

Dissenting Report by Coalition Senators

1.1 Coalition Senators recognise the Australian Government, through the 2016 Defence White Paper, Integrated Investment Plan, and Naval Shipbuilding Plan, has provided a framework to build a sustainable sovereign shipbuilding industry.

1.2 To achieve the required level of Australian industry involvement in these projects, the Commonwealth Government established the Capability Acquisition and Sustainment Group. Industry days have been held around Australia with the intent of informing local businesses of opportunities in the supply chain for major defence projects.

1.3 Coalition Senators understand through extensive engagement with local industry 800 Australian companies have registered interest with Naval Group and 222 Australian companies have registered interest with Lockheed Martin Australia on the future submarine program alone.

1.4 Coalition Senators commend the Commonwealth Government for the significant work being undertaken to establish a sovereign shipbuilding industry in Australia.

Building a sovereign shipbuilding industry

1.5 Coalition Senators note milestones in the Continuous Shipbuilding Program are being met, with Austal having launched the first Guardian-Class PPB launched on 30 May, 2018.

1.6 Through the 2016 Defence White Paper and Naval Shipbuilding Plan the Government articulated an ambition for a sovereign Australian naval shipbuilding enterprise to be delivered through the continuous shipbuilding plan.

1.7 The investment made by the Government in the Naval Shipbuilding Plan is also intended to revitalise Australia's heavy engineering and advanced manufacturing industrial capability and capacity.

1.8 This includes a vision to maximise Australian industry involvement over time across the full spectrum of the enterprise – from capability design to complex project management, construction and sustainment activities; such that future Australian Governments will be able to plan and execute the design, construction and sustainment of future fleets of major surface combatants in Australia.

1.9 The Shipbuilding Plan describes a productive Australian naval shipbuilding industry with potential for delivery of an export capacity as a strategic national asset.

1.10 Coalition Senators understand through the competitive evaluation process, Government is ensuring that design and build partners deliver Australian Industry Capability solutions that maximise Australian industry involvement and contribute to an enduring shipbuilding and sustainment capability in Australia.

1.11 Coalition Senators recognise a shipbuilding enterprise will require strong and incentivised partnerships between ship designer and shipbuilder. Furthermore, that the

development of a motivated, innovative, cost-competitive and sustainable Australian industrial base will be underpinned initially by experienced international ship designers and builders who transfer these attributes to Australian industry.

1.12 With this, Coalition Senators believe the appropriate framework is in place to ensure the development of a sustainable sovereign shipbuilding industry, maximising local industry involvement.

Ensuring Australian industry involvement

1.13 Coalition Senators note that, as part of the Defence Industrial Capability Plan, the Government strengthened the definition of Australian Industry as follows:

Australian defence industry consists of businesses with an Australian Business Number and Australian-based industrial capability (such as Australian company and board presence, skills base, value-add work in Australia, infrastructure) that are providing or have the capacity to provide defence-specific or dual-use goods or services in a supply chain that leads to the Australian Department of Defence or an international defence force.¹

1.14 The Australian Industry Capability (AIC) program requires tenderers to demonstrate how they will maximise opportunity for competitive Australian industry to participate in Defence material procurements of \$20 million or greater.

1.15 The Government has strengthened requirements on tenderers in the AIC Plan to demonstrate how they will maximise Australian industry capability over the life of the project and build enduring defence industry capability to meet Defence's broader needs. The commitments made in the successful tenderer's AIC plan form part of the resultant contract and are a binding contract deliverable.

1.16 Coalition Senators understand an AIC assurance review process is currently being designed and piloted. The assurance review process will ensure AIC plans are effectively implemented and monitored and that the work that was committed to Australian industry, especially SMEs, under a contract was delivered by Australian industry. It will also provide a framework for Defence to assist industry to meet their contracted AIC deliverables where they are yet to do so.

