

The Senate

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Foreign Affairs, Defence and Trade  
Legislation Committee

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Defence Amendment (Sovereign Naval  
Shipbuilding) Bill 2018

February 2019

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# Chapter 1

## Introduction

### Referral of the Inquiry

1.1 On 28 June 2018, pursuant to the Senate Selection of Bills Committee report, the Defence Amendment (Sovereign Naval Shipbuilding) Bill 2018 (the Bill) was referred to the Senate Foreign Affairs, Defence and Trade Legislation Committee (the Committee) for inquiry and report by 15 October 2018.<sup>1</sup> On 15 October 2018, the Senate agreed to extend the reporting date to 5 December 2018.<sup>2</sup> On 26 November 2018, the Senate agreed to a further extension until the last sitting day in the first sitting week in February 2019.<sup>3</sup>

1.2 The Selection of Bills Committee advised that the reasons for referral were to:  
Examine the national security and economic benefits that flow from enhancing Australia's sovereign naval shipbuilding capability.<sup>4</sup>

### Conduct of the Inquiry

1.3 Details of the Committee's Inquiry, including links to the Bill and associated documents, were placed on the Committee's webpage and submissions were invited by 10 August 2018.

1.4 The Committee directly contacted a number of relevant organisations to notify them of the Inquiry and invite submissions. Submissions received by the Committee are listed at Appendix 1.

1.5 The Committee held two public hearings in Canberra: on 8 November and 29 November 2018. A list of witnesses who gave evidence is available at Appendix 3.

### Purpose of the Bill

1.6 The Bill is a private senator's bill introduced into the Senate by Senator Rex Patrick on 9 May 2018.<sup>5</sup>

1.7 The Bill seeks to amend the *Defence Act 1903* (the Defence Act) to prohibit the Commonwealth, other than in time of war or during a time of defence emergency, from entering into an agreement with an entity for the building of a naval vessel exceeding 30 metres in length, unless it is built in Australia by a high performing Australian owned and controlled company which is capable of delivering ongoing shipbuilding and a program of future upgrades.

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1 *Journals of the Senate*, No. 105—28 June 2018, pp. 3357-3359.

2 *Journals of the Senate*, No. 122—15 October 2018, pp. 3894-3895.

3 *Journals of the Senate*, No. 130—26 November 2018, p. 4230.

4 Senate Standing Committee for the Selection of Bills, *Report No. 7 of 2018*, 28 June 2018, Appendix 2.

5 *Journals of the Senate*, No. 96—9 May 2018, p. 3072.

1.8 In his second reading speech on 9 May 2018, Senator Patrick noted his support of the Federal Government's continuous naval shipbuilding program,<sup>6</sup> but advocated that a different approach to procurement practices was necessary in order to meet national security interests and to maximise the economic benefits of the program to Australia.<sup>7</sup>

1.9 Senator Patrick set out a number of examples of recent naval and maritime construction programs which demonstrated a shift away from using local shipbuilders, including replacement supply ships, the Future Submarine program and the new icebreakers which are being built by foreign entities. He also cited the Future Frigate program where the government had shortlisted three foreign ship designers to tender for the job.<sup>8</sup> Senator Patrick advised the Senate that:

...the Government's approach is to see foreign companies take the lead in these nationally significant programs; foreign companies that will control the programs, foreign companies that will install their own management teams in Adelaide and elsewhere, foreign companies that will control the intellectual property and determine our shipyards' strategic direction.<sup>9</sup>

1.10 The Explanatory Memorandum (EM) highlighted some of the asserted reasons why the engagement of Australian companies to build Australia's future naval vessels is important:

- It will ensure the know-how of these programs is transferred to an Australian-controlled company, not to a subsidiary company of a foreign entity.
- Australian shipbuilders will be able to assure export customers that they have the confidence of their own Navy.
- It will ensure that foreign entities will not have veto power over any export opportunities Australian naval shipbuilders wish to engage in.
- There will be reduced exposure to foreign corporate risk in relation to naval construction projects of great importance to national security.
- It will ensure the shipbuilding workforce can be better managed.

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6 The then Prime Minister, the Hon Malcolm Turnbull MP, and the then Minister for Defence Industry, the Hon Christopher Pyne MP, outlined the government's commitment to implement continuous naval shipbuilding as soon as practicable in the 'Foreword' to the *Naval Shipbuilding Plan*, released in May 2017, pp. 4-5.

7 *Senate Hansard*, 9 May 2018, p. 2751.

8 The government subsequently announced on 29 June 2018 that British company BAE Systems would design the future frigates and they would be built by ASC Shipbuilding at the Osborne Naval Shipyard in South Australia, operating as a subsidiary of BAE Systems during the build. See Joint Media Release, Prime Minister, Minister for Defence Industry, Minister for Defence and Minister for Finance—*The Hunter Class—defending Australia and security our shipbuilding sovereignty*, 29 June 2018.

9 *Senate Hansard*, 9 May 2018, p. 2752.



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- Profits from Australian naval construction will be made in Australia by Australian shipbuilders.<sup>10</sup>

## Summary of the Bill

1.11 Item 1 of this Bill proposes to insert Part 1XE Sovereign naval shipbuilding into the Defence Act. As noted above, the Bill will amend the Defence Act to require that new vessels to be built for the Commonwealth and intended for use by the Royal Australian Navy, except in times of defence emergency or in time of war, be built in Australia by a well-established, high performance Australian owned and controlled shipbuilder.

