speculation.

1.26 The Government process appears to be all at sea. Spreading confusion in relation to SEA1000 is not in the national interest and certainly not in the interests of Australian naval shipbuilding or the thousands of people who rely upon it for employment, directly and indirectly.

1.27 This selective leaking in other circumstances may well have triggered an AFP investigation – however this seems most unlikely given the apparent sources of the leaks.

Election promise

1.28 The then Opposition Defence Spokesman David Johnston held that role for about four years and by the time he entered Government was widely considered to be

3 See: http://www.afr.com/p/national/blow_builder_local_jobs_as_government_Sf6r98wHZPDJrrIDV340eK

4 See: <http://www.abc.net.au/am/content/2014/s4113647.htm>

well across the Defence portfolio, particularly on matters to do Australia's current and future submarine capability.

1.29 On a trip to Adelaide on 8 May 2013 he made the position of the Opposition crystal clear to the people of South Australia in relation to the SEA1000 project. After beginning a press conference, the then Opposition Defence Spokesman said, unprompted:

The Coalition today is committed to building 12 new submarines here in Adelaide, we will get that task done, and it is a really important task, not just for the Navy but for the nation. And we are going to see the project through, and put it very close after force protection, as our number [word omitted from transcript] priority if we win the next Federal Election.⁵

1.30 The Defence Minister has since 'nuanced' this statement during Senate Estimates and Senate Question Time and denies he is bound by it.

1.31 However, it is clear that the Coalition did promise to build Australia's next fleet of submarines in Adelaide and are bound by it.

1.32 The people of South Australia and Australia know that the Government promised to build the Future Submarines in South Australia and will judge the Government's level of sincerity accordingly.

Recommendation 1

1.33 That the Government deliver on its election promise to have the Future Submarines built in South Australia.

China-Japan tensions

1.34 It is becoming clear that China is concerned about any moves by Australia to acquire submarines from Japan.

1.35 According to a recent report by the Centre for China in the World at Australian National University, 'A New Australia China Agenda', Chinese military officers had already expressed a concern that Australia's quest for twelve submarines can't easily be reconciled with Australia's Defence White Paper's defence of the homeland security posturing.

1.36 ANU's report, Edited by Geremie R Barmé and Ryan Manuel, states in unequivocal terms:

5 See:

<http://www.senatorjohnston.com.au/Media/OtherMedia/tabid/71/articleType/ArticleView/articleId/326/Doorstop--Future-submarine-project.aspx>

As Australia has strengthened its alliance with the US, and as frictions and clashes have complicated the external environment for countries in the region, the Australia–China relationship itself is being tested.

1.37 These concerns from China will be escalating since the Government opened the door to military technology cooperation in relation to submarines with Japan.

1.38 According to a report released this month (November 2014) by Professor Nick Bisley of La Trobe University and Brendan Taylor of the Strategic and Defence Policy Centre of ANU:

...a further intensification of this relationship in future will only heighten Tokyo's expectations of Australian support and potentially deepen Canberra's East China Sea entrapment dilemmas. This would be particularly so were Tokyo to acquire the means for exerting leverage over Canberra, as some commentators have argued could potentially occur were Australia to develop any form of technological dependency as a result of acquiring its future submarines from Japan.⁶

1.39 These concerns from China are unsurprising. China has always taken a keen interest in the military acquisitions of countries nearby and especially by Taiwan, which it asserts to be a part of China.

1.40 However, as former Foreign Minister Bob Carr has recently said publicly, Australia should be observing a policy of neutrality when it comes to the escalating disputes between Japan and China.

1.41 By moving closer to the Japanese Defence Ministry and Military, seeking further cooperation and technology sharing in relation to submarines in the absence of a genuine competitive tender process, Australia is inflaming China unnecessarily.

1.42 These strategic considerations are a potentially damaging distraction from normal factors that impact the selection of the Future Submarines.

1.43 China is Australia's number one trading partner. Much of the future prosperity of Australians is directly linked to trade with China. The Government should not be risking this by complicating our submarine acquisition with a move closer to the Japanese military in the absence of a genuinely competitive tender process.