1.17 The forthcoming Defence Industry Participation Policy will provide a policy framework for maximising Australian and local industry involvement across Defence materiel and non-materiel Defence procurement of \$4 million and above.

1.18 Coalition Senators understand Defence is piloting Local Industry Capability Plans as part of six major capital facilities projects. This requires tenderers to develop a plan outlining how local industry, including SMEs, has been, or will be engaged in the development of the proposed solution. The Plan will also require tenderers to outline the work proposed to be undertaken by local industry. The results of the pilot projects will inform the development of the Defence Industry Participation Policy.

1.19 The new Defence Industry Participation Policy will provide a more consistent approach to the consideration of Australian industry at the national and local levels in

1 Department of Defence, *Defence Industrial Capability Plan*, April 2018, p. 11

Defence procurement of \$4 million and above and for construction procurements of \$7.5 million and above.

1.20 Coalition Senators note that the Government's policy is to maximise AIC, however, mandating an AIC level (as suggested in the Chair's report on p. xiii) would mean that prospective bidders for Defence contracts would only seek to clear a hurdle of local content, rather than have to compete to have the maximum level of Australian industry content in their proposals.

1.21 Coalition Senators further note that the government ensures a high level of Australian industry involvement through the Australian Industry Capability Program. This requires that bidders for major defence acquisitions develop detailed Australian Industry Capability plans, which detail how they plan to involve Australian companies in their build. The commitments made in the successful tenderer's AIC plan form part of the resultant contract and are a binding contract deliverable.

1.22 Coalition Senators reject the assertion in the Chair's report that "the government has at times actively excluded Australian workers and shipbuilders from participating in naval shipbuilding programs."² The Government is creating a naval shipbuilding industry in this country using Australian workers, Australians shipyards, and Australian steel. Out of 57 new vessels, 54 are being built in Australia, creating more than 25,000 Australian jobs both directly and indirectly.

1.23 To meet the objectives and expectations of the Commonwealth as outlined in the Defence White Paper and Naval Shipbuilding Plan and summarised above, Coalition Senators believe future projects should be:

- (a) In support of the objectives of continuous naval shipbuilding, which encompasses the AWD, PPB-R, OPV and Frigate programs, primes will be required to demonstrate how they will provide continuity to the workforce, local supply chain and existing Australian shipbuilding industry engagement.
- (b) In support of development of sovereign Australian shipbuilding capability, demonstrate how they will enhance the existing domestic shipbuilding industry, workforce and supply chain and maximise the investments the Government has already made in the capability of the industry.

1.24 Coalition Senators note that Defence's support to SMEs is significant and ongoing. SMEs are a critical part of Australia's defence industry, able to take advantage of the many opportunities to obtain contracts in the supply chains of prime contractors or to partner with larger defence companies.

1.25 Coalition Senators recognise that businesses cannot always secure opportunities alone, especially where they have not been exposed to the defence market or understand the broad opportunities that are available. This is why the

2 Senate Economics References Committee, *Future of Australia's naval shipbuilding industry – Final report*, June 2018, Chair's report, p. xi.

Australian Government established the Centre for Defence Industry Capability (CDIC) as the single entry point to support and grow Australia's defence industry.

1.26 The CDIC provides a streamlined entry point for SMEs already in the sector and those seeking to engage with Defence and the defence market, and works with SMEs and Defence to help build a world class, globally competitive Australian industry. The CDIC's primary focus is to build the Australian supply chains critical at the beginning of projects and transitioning greater work to Australia in major capital equipment programs, to maximise Australian industry involvement and benefits to Defence and industry.

1.27 Coalition Senators note that the Government has also established the Defence Innovation Hub and the Next Generation Technologies Fund to support SMEs and lower barriers to doing business and innovating with Defence. Together, these initiatives were established to provide industry with improved transparency of Defence's investment plans, enhance Defence's identification and management of sovereign industrial capabilities, and ultimately improve the delivery of capability to Defence.