1.12 The Bill will apply to vessels of over 30 metres in length which would include all major Navy vessels including patrol boats similar to the Pacific class patrol boats, offshore patrol vessels, corvettes, frigates, destroyers, cruisers, aircraft carriers, amphibious ships, submarines, supply ships, and auxiliaries. Smaller vessels such as launches, rigid-hulled inflatable boats, lifeboats, small landing craft and barges are excluded.<sup>11</sup>

1.13 The Bill also requires that any such agreement must provide for the provision, grant or conferral by the entity to the Commonwealth of intellectual property rights relating to the vessel for the future maintenance, repair or modification of the vessel.<sup>12</sup>

1.14 Item 2 proposes that new Section 117AJ, as inserted by the Schedule, 'will apply in relation to agreements entered into on or after 9 May 2018, the day after the introduction into Parliament of the 2018-19 Commonwealth Budget',<sup>13</sup> thereby ensuring that:

...all future naval construction programs that are currently under consideration by the Commonwealth, and likely to be subject to agreements in the period following the introduction of the 2018-19 Budget, are subject to the provisions of this Bill.<sup>14</sup>

1.15 Senator Patrick asserted to the Senate that the effect of the provisions in the Bill would provide unquestionable benefits in terms of national security and economic development and that:

While the Bill will allow overseas procurement of naval vessels in time of a defence emergency or war, it will provide an unambiguous legislative direction that Australian naval construction must take place in Australia by Australian companies with the consequent benefits for our defence industrial base and long-term strategic self-reliance.<sup>15</sup>

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10 EM, [p. 2].

11 EM, [p.4].

12 See Defence Amendment (Sovereign Naval Shipbuilding) Bill 2018; EM, [pp. 3-4].

13 EM, [p. 5].

14 EM, [p. 5].

15 *Senate Hansard*, 9 May 2018, p. 2753.

## Consideration by other committees

1.16 The Committee notes that the Standing Committee for the Scrutiny of Bills made no comment in relation to the Bill.<sup>16</sup>

1.17 The Committee also notes that the Parliamentary Joint Committee on Human Rights considered the Bill and determined that it did not raise human rights concerns.<sup>17</sup>

## Other related inquiries

### *Senate Economics References Committee*

1.18 On 28 June 2018, the Senate Economics References Committee tabled its report titled *Future of Australia's naval shipbuilding industry*. This was the final report of a wide ranging inquiry conducted over the course of two Parliaments which examined the sustainability of Australia's naval shipbuilding industry. The Inquiry was originally referred to the Senate Economics References Committee on 25 June 2014, during the 44<sup>th</sup> Parliament, and was subsequently re-referred to that committee on 11 October 2016 following the 2016 federal election. In re-referring the Inquiry, the Senate agreed to amend the terms of reference to reflect advances in the Inquiry.<sup>18</sup> The final report considered a range of issues, including national long term planning, workforce planning strategy and support available to small and medium sized enterprises. Also forming an important part of the committee's final report was consideration of an Australian naval shipbuilding sovereign capability.<sup>19</sup>

1.19 During the course of the Inquiry, the Senate Economics References Committee tabled three substantial interim reports covering specific aspects of Australia's naval shipbuilding industry, including:

- Part I—the tender process for the Navy's new supply ships (tabled 27 August 2014);
- Part II—the future submarines (tabled 17 November 2014); and
- Part III—long-term planning (tabled 1 July 2015).

1.20 At the time of reporting, the government response to the Economics References Committee Inquiry had not been received.

### *Joint Standing Committee on Treaties*

1.21 The Joint Standing Committee on Treaties (JSCOT) examined the two then proposed treaty actions with the French Republic which support Australia's Future Submarine Program. The JSCOT reported its findings in *Report 169—Future*

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16 Standing Committee for the Scrutiny of Bills, *Scrutiny Digest 6 of 2018*, 20 June 2018, p. 54.

17 Parliamentary Joint Committee on Human Rights, *Report 5 of 2018*, 19 June 2018, p. 53.

18 Senate Economics References Committee, *Future of Australia's naval shipbuilding industry – Final report*, June 2018, pp. 1-2.

19 See Senate Economics References Committee, Chapter 5, 'An Australian naval Shipbuilding sovereign capability', pp. 99-123.

*Submarine Program–France, Classified Information Exchange–France*, which was sent to the Speaker on 13 April 2017, pursuant to standing order 247; and presented in the House of Representatives on 9 May 2017.

1.22 This report reviewed the following treaty actions:

- *the Framework Agreement between the Government of Australia and the Government of the French Republic concerning Cooperation on the Future Submarine Program* (Adelaide, 20 December 2016); and
- *the Agreement between the Government of Australia and the Government of the French Republic regarding the Exchange and Reciprocal Protection of Classified Information* (Paris, 7 December 2016).