Competitive design tender

1.44 A multi-pass competitive procurement process is considered best practice in defence procurement for large, expensive and complex naval assets.

6 *Conflict in the East China Sea: would ANZUS apply?*, p. 56.
<http://www.uts.edu.au/sites/default/files/18924-acri-anzus-booklet-web.pdf>

1.45 The committee heard this advice repeatedly from some of the nation's most eminent operational naval, naval shipbuilding and submarine construction experts.

1.46 A competitive acquisition process for a Future Submarine design would produce the best offers from potential design partners. It creates a process in which the Government defines its needs, design partners produce plans to meet those needs and estimates what it would likely cost.

1.47 Industry advocate Chris Burns, of the Defence Teaming Centre South Australia, summed up the consensus of many expert witnesses, telling the committee:

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.⁷

1.48 According to the Defence Capability Development Manual a multi-pass decision making process would be followed for a project such as SEA1000:

The need arises (for more than two decision pass points) particularly in the case of capability proposals of major strategic significance, that have very high costs or that are politically sensitive. Proposals for new combat aircraft or for major surface or subsurface combatants are examples of capability development projects likely to involve additional decision points.⁸

1.49 Typically Multi-pass decision points would be reached by the Government to narrow the field and arrive at a final decision of design partner.

1.50 However, the Defence Minister says the Government is following a two pass process for Future Submarines.⁹

1.51 A non-competitive process would likely produce a sizeable 'premium' to the cost of SEA1000, because the Government would not be able to apply a competitive tension to its sole-source supplier.

1.52 Despite the Government deeming SEA1000 a very urgent project and asserting that a risk of a 'capability gap' was emerging, the Government is yet to commit to a competitive tender process or competitive project definition study.

1.53 Speculation has emerged that suggests Japan may not agree to a competitive process. While this may explain the delay in the Government setting one up, it is an unacceptable requirement for any potential supplier of Australian submarines.

7 *Committee Hansard*, 14 October 2014.

8 Defence Capability Development Manual, paragraph 3.17.
http://www.defence.gov.au/capability/_home/_pubs/dcdm.pdf

9 Opinion editorial, *Adelaide Advertiser*, 18 October, 2014,
<http://www.minister.defence.gov.au/2014/10/18/minister-for-defence-correcting-the-record-on-submarines-opinion-editorial-adelaide-advertiser/>

1.54 Further, due to the intense speculation around a Japanese submarine acquisition, any competitive tender process set up in the future may now be suspected of being a token process by other potential suppliers.

Recommendation 2

1.55 That the Government launch a competitive tender process, including a funded competitive project definition study and take adequate measures to ensure transparency and confidence that the process is a real and fair competition for potential suppliers.

Australian submarine build

1.56 This committee has heard no evidence that suggests Australian industry lacks the capability, productivity, track record or know-how that would prevent it from competently building Australia's next fleet of submarines.

1.57 To the contrary, the committee has heard expert after expert describe in detail how Australia is well placed to deliver these submarines in a timely and efficient manner.

1.58 Moreover, the wider economic and technological benefits for the country were quantified by experts such as Professor Goran Roos of the Advance Manufacturing Council and Professor at UTS Business School (Adelaide) and Dr Peter Brain, Executive Director of the National Institute of Economic and Industry Research.

The conclusions on these very conservative assumptions is that Australia as a country is at least \$21bn better off to build in Australia than to purchase overseas in addition to creating 120,000 man years of additional jobs in the economy over the life of the project as compared to building overseas.¹⁰

1.59 The committee heard evidence from a range of experts that the through-life benefits of engaging local navy shipbuilding industry, including but not limited to:

- (a) The strategic advantage of building and maintaining Australia's essential naval assets in Australia, including and especially during periods of conflict and tension overseas when Australia should not be reliant upon overseas suppliers
- (b) The multiplier effects for the economy of spending defence funds in Australia rather than overseas
- (c) Reductions in through-life maintenance and sustainment costs due to investment in infrastructure and skills during the construction phase

10 *Submission 25*, p. 17.