1.28 Coalition Senators note that the Government has also released a number of other policies and programs which support SME engagement with Defence:

- (a) The Government has strengthened the Australian Industry Capability (AIC) Program to ensure that there is maximisation of the inclusion and evidence of having positively engaged Australian SMEs. The requirement calls upon tenderers to present and demonstrate how they will undertake contract development initiatives if successful and lock in work packages with Australian industry. Under the strengthened AIC Program, SMEs will benefit from a requirement for Primes to facilitate the transfer of skills, technology and knowledge to Australia. This supports an enduring industrial base through securing Australian industry access to intellectual property rights. The AIC program further supports SMEs through creating international supply chain opportunities to further leverage Defence's investment in Australian industry through acquisition and sustainment opportunities.
- (b) The Government has released the Defence Industrial Capability Plan to outline Australia's long-term vision and objectives for Australia's defence industry and provide detail on the opportunities and support available to our SMEs.
- (c) The Government released the Defence Export Strategy on 29 January 2018 to drive Australian defence industry exports in order to establish a robust defence industry to underpin ADF capability needs.
- (d) The Government will also release the Defence Skilling and STEM Strategy in 2018 to help Australian defence industry, particularly SMEs, to have a workforce with the right skills to meet future capability requirements.

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- (e) The forthcoming Defence Industry Participation Policy will provide a policy framework for maximising Australian and local industry involvement across Defence materiel and non-materiel Defence procurement of \$4 million and above.

1.29 Coalition Senators believe that the Commonwealth Government has established the appropriate framework to ensure Australian industry involvement by small, medium and large companies in major defence projects.

Infrastructure upgrades

1.30 Coalition Senators believe that to support a sustainable sovereign shipbuilding industry, infrastructure upgrades are required at the two Australian Naval Shipbuilding hubs, Osborne in South Australia, and Henderson in Western Australia.

1.31 The Naval Shipbuilding Plan highlights two Offshore Patrol Vessels, nine Future Frigates, and 12 Future Submarines will be built at the Osborne Naval Shipyard.

1.32 ANI entered into a contract valued at over \$500 million in October 2017 with Lendlease to be the managing contractor for the construction of the Osborne South Naval Shipyard.

1.33 The Commonwealth Government has also purchased the Techport Common User Facility from the South Australian Government as a cost of \$230 million.

1.34 ANI have advised these projects will create up to 600 jobs.

1.35 Coalition Senators understand the Commonwealth Government and Western Australian State Governments are working together to identify infrastructure gaps at the Henderson Marine Complex. The Common User Facility is owned by the Western Australian State Government while other companies based in the Australian Marine Complex are situated on privately owned land.

Workforce planning

1.36 Coalition Senators note the Commonwealth Government has established the Naval Shipbuilding College, headquartered in Adelaide. The NSC will operate as a hub-and-spoke model that enable students to undertake courses through NSC approved training organisations or higher education providers across Australia.

1.37 The vast majority of the people working on naval projects will be Australian. In order to mitigate risk and learn from countries more experienced in ship design, it is essential that experts are involved from the start as the Naval Shipbuilding Plan makes clear. Kim Gillis, Deputy Secretary of the Capability Acquisition and Sustainment Group, stated that some foreign workers will be brought in for a short period of time to:

...transfer knowledge to Australian supervisors and managers and then return home.³

3 Senate foreign Affairs, Defence and Trade Legislation Committee, *Committee Hansard* (Budget Estimates), 30 May 2018, p. 40.

1.38 The Chair's Report notes that "The decision to split the [OPV's] construction sites has attracted criticism that the decision was not made in the national interest".⁴ Coalition Senators note that the decision to split the build of Offshore Patrol Vessels because it is crucial to maintain the skills of the workers at Osborne ahead of Future Frigates in 2020 and Future Submarines in 2022-23.

1.39 Coalition Senators note the importance of workforce growth and development in continuous naval shipbuilding. Having a consistent shipbuilding workforce means the government and industry have to spend less on skilling workers and can get more productivity and efficiency as a result.