1.23 The first treaty action listed above provides a framework for cooperation on a range of matters, including in particular, some areas relevant to issues covered in the Bill, such as

- the transfer, ownership and use of technology and information;
- asserting Australia's sovereign operation and security of supply;
- local industry engagement and cooperation; and
- research and technology development.<sup>20</sup>

1.24 While the JSCOT supported both treaty actions, it did make a number of recommendations, including on issues regarding sovereign capability in regard to the transfer of necessary intellectual property and its ongoing management, and contractual arrangements to ensure maximum opportunity for Australian companies to bid for work.<sup>21</sup>

1.25 The government brought both agreements as listed above into force on 5 and 4 May 2017 respectively.<sup>22</sup>

1.26 The government response to the JSCOT report was tabled on 20 November 2017 and agreed with the recommendation relating to the transfer of intellectual property; and agreed in-principle with the recommendation regarding the opportunity for Australian companies to bid for work.<sup>23</sup>

### **Recommendation 1**

***2.152 The Committee recommends that the Department of Defence ensures that the full lessons from the design, acquisition and sustainment***

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20 Joint Standing Committee on Treaties (JSCOT), *Report 169 Future Submarine Program France, Classified Information Exchange – France*, April 2017, p. iii.

21 JSCOT, *Report 169 – Future Submarine Program – France, Classified Information Exchange – France*, April 2017, pp. xvii-xviii.

22 Australian Government response to the JSCOT: *Report 169 Future Submarine Program – France, Classified Information Exchange – France*, November 2017, [pp. 3-4].

23 Australian Government response to the JSCOT: *Report 169 Future Submarine Program – France, Classified Information Exchange – France*, November 2017, [pp. 2-3].

*of the Collins Class Submarine are learned, in particular, to ensure that the intellectual property is appropriately managed to maintain Australia's sovereign operation of the Future Submarine. The Committee requests that the Department of Defence provides a report back to the Committee during the 2018 Winter Sittings of the Parliament on the progress of obtaining the necessary intellectual property and its ongoing management, and in relation to the contractual and other arrangements that will secure maximal opportunities for Australian industry involvement.*

#### **Government response**

The Government agrees with this recommendation.

The Government acknowledges that a lack of adequate intellectual property rights impaired the Commonwealth's ability to operate and sustain the Collins Class submarines as they entered service in accordance with Australia's requirements, resulting in delays, increased costs and restricted improvement and support of the Collins submarine capability.

The Future Submarine Program's approach to intellectual property has been predominantly driven by the lessons learnt from the Collins Submarine Program. From the outset of the Competitive Evaluation Process, a prime objective of the Future Submarine Program has been to establish a sovereign capability to operate and sustain the Future Submarine.

In the Framework Agreement with France and under the Design and Mobilisation Contract between the Commonwealth and DCNS, appropriate intellectual property rights to achieve this objective have been established.

The Department of Defence will provide a report to the Joint Standing Committee on Treaties during the 2018 Winter Sittings of the Parliament on the progress of obtaining the necessary intellectual property and its ongoing management.

Any report to Parliament will need to take into account commercial sensitivities with the transfer of technology to Australia with due regard given to the relevant commercial and public interest immunity considerations.

#### **Recommendation 2**

*2.153 In reference to Article 13(2)(b), the Committee recommends the Government seeks to ensure that the further detailed agreements and arrangements have the effect of allowing Australian companies to bid for work in all phases of the Future Submarine Program on a preferred basis, all other things being equal.*

#### **Government response**

The Government agrees in-principle with this recommendation. One of the Government's objectives is to ensure that Australian industry involvement is maximised to achieve the sovereign capacity to build, operate and sustain a regionally superior fleet of Future Submarines in Australia consistent with relevant capability, cost, and schedule considerations.

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The Commonwealth retains the final decision on the selection of companies involved in the Future Submarine Program, having taken account of sovereignty objectives and capability, cost and schedule.<sup>24</sup>

### ***Senate estimates hearings***

1.27 This Committee has had an ongoing interest in naval shipbuilding issues, including sovereign capability, over a number of years and has discussed these issues during Senate estimates hearings with the Minister for Defence and Defence officials. In addition, the Senate Finance and Public Administration Legislation Committee routinely examines ASC Pty Ltd at Senate estimates hearings on a range of matters relating to naval shipbuilding.

### **Existing policy framework**

1.28 Most submissions to the Inquiry discussed broad issues and either did not address or did not confine their comments to the provisions of the Bill. In order to understand the background and context underpinning what is intended by the Bill, the next section details the existing policy and procurement frameworks currently in place to deliver a sovereign naval shipbuilding capability. These documents outline both the government's recognition of the strategic importance of a sovereign defence industry as well as detailing plans for implementation.

1.29 On 25 February 2016 the government released three policy papers which outlined its broad direction and set out the long term plans for Australia's defence, outlined all elements of the government's Defence investment program, and examined the future critical defence-industry partnership: the *2016 Defence White Paper*, the *2016 Integrated Investment Program* and the *2016 Defence Industry Policy Statement*. Building on these broad policy statements, the government subsequently released key planning documents, including the *2017 Naval Shipbuilding Plan* and the *2018 Defence Industrial Capability Plan*.

### ***2016 Defence White Paper***

1.30 The *2016 Defence White Paper* states the importance of a sustainable Australian naval shipbuilding industry to Australia's defence capability in order to manage future strategic challenges. It affirms the government's commitment to a permanent naval shipbuilding industry and need for a long-term plan to ensure that Australia retains a sovereign shipbuilding industry.<sup>25</sup> The White Paper outlines the strategic importance of developing a strong and sustainable naval shipbuilding industry:

The Government's strategy is centred on a long-term continuous build of surface warships in Australia, involving construction of our future frigates and offshore patrol vessels in Australia. A continuous build of our major warships and minor naval vessels will see Defence better manage the

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24 Australian Government response to the JSCOT: *Report 169 Future Submarine Program – France, Classified Information Exchange – France*, November 2017, [pp. 2-3].