- (d) The development of a highly skilled workforce and increased innovation that comes through research and development and knowledge transfer for the wider economy
- (e) The project's contribution to national economic growth and employment. These benefits have been recognised by the Canadian Government in its National Shipbuilding Procurement Strategy (NSPS)¹¹
- (f) The tax revenue advantages to Government of engaging local industry, estimated to be up to a third of the cost of the project, as outlined in a 2012 paper published by the Royal United Services Institute of the UK.¹²

1.60 The importance to South Australia of building Future Submarines in Adelaide has increased due to the impending closure of Australia's car making industry and the flow-on effects in South Australia and Victoria of the expected loss of more than 30,000 manufacturing jobs and many thousands of others in supply and service jobs that support the car-making sector.

1.61 By the Government delivering on its election promise to build Future Submarines in Adelaide it has the opportunity to offset the serious job losses South Australia will suffer in coming years.

1.62 Indeed, the oft-cited 'Valley of Death', which will see navy shipbuilding jobs lost due to lack of engagement from the Federal Government in coming years, is a risk to the nation as a whole, with the potential loss of approximately 7000 naval ship building jobs¹³ and thousands more in supply industries.

1.63 The Valley of Death is already upon us. The Committee has heard that Forgacs laid-off 110 skilled navy maritime jobs from its Newcastle Tomago yard recently¹⁴ due to a lack of continuity in naval ship building work.

1.64 The enormity of the Valley of Death will become clear from next year when work for the Air Warfare Destroyer project in Newcastle and Melbourne comes to an end, and will worsen from 2016 when work in Melbourne on the navy's Landing Helicopter Deck (LHD) ships comes to an end.¹⁵

11 Canadian National Shipbuilding Procurement Strategy (NSPS), <http://www.tpsgc-pwgsc.gc.ca/app-acq/sam-mps/snacn-nsps-eng.html>

12 *Over a third of UK sourced defence contracts may be recovered by the Treasury in tax revenue*, https://www.rusi.org/news/ref:N4F194BF09B370/#.U_v0wvnEJSi

13 Mr Glenn Thompson, AMWU, *Committee Hansard*, 21 July 2014, p. 34.

14 Mr Glenn Thompson, AMWU, *Committee Hansard*, 21 July 2014, p. 35.

15 Mr Glenn Thompson, AMWU, *Committee Hansard*, 21 July 2014, p. 33.

1.65 The Government has the opportunity, and Australian industry has the capability, to build both the Future Frigates and Future Submarine projects in Australia from the 2020s.

1.66 Carrying out this crucial shipbuilding work in Australia is in the national interest, in the interests of the Navy and of the Defence Force and the wider national economy.

Defence industry engagement

1.67 It has become regrettably clear that the Government is not engaging Australian industry adequately, nor is it engaging potential international design partners in a comprehensive and well-understood procurement process.

1.68 Further context for the Government's decision on the replenishment ships is provided by its decision, also revealed in June, to outsource the construction of 12 smaller navy vessels to Vietnam via a novel commercial arrangement with an Australian bank, and the construction of two ice breakers in Europe.¹⁶

1.69 The committee heard, and I have heard separately outside the committee, that Australian industry is either being kept in the dark or else the Government and Defence appears to be 'going through the motions' with local and international suppliers.

1.70 This goes against the recommendations of the 2012 ANAO report into the C27J project, which required that DMO keep Australian industry apprised of the status of a procurement project and of the process being followed.

1.71 Besides being confused about the process due to Government backgrounding of media in relation to unannounced and disputed decision points, industry has also been confused by the statements of senior DMO executives and the Defence Minister.

1.72 For example, DMO Chief Executive Warren King was questioned about the status of the so-called Option 3 and Option 4, an evolved Collins Class design or an entirely bespoke design for Future Submarines:

Senator KIM CARR: Explain to me what it is. I am particularly interested, given that the Commonwealth of Australia provided \$20 million in January 2012 for the funding of SEA 1000. Has all of that process been put aside so that we can now investigate this question of buying boats from Japan?