1.40 Coalition Senators understand the Naval Shipbuilding College will consult with the Naval Shipbuilding Industry Reference Committee to further inform workforce requirements for naval shipbuilding and sustainment.

1.41 Coalition Senators observe steps the Commonwealth Government are taking to retain, retrain and redeploy workers. Measures include:

- (a) A targeted retention strategy has been instigated to create up to 200 positions within ASC Submarines for current shipbuilders working on the Air Warfare Destroyer Program. This includes up to 100 workers supporting the Future Submarine Program Office and filling vacant positions in the Collins Class sustainment workforce.
- (b) Up to 100 scholarships will be offered to workers to upskill in areas such as operations management, computer-aided design and engineering.
- (c) In addition, Australian Naval Infrastructure has advised up to 600 additional jobs will be created through the Osborne South shipyard redevelopment.

Future Submarine Program

1.42 Coalition Senators refute the claim in the Chair's report that "the total cost of the continuous shipbuilding program could also jump from \$89 billion dollars to around \$200 billion in out-turned dollars."⁵ The 2016 Integrated Investment Program states that the acquisition cost of the Future Submarine capability is estimated at greater than \$50 billion out turned. As has been explained, the current estimate is \$50 billion in constant dollars. There has been no cost blowout and the figures quoted by Defence are consistent.

1.43 Coalition Senators believe the Strategic Partnership Agreement is a critical document for our Future Submarine Program. It's essential the Government negotiates the best possible outcome for our nation. Getting this right now will ensure the program runs as well as possible and avoids issues in the future.

4 Senate Economics References Committee, *Future of Australia's naval shipbuilding industry – Final report*, June 2018, Chair's report, p. 22

5 Senate Economics References Committee, *Future of Australia's naval shipbuilding industry – Final report*, June 2018, Chair's report, p. 13.

1.44 Coalition Senators also note the Department of Defence has provided responses to the committee relating to concerns raised regarding the capability of the Future Submarine, including the use of pump-jet propulsion.

Current submarines

1.45 Coalition Senators note that existing submarine infrastructure in Australia to support sustainment of the Collins Class fleet is currently facilitated through two shipyards; ASC West at Henderson in Western Australia, and ASC North at Osborne in South Australia.

1.46 Coalition Senators further note that decisions about the location of Collins Class and Future Submarine sustainment will not be required for some time to come and would be anticipated to be considered as part of longer-term capability management planning

Offshore Patrol Vessel Program

1.47 Coalition Senators note that Defence has contracted Luerksen Australia for the design and build of 12 new Offshore Patrol Vessels.

1.48 The Offshore Patrol Vessels will be constructed in Australia, from Australian steel, and create 400 direct and up to 600 indirect jobs. Government has advised that the project is on time, with a fixed budget. Construction of the first vessel will start this year.

1.49 Coalition Senators note that the Government required the successful designer of the OPVs to partner with an Australian shipbuilder. As part of the OPV tender, designers had to team up with an Australian shipbuilder. In the case of the successful tender, Luerksen teamed up with Forgas, a subsidiary of Cimtec.

1.50 In relation to the claim that Defence chose the winning designer without having any idea about sustainment costs, Mr Kim Gillis, Deputy Secretary of the Capability Acquisition and Sustainment Group made the following statement to Senate Estimates in May:

The Government was provided with the sustainment data for the Offshore Patrol Vessels based on historical usage and designer forecasts. This is standard shipbuilding practice. Defence provided government with an indicative lifecycle cost for the Offshore Patrol Vessels across a 20-year lifecycle. This indicative cost was based on previous programs, historical usage and upkeep data provided by the tenderers. This is typical for shipbuilding projects at this stage.⁶

Australian National Audit Office (ANAO) report

1.51 Coalition Senators believe establishing an Australian shipbuilding and submarine industry is a significant nation building project, and accordingly carries risk. But Coalition Senators note the risks are manageable.