25 *Defence White Paper 2016*, p. 113.

demand for naval vessels to ensure continuous construction over the long term. This will end the boom-bust cycle for shipbuilding, lower the costs of acquiring naval vessels and provide a long-term, sustainable plan for the shipbuilding industry.

...

This strategy will transform Australia's naval shipbuilding industry, generate significant economic growth, sustain Australian jobs over the coming decades and assure the long-term future of this key Australian defence industry.

...

The Government is committed to delivering this long-term strategy and is prepared to invest in the skills and knowledge base of the Australian naval shipbuilding industry to help build a strong and sustainable naval shipbuilding industry.<sup>26</sup>

### ***2016 Defence Industry Policy Statement***

1.31 The *2016 Defence Industry Policy Statement* describes the importance of the Defence and industry partnership and states that Australia's defence industry is a critical partner in Defence's success in meeting future challenges across capabilities, including shipbuilding:

Australia's defence industry is essential to the operations of the Australian Defence Force (ADF) and to the capability we need to protect Australia and our national interests.

...

In the next two decades, Australia will embark on one of the most extensive and ambitious shipbuilding programs anywhere in the world to modernise the Royal Australian Navy. On 4 August 2015, the Government announced continuous shipbuilding programs for major surface combatants and minor war vessels.

A robust partnership between Defence and industry and a highly skilled Australian workforce will be critical if we are to deliver shipbuilding and submarine programs of such national significance.<sup>27</sup>

1.32 The *2016 Defence Industry Policy Statement*, for the first time, formally recognises the role of Australian defence industry as a discrete Fundamental Input to Capability.<sup>28</sup> This recognition therefore requires Defence to consider the industrial capability and capacity of Australian businesses to deliver defence capability. Naval

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26 *Defence White Paper 2016*, pp. 113-114.

27 *2016 Defence Industry Policy Statement*, pp. 5-6.

28 Until this time the Fundamental Inputs to Capability included: personnel, organisation, collective training, major systems, supplies, facilities and training areas, support, and command and management. See *2016 Defence Industry Policy Statement*, p. 19.

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shipbuilding was noted as an example of an industry which is a Fundamental Input to Capability.<sup>29</sup>

1.33 The *2016 Defence Industry Policy Statement* also addresses the importance of securing Australian sovereign industrial capabilities. The statement recognises that some capabilities are of such fundamental importance to Australian defence missions that they must be developed and supported by Australian industry, and therefore 'it is critical that the industry base associated with these capabilities is maintained and supported by Defence as sovereign industrial capabilities'.<sup>30</sup>

1.34 In order to identify and manage those sovereign industrial capabilities it was noted that a framework would be developed to assess industrial elements that support capabilities.<sup>31</sup>

### ***Naval Shipbuilding Plan***

1.35 On 16 May 2017 the government released the *Naval Shipbuilding Plan* which details how the government will deliver its commitment to build a 'strong, sustainable and innovative Australian naval shipbuilding industry'.<sup>32</sup> The plan sets out the key future naval capabilities, acquisition and sustainment to meet Australia's strategic requirements.<sup>33</sup> It also identifies four key enablers required to implement the plan and deliver the essential naval capabilities, which are:

- modern, innovative and secure naval shipbuilding and sustainment infrastructure;
- a highly capable, productive and skilled naval shipbuilding and sustainment workforce;
- a motivated, innovative, cost-competitive and sustainable Australian industrial base, underpinned initially by experienced international ship designers and builders who transfer these attributes to Australian industry; and
- a national approach to delivering the Naval Shipbuilding Plan.<sup>34</sup>

1.36 The plan notes that:

...these four key enablers will see Australia develop the sovereign Australian capability to deliver affordable and achievable naval shipbuilding and sustainment through an Australian industrial base that is reformed, secure, productive and cost-competitive.<sup>35</sup>

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29 *2016 Defence Industry Policy Statement*, pp. 19-20.

30 *2016 Defence Industry Policy Statement*, p. 23.

31 *2016 Defence Industry Policy Statement*, p. 23.

32 *Naval Shipbuilding Plan*, Foreword, p. 4.

33 *Naval Shipbuilding Plan*, pp. 21-45.

34 *Naval Shipbuilding Plan*, p. 12.

35 *Naval Shipbuilding Plan*, p. 13.

...

By constructing the Navy's future capabilities in Australia while also strengthening the nation's advanced manufacturing industrial base, the Government is delivering on its unwavering commitment to both national security and economic prosperity.<sup>36</sup>

...