Mr King: No, we are still looking at options 3 and 4.

Senator CONROY: So work is still being undertaken on options 3 and 4?

16 *South Australian ship builders cut out of contracts as Federal Government buys overseas*, <http://www.adelaidenow.com.au/news/south-australia/south-australian-ship-builders-cut-out-of-contracts-as-federal-government-buys-overseas/story-fni6uo1m-1226945174449>

Mr King: At this stage, yes.

Senator CONROY: No work has been scaled back?

Mr King: No ...

1.73 Yet in the Senate Estimates hearings in October the Defence Minister described Options 3 and 4 as follows, referring to the doorstep press conference he gave to media on 8 May 2013:

I said in that interview that we will pursue Options 3 and 4 unless they turn out to be fantasy. Senator you and I both know that those two options are fantasy.¹⁷

1.74 This begs the question of why is the DMO carrying out work into design options for SEA1000 that its Minister considers to be fantasy.

1.75 And what is defence industry to make of a process that appears so conflicted at the top of Defence and Government?

Recommendation 3

1.76 That Defence and Government re-engage with Australian and international defence industry positively and fairly, keeping them informed of the state of SEA1000 and the process being followed.

ASC productivity

1.77 The issue of ASC productivity during the AWD project has become a matter of public interest since the release of the ANAO report in 2012 and the Winter-White report in June this year.

1.78 The Defence Minister has repeatedly asserted in the media, and in Senate Estimates and the Senate, variations of:

I inherited a project running several years late and several hundred million dollars over budget; with man hours per tonne running at 150 man hours per tonne when the benchmark internationally is 60 man hours per tonne and the benchmark was set at 80 man hours per tonne, so we've got a problem program.¹⁸

1.79 On 29 July 2014, the Defence Minister said this to the media in Adelaide:

17 Foreign Affairs Defence and Trade, Senate Estimates, 22 October 2014.

18 Foreign Affairs Defence and Trade Committee, Senate Estimates, 22 October 2014.

We cannot go forward with 150 man-hours per tonne in the face of a reasonably fluid benchmark of about 80. We are approximately double what we should be – that is not acceptable.¹⁹

1.80 On 27 August the Defence Minister told the Senate:

Hundreds of millions of dollars over budget, it was two years late. With an international benchmark of 60 man-hours per tonne, we set the benchmark at 80 man-hours per tonne—and what were they doing? One hundred and fifty man-hours per tonne. Some of these blocks had to be reworked up to four times. I owe it, we owe it, to the taxpayer to get this right. There are eight ships for Adelaide if we can get this right. So instead of bleating, get onto your mates up there and tell them to lift their productivity. It is that simple.²⁰

1.81 The Defence Minister has promised that no more major naval ship building work will be awarded to Australian industry until 'AWD is fixed'.

1.82 However, the committee heard evidence from ASC that these comparisons in relation to benchmarks by the Defence Minister were misleading.

1.83 Martin Edwards, ASC General Manager for Current Operations for the AWD Project, explained to the committee at the Adelaide hearing the context of these productivity figures and what the current benchmark figure was for the current stage of the AWD project:

There has been much commentary about productivity on the AWD program and its impact on future programs. This has been driven in part by annual reports by First Marine International, or FMI. These are conducted for DMO and are an annual activity benchmarking our productivity. FMI use a productivity measure known as compensated gross tonnage divided by the labour hours, to benchmark productivity between types of ships and different shipyards around the world. Compensated gross tonnage is not a measure of a ship's mass. It is a measure of a ship's volume and complexity and is used to enable comparison between different ships and shipyards.