6 Senate Foreign Affairs, Defence and Trade Legislation Committee, *Proof Committee Hansard* (Budget Estimates), 29 May 2018, p. 7

1.52 The alternative to an Australian shipbuilding industry would be to send the \$200 billion of taxpayers' money we are spending on the largest build-up of our military capability in our peacetime history overseas, creating jobs and advanced manufacturing in other people's economies.

1.53 Coalition Senators note the Government's advice that it is on schedule, on budget and is creating the jobs and investment we expected while delivering the capability the Navy needs.

1.54 Coalition Senators note that majority report of this report has ignored the ANAO report's positive findings that:

- (a) Defence continues to work towards effective planning and mobilisation to deliver the Australian Government's Naval Shipbuilding Plan
- (b) Defence has identified the key elements for a successful continuous shipbuilding enterprise
- (c) Defence has identified the key elements for a successful continuous naval construction programs, noting that each program is in the early stages
- (d) Defence is currently on schedule to deliver the OPVs, Future Frigates and Future Submarine Program.

Naval Shipbuilding College

1.55 Coalition Senators note that the Request for Proposals to establish and run the Naval Shipbuilding College closed on 27 October 2017. Following Tender Evaluation, contract negotiations were to be conducted over December 2017 and January 2018.

1.56 There were changes to the timings of this process due to the concerns raised by the Australian Skills Quality Authority with TAFE South Australia. In light of the concerns raised, the Commonwealth and the tenderer needed to understand the ability of TAFE South Australia to provide courses for the College.

1.57 By April 2018 the significant efforts undertaken by TAFE South Australia to resolve the issues of concern to ASQA provided the Australian Government, and the Naval Shipbuilding College, with greater confidence in TAFE South Australia's potential contribution to the naval shipbuilding enterprise.

1.58 Coalition Senators note the NSC original contract value is unchanged and remains \$62 million – as signed in March 2018. Defence, in reviewing the information from both Requests for Information and Tendered Information, chose to contract a work scope that resulted in a contracted amount higher than initially estimated in March 2017.

National Shipbuilding Advisory Board

1.59 Coalition Senators believe that concerns expressed in the chair's report about the cost of the NSAB (p. xii) are misguided. The Government is dealing with multi-billion-dollar contracts that demand the best advice possible. The NSAB forms a

crucial part of the Government's plan to prevent the delays and operational issues that have occurred on previous projects.

1.60 Coalition Senators note the Advisory Board members are subject matter experts with unprecedented credentials, and real-world experience running complex Defence projects. The Advisory Board has more than a century of collective submarine and shipbuilding design and construction expertise.

1.61 Coalition Senators do not believe there is cause to be unclear on the role of the board, as is stated in the Chair's report (p. xii). The board's role is to provide independent, expert advice directly to Ministers.

Recommendations

1.62 Coalition Senators believe updates on defence projects should be provided to both the Joint Standing Committee on Foreign Affairs, Defence and Trade and the Senate Legislation Committee on Foreign Affairs, Defence and Trade. Coalition Senators further note the Defence Sub-Committee is inquiring into the benefits and risks of a Bipartisan Australian Defence Agreement, as a basis of planning for, and funding of, Australian Defence capability. The findings of this inquiry should be taken into account when considering the response to this recommendation.

1.63 Similarly, updates relating to defence and shipbuilding infrastructure should also be provided to the Parliamentary Standing Committee on Public Works.

1.64 Coalition Senators note the Department of Defence have made clear the sustainment of the Collins Class Submarine is the subject of long-term capability planning and there are no plans to move the sustainment location.

1.65 Coalition Senators agree-in-principle with recommendation five.

1.66 Whilst noting the Commonwealth Government has already developed a framework to ensure Australian industry involvement in major defence contracts is maximised, Coalition Senators agree-in-principle with recommendation number seven and believe definitions could be further tightened.

Senator Jane Hume
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