The Australian Industry Capability Program and Defence Industrial Capability Plan, coupled with this Naval Shipbuilding Plan, complement each other to provide the foundation to plan, guide and develop the sovereign shipbuilding industry we need.<sup>37</sup>

1.37 Mr Marc Ablong, Acting Deputy Secretary Strategic Policy and Intelligence, Department of Defence, advised the Committee at the Additional Estimates hearing on 28 February 2018 on the definition of 'sovereign' in terms of the sovereign Australian shipbuilding industry as referred to in the Naval Shipbuilding Plan:

It was the ability...to be able to design, construct, sustain and dispose of major surface combatants and minor naval vessels. In the circumstances of submarines, it was the ability to construct, sustain and dispose of submarines. Now obviously the individual elements of each of those projects that need to be sovereign or not will depend upon a number of circumstances, including the economic value associated with trying to do something here in Australia that we might not have done before and those things that are critical in a supply chain for our ability to access in times of in extremis. There are a number of those elements.<sup>38</sup>

### ***2018 Defence Industrial Capability Plan***

1.38 The *2018 Defence Industrial Capability Plan* (DICP) was released on 23 April 2018 and sets out the government's approach to achieving a long-term sovereign defence industry. This is Australia's first defence industry plan and outlines the strategy to grow a sovereign defence industry base, including priorities and the resourcing and support needed to achieve this objective.

1.39 The Ministers' foreword to the DICP advises:

Our defence industry is a critical national strategic asset for Australia. We must build a strong, sovereign naval shipbuilding and broader defence industry to manage strategic risk, defend our nation and grow our economy.<sup>39</sup>

1.40 The DICP introduces the Sovereign Industrial Capability Assessment Framework, includes the initial list of the Sovereign Industrial Capability Priorities, summarises the Integrated Investment Program and notes future investment

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36 *Naval Shipbuilding Plan*, p. 23.

37 *Naval Shipbuilding Plan*, p. 85.

38 *Committee Hansard*, 28 February 2018, p. 81.

39 *2018 Defence Industrial Capability Plan*, p. 7.



opportunities. The list of capability priorities are those identified as critical to the Defence mission and includes the Continuous Shipbuilding Program (including the rolling submarine acquisition).

1.41 The DICP provides clarity on the key terminology. Defence sovereignty is defined as:

...the ability to independently employ Defence capability or force when and where required to produce the desired military effect. It does not automatically mean a defence capability has to be designed, developed or maintained in Australia, but it does mean Defence has to have access to a functioning defence capability (whether radars or tanks) as and when required.<sup>40</sup>

1.42 Australian defence industrial capability is defined as:

...the capability provided by Australian industry that contributes directly to the delivery of a defence capability. It becomes a sovereign industrial capability when Australia assesses it is strategically critical and must therefore have access to, or control over, the essential skills, technology, intellectual property, financial resources and infrastructure as and when required.<sup>41</sup>

1.43 The DICP also provides a definition of Australian defence industry as consisting of:

...businesses with an Australian Business Number and Australian-based industrial capability (such as [an] 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.<sup>42</sup>

1.44 In launching the DICP, the then Minister for Defence Industry, the Hon Christopher Pyne MP, noted that the DICP 'restates the Government's policy of maximising the involvement of competitive Australian companies in the acquisition, operation, and sustainment of defence capability'. The Minister emphasised that:

Being a serious contributor in Australian defence industry means having Australian-based industrial capability.

It means company and board presence, infrastructure, and a skills base that can complete value-added work here in Australia, employing Australian workers.<sup>43</sup>

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40 *2018 Defence Industrial Capability Plan*, p. 17.

41 *2018 Defence Industrial Capability Plan*, p. 17.

42 *2018 Defence Industrial Capability Plan*, p. 11.

43 The Hon Christopher Pyne MP, 'Speech to the Australian Strategic Policy Institute', 23 April 2018.

### ***Government initiatives supporting Australian defence industry***

1.45 The policy documents and plans outlined above set out the government's broad defence strategic direction and commitment to grow an Australian sovereign defence industry base to support future capabilities, including naval shipbuilding. Some of the specific key initiatives established or planned under the framework which will develop and support Australian industry are set out below.

#### *Centre for Defence Industry Capability*

1.46 The establishment of the Centre for Defence Industry Capability (CDIC) was announced in the *2016 Defence Industry Policy Statement* as an initiative to re-set the Defence-industry partnership, and was launched in December 2016. Supported by AusIndustry's outreach network, the CDIC's purpose is to provide leadership for the sector and help build the capability and capacity of Australian industry to support Defence. The CDIC brings together the private sector, Defence and AusIndustry to deliver initiatives to facilitate innovation, business competitiveness and exports, and fund defence industry development.<sup>44</sup>

#### *Defence Innovation Hub*

1.47 Also announced in the *2016 Defence Industry Policy Statement* was the establishment of the Defence Innovation Hub (DIH) as a virtual organisation to manage a portfolio of Defence innovation investments.<sup>45</sup> Launched by the then Minister for Defence Industry, in December 2016, the initiative will invest around \$640 million over the decade to mature and further develop technologies that have moved from the early science stages into the engineering and development stages of the innovation process. The DIH will also facilitate innovation activities from initial concept, through to prototyping and integrated testing.<sup>46</sup> The *2016 Defence Industry Policy Statement* sets out the Hub's responsibilities as:

- clearly articulating Defence capability needs and challenges;
- requesting proposals from industry and academia for innovative capabilities;
- providing the Investment Committee with recommendations on funding priorities and innovation activities;
- building collaborative programs with Defence stakeholders and contract management for innovation activities, including supporting the testing and assessment of innovation projects; and
- championing innovation across Defence.

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44 *2016 Defence Industry Policy Statement*, pp. 15-16; see also <https://www.business.gov.au/Centre-for-Defence-Industry-Capability/About-the-CDIC> (accessed 27 July 2018).

45 *2016 Defence Industry Policy Statement*, p. 34.