The measurement includes all production trades and importantly project support staff, such as engineers, planners and other elements of the program. Sixty to 65 hours for compensated gross tonne is highlighted as the core productivity benchmark that we should achieved. However, this is only achieved after a number of ships, usually greater than four or five, of the same class have been built. Of course, we are only currently building three air warfare destroyers, so we will not get to this core level. This

19 Doorstop press conference, 29 July 2014, <http://www.minister.defence.gov.au/2014/07/29/minister-for-defence-doorstop-defence-industry-conference-2014-adelaide/>

20 Senate Question Time, 27 August 2014, <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query%3DId%3A%22chamber%2Fhansards%2F51bf64f5-0da0-45b0-8f27-30816cdb43b4%2F0041%22>

learning curve effect means that the first ship in a class always takes more hours to build than the second and the third less than the second—and so it goes on. This is the same for any shipyard building a new class of vessel.

FMI advises this effect can increase the core productivity by about 50 per cent on the first of class. On this basis, the first of class Air Warfare Destroyer would be expected to be built or to achieve in the order of 120 to 130 hours per CGT. Currently, shipyard building is in the order of 150 hours of compensated gross tonne. However, if adjusted for abnormal factors such as issues associated with design and scope transfer from other yards to ASC, we are currently forecasting to achieve somewhere in the order of 132 hours for compensated gross tonne or approximately five per cent higher than the international benchmarks—however, we can do better. The actual achievement will only be known when the first of class is completed and delivered; so, at this time, it is only a forecast. However, based on this, we expect a third Air Warfare Destroyer to achieve around the targeted 80 to 85 hours for compensated gross tonne.²¹

1.84 This evidence to the committee shows that AWD is not running at almost half the productivity that it should, as the Defence Minister has asserted, but that it is only slightly off the productivity expected at this early stage of such a complex project.

1.85 The full explanation of AWD difficulties are many and varied and were covered in detail in the ANAO report of 2012 and the Winter-White report, completed in June this year.

1.86 However, the Government has refused to release the Winter-White report, despite the Senate passing two motions that I moved to have it produce the document.

1.87 Government secrecy in relation to the Winter-White report has damaged the ability of analysts, the media and Parliamentarians to understand the causes of the AWD problems and necessary remedial work required.

1.88 This is unacceptable given the Defence Minister says no further naval shipbuilding will be awarded to Australian industry until the AWD project is remediated.

1.89 The Government has promised a remedial program involving bringing in a number of experienced naval shipbuilding project managers, reportedly from Navantia,²² but there has been no announcement of this program commencing to date and it remains unknown when the Government intends to roll this program out.

21 *Committee Hansard*, 14 October 2014 .

22 *The Australian*, 23 September 2014, <http://www.theaustralian.com.au/national-affairs/defence/shipbuilders-from-spanish-firm-navantia-called-in-to-salvage-destroyer-program/story-e6frg8yo-1227066999460?nk=60d38d7a4b5bff75c6f04a4dfed3ecab&login=1>

1.90 Missing from the Government's repeated attacks on AWD has been any recognition—bar a perfunctory one-page précis of the Winter-White report—that the causes for the AWD project's problems stem from its inception by DMO, which decided to set up a so-called 'Alliance' structure under the leadership of Warren King, now the DMO's Chief Executive.

1.91 The Government appears keen to point the finger of blame at the Australian naval shipbuilders on the AWD project, promising to halt all major naval work awarded to Australian industry as a result, but the truth is much more inconvenient.

1.92 There's a question as to whether the slippage in the schedule was due in part to the structure of the Alliance from the outset.

1.93 I understand that DMO practices may have contributed significantly to inefficiencies at Australian shipbuilders, especially with lead shipbuilder ASC.

Recommendation 4

1.94 That the Government release the Winter-White report immediately, if necessary removing commercial-in-confidence information, so that the debate on the Future Submarines and other naval acquisitions can be properly conducted.

Recommendation 5

1.95 That the Government commission an independent wide-ranging inquiry of the Defence Materiel Organisation as a result of its role in the AWD project becoming a Project of Concern for the Government. Terms of reference should also include a root-and-branch analysis of the DMO and any consequential recommendations for reform.

**Senator Nick Xenophon
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