46 See <https://www.business.gov.au/centre-for-defence-industry-capability/defence-innovation/defence-innovation-hub> (accessed 27 July 2018).

The virtual Hub will assist Australian companies, and academic and research organisations to assess whether innovations have a Defence application and will provide access to funding to collaboratively mature those ideas. It will be informed by Defence capability priorities identified in the force design process.<sup>47</sup>

#### *Australian Industry Capability Program*

1.48 The Australian Industry Capability (AIC) Program has been operating since 2008 to maximise opportunities for Australian industry to compete in Defence procurements on a best value basis. Under the initial version of the program, all bids for Defence projects valued above \$50 million or projects with Priority Industry Capability implications were required to include an AIC plan to consider participation by Australian industry on a value for money basis. The successful tenderer's AIC plan was then included in the contract as an enforceable provision. For procurements below \$50 million there was no requirement to provide a formal AIC plan; however bids were required to maximise cost-effective Australian industry participation and details of local work were required to be summarised in an AIC schedule.<sup>48</sup>

1.49 The AIC Program aims are to:

- provide opportunities for Australian companies to compete on their merits for Defence work within Australia and overseas;
- influence foreign Prime Contractors and Original Equipment Manufacturers (OEM), including Australian subsidiaries, to deliver cost-effective support;
- facilitate transfer of technology and access to appropriate Intellectual Property (IP) rights; and
- encourage investment in Australian industry.<sup>49</sup>

1.50 Since its introduction, the AIC Program has been modified to strengthen its requirements. In 2011 Defence implemented the following initiatives:

- lowering the threshold for companies to submit an AIC Plan in tender responses from \$50 million to \$20 million;
- removing the existing AIC-related Liquidated Damages clauses from the Australian Standard for Defence Contracting Conditions of Contract, and replacing them with a clause in the Conditions of Tender that enables a company to be excluded from consideration in the tender if they failed in previous contracts to meet their AIC program obligations;

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47 2016 *Defence Industry Policy Statement*, pp. 34-35.

48 Department of Defence, *Building Defence Capability: A policy for a smarter and more agile defence industry base*, p. 73.

49 See <http://www.defence.gov.au/casg/DoingBusiness/Industry/Industryprograms/AustralianIndustryCapability/about.aspx> (accessed 27 July 2018).

- introducing AIC program performance as an assessment category in its own right in the Company ScoreCard system and hence in the tender evaluation process;
- removing the ability of contractors to reduce the level and type of work to be subcontracted to Australian industry;
- recording the requirement for appointees to manage AIC program responsibilities in Project and Product Charters; and
- introducing the requirement to publish Defence AIC Plans.<sup>50</sup>

1.51 On 29 June 2017, the then Minister for Defence Industry announced that the government would further strengthen the AIC Program through the release of a new Australian Industry Capability Plan template which the Minister noted would place more demands on defence companies in outlining how and where they will involve Australian industry before the government would even consider their bid.<sup>51</sup> The changes to the template addressed the following:

- the tenderer's strategy for maximising Australian industry involvement in the project and ensuring Australian industry capability benefit beyond the work period;
- maximised inclusion and evidence of having positively engaged Australian Small to Medium Enterprises and Indigenous Business Enterprises;
- proposed investment in innovation, and collaborative research and development efforts in Australia;
- establishing, transitioning or enhancing skills, knowledge, systems, technology and infrastructure within Australian industry; and
- identification and promotion of Australian defence export opportunities and as a contributor to the global supply chain.<sup>52</sup>

1.52 The Minister noted that this improved approach to maximising Australian industry content:

...reflects the seriousness with which this Government takes ensuring we are maximising Australian industry involvement in our Defence capability and the thousands of jobs that will flow from this commitment.

It is also a clear signal to overseas large contractors wishing to do business in Australia that they need to take Australian defence industry capability seriously...<sup>53</sup>

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50 See <http://www.defence.gov.au/casg/DoingBusiness/Industry/Industryprograms/AustralianIndustryCapability/about.aspx> (accessed 27 July 2018).

51 The Hon Christopher Pyne MP, Minister for Defence Industry, 'Turnbull Government moves to increase Australian involvement in Defence projects', *Media Release*, 29 June 2017, <https://www.minister.defence.gov.au/minister/christopher-pyne/media-releases/turnbull-government-moves-increase-australian-involvement> (accessed 27 July 2018).

52 See <http://www.defence.gov.au/SPI/Industry/AIC.asp> (accessed 27 July 2018).

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### *Next Generation Technologies Fund*

1.53 The Next Generation Technologies Fund is an initiative coming out of the *2016 Defence Industry Policy Statement* where the government will invest around \$730 million over the decade in new funding to focus research and investment to better position Defence to respond to strategic challenges and develop next-generation capabilities of the future. The fund is managed by the Defence Science and Technology Group within Defence and was launched by the then Minister for Defence Industry in March 2017 who advised:

This fund will draw on the collective scientific expertise of our nation across both industry and university sectors, to give the ADF a winning edge with advanced technologies.

...

There are a range of opportunities for universities and companies to contribute innovative technology solutions to defeat future threats, many of which are not even on the radar today.

The Government is determined to make the most of the investment in the Next Generation Technologies Fund and ensure that industry and academia are actively engaged in developing unbeatable capabilities for Australia's future defence force.<sup>54</sup>

### *Defence Export Strategy*

1.54 Launched on 29 January 2018, the *Defence Export Strategy* (the Strategy) sets out a system to plan, guide and measure defence export outcomes. The Strategy was developed in recognition that the Australian defence industry cannot be sustained by domestic needs only, and aims to position Australia as one of the top ten global defence exporters within the next decade.<sup>55</sup> It will assist to identify new markets and opportunities to provide diversification and:

...help unlock the full potential of Australian defence industry to grow, innovate, and support Defence's future needs. Exports will provide our defence industry with greater certainty of future investment and support high-end manufacturing jobs for Australians for generations to come.<sup>56</sup>

1.55 Initiatives and investments under the Strategy include:

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53 The Hon Christopher Pyne MP, Minister for Defence Industry, 'Turnbull Government moves to increase Australian involvement in Defence projects', *Media Release*, 29 June 2017, <https://www.minister.defence.gov.au/minister/christopher-pyne/media-releases/turnbull-government-moves-increase-australian-involvement> (accessed 27 July 2018).

54 The Hon Christopher Pyne MP, Minister for Defence Industry, *Media Release*, '\$730 million fund for game-changing defence technologies', 16 March 2017, <https://www.pyneonline.com.au/media-centre/media-releases/730-million-fund-for-game-changing-defence-technologies> (accessed 27 July 2018).

55 See <http://www.defence.gov.au/Export/Strategy/Default.asp> (accessed 30 July 2018).

56 See <http://www.defence.gov.au/Export/Strategy/Default.asp> (accessed 30 July 2018).

- a new Australian Defence Export Office to work with Austrade and the Centre for Defence Industry Capability to coordinate whole-of-government efforts;
- a new Australian Defence Export Advocate to provide high-level advocacy for defence exports and work across industry and government to ensure efforts are coordinated;
- a \$3.8 billion Defence Export Facility administered by Efic, Australia's export credit agency to assist Australian companies get the finance they need to underpin the sales of their equipment overseas; and
- \$20 million per year to implement the Defence Export Strategy and support defence industry exports.<sup>57</sup>

### *Other initiatives*

1.56 Other initiatives which have been in place over a number of years which are designed to assist and develop the defence industry include the Capability Life Cycle program, which ensures the contribution of Australian industry at all stages of decision-making about defence capability; and the Defence Industry Security Program, which informs industry about security requirements and threats and assists with compliance. Both programs have undergone reforms to strengthen the benefits and outcomes achieved.<sup>58</sup>

### ***2018 Defence Industry Capability Plan initiatives***

#### *Sovereign Industrial Capability Priority Grants Program*

1.57 The Sovereign Industrial Capability Priority Grants Program supports the development, maintenance or enhancement of the capability of Australian small to medium enterprises that contribute to one or more of the Sovereign Industrial Capability Priorities. From the second half of 2018, the program will provide grants of up to \$1 million for capital expenditure or non-recurring engineering costs, subject to a 50:50 matched funding requirement.<sup>59</sup>

#### *Sovereign Industrial Capability Priorities Implementation Plans*

1.58 An implementation plan for each of the Sovereign Capability Priorities will be prepared to identify the level of access and control Australia requires for each Priority and the long-term goals for development. Implementation plans will be released from mid-2019.<sup>60</sup>

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57 The Hon Christopher Pyne MP, Minister for Defence, *Media Release*, 'Launch of job-creating Defence Export Strategy', 29 January 2018, <https://www.minister.defence.gov.au/minister/christopher-pyne/media-releases/launch-job-creating-defence-export-strategy> (accessed 2 August 2018).

58 *2018 Defence Industrial Capability Plan*, pp. 24-25.

59 *2018 Defence Industrial Capability Plan Fact Sheet – Sovereign Industrial Capability Priorities*, p. 4.

60 *2018 Defence Industrial Capability Plan*, p. 156.

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### *Industrial strategies for each integrated investment program*

1.59 To support the implementation of the DICP, industrial strategies for each of the six Integrated Investment Program capability streams will be released from mid-2019 to provide Australia's short, medium and long-term industrial objectives for each stream.<sup>61</sup>

### *Industry development projects*

1.60 Administered and funded through the CDIC, Industry Development Projects are intended to provide a rapid response to address a sector-wide need that has been identified from within industry, the CDIC or within Defence. It is designed to provide a mechanism to introduce programs, studies, research, grants, procurement or other initiatives to support a sector wide requirement.<sup>62</sup>

### ***Commonwealth Procurement Framework***

1.61 The next section summarises the existing policy framework in place to assist Commonwealth officials when conducting procurement activities.

### *Commonwealth Procurement Rules*

1.62 The Commonwealth Procurement Rules (CPRs) are issued by the Minister for Finance under section 105B(1) of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) and are the core of the Commonwealth's procurement framework. Officials from all Commonwealth departments (non-corporate Commonwealth entities) and prescribed corporate Commonwealth entities listed in section 30 of the Public Governance, Performance and Accountability Rule 2014, are required to conduct procurement processes in accordance with the CPRs. The most recent version of the CPRs commenced on 1 January 2019.<sup>63</sup>

1.63 The CPRs set out the rules that officials must comply with when procuring goods and services. At the core of the CPRs is achieving value for money which requires consideration of the financial and non-financial costs and benefits associated with the procurement.<sup>64</sup>

1.64 Paragraph 2.5 of the CPRs states that:

An *Accountable Authority* may use Accountable Authority Instructions to set out entity-specific operational rules to ensure compliance with the rules of the procurement framework.

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61 2018 Defence Industrial Capability Plan, p. 154.

62 2018 Defence Industrial Capability Plan, p. 155.

63 The 2019 update to the CPRs incorporates new requirements arising from international trade obligations and will apply to any new procurement undertaken from 1 January 2019. Subsequent references refer to paragraph numbers from the 2018 edition of the CPRs.

64 Department of Finance, *Commonwealth Procurement Rules*, p. 9.

1.65 Paragraph 2.6 of the CPRs states that:

Nothing in any part of these CPRs prevents an *official* from applying measures determined by their *Accountable Authority* to be necessary for the maintenance or restoration of international peace and security, to protect human health, for the protection of essential security interests, or to protect national treasures of artistic, historic or archaeological value.

1.66 Division 1 of the CPRs sets out the rules applicable for all procurements, regardless of their value. The rules are grouped according to the following areas:

- value for money;
- encouraging competition;
- efficient, effective, economical and ethical procurement;
- accountability and transparency in procurement;
- procurement risk; and
- procurement method.

#### *Achieving value for money*

1.67 The CPRs make clear that achieving value for money is at the core of the framework requiring the consideration of both the financial and non-financial costs and benefits associated with the procurement.<sup>65</sup>

1.68 The *2016 Defence Industry Policy Statement* explains the importance of the value for money consideration in the capability development process:

The Government understands the importance of the value for money concept being clear in the context of Defence capability procurement. The Commonwealth Procurement Rules and Defence procurement policy require procurement officers to take into account a range of issues in considering value for money, including financial and non-financial costs and the quality of goods and services.

Defence capability decisions will continue to seek to achieve the best value for money, based on the Commonwealth Procurement Rules, and include explicit consideration of:

- the sovereign requirements for Australian industry involvement, which would help guarantee the ADF's independence of action
- the identification of opportunities to maximise internationally competitive Australian industry involvement.<sup>66</sup>

1.69 Division 2 of the CPRs sets out additional rules to those in Division 1 to be applied when the estimated value of the procurement is at or above the relevant procurement threshold and when an exemption as listed in Appendix A of the CPRs has not been utilised. The relevant procurement threshold for non-corporate

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65 Department of Finance, *Commonwealth Procurement Rules*, p. 9.

66 *2016 Defence Industry Policy Statement*, p. 21.



Commonwealth entities, other than for procurements of construction services, is \$80,000.<sup>67</sup> Procurements that are exempt from the rules of Division 2 by the operation of Appendix A are still required to be undertaken in accordance with the value for money consideration and with the rules of Division 1 of these CPRs and must not be interpreted or applied in a manner that diminishes or negates Division 1.

1.70 In addition to the requirement that the procurement achieve a value for money outcome, paragraph 10.31, added in 2017 to Division 2 of the CPRs, specifies that for procurements above \$4 million, Commonwealth officials are required to consider the economic benefit of the procurement to the Australian economy. Also added in 2017, Paragraph 10.32 specifies that this policy operates within the context of relevant national and international agreements and procurement policies to which Australia is a signatory.

#### *Defence Procurement Policy Manual*

1.71 The *Defence Procurement Policy Manual* (DPPM) sets out the mandatory policy that Defence officials must comply with when undertaking procurement. The DPPM incorporates the CPRs and additional Defence Procurement Policy Directives, which supplement specific CPRs in the context of particular circumstances and needs of Defence:

The DPPM provides primary operational instructions to Defence officials in carrying out their duties related to procurement, in a way that is tailored to Defence's particular circumstances and needs.<sup>68</sup>

1.72 Defence Procurement Policy Directives D2-D4 in the DPPM provide additional instructions for Defence officials about the application of paragraph 2.6 of the CPRs. The Secretary of Defence, as the Accountable Authority under the PGPA Act, has determined that the procurement of a number of good and services are exempt from the operation of Division 2 of the CPRs.<sup>69</sup>

1.73 Exempting those goods and services from the additional requirements under Division 2 of the CPRs, also means that the requirement under paragraph 10.31 of the CPRs (outlined above) in relation to consideration of the economic benefit of the procurement to the Australian economy does not apply. However, the DPPM notes that for these Defence procurements, the consideration of economic benefit nevertheless occurs through the evaluation of the Australian Industry Capability (AIC) requirements of the procurement:

In particular, tenderers are required to submit an AIC plan which sets out the tenderers' Local Industry Activities (LIAs) to meet the specified Industry Requirements of the procurement. Tenderers are required to

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67 Department of Finance, *Commonwealth Procurement Rules*, p. 20.

68 Department of Defence, *Defence Procurement Policy Manual*, Version 1.1, 19 December 2017, p. 4.

69 Department of Defence, *Defence Procurement Policy Manual*, Version 1.1, 19 December 2017, p. 13. Refer to Table 1 on pp. 29-30 for a full list of Defence specific exemptions under Division 2.

describe the benefits of their LIAs, including the significance of the work, the skills and knowledge that will be transferred, the training that will be provided, the new technologies or innovations that will be introduced, and the contribution to Australian company competitiveness, including access to global supply chains, technical data and intellectual property.<sup>70</sup>

1.74 Defence Procurement Policy Directive D13 deals with AIC and states:

Defence *officials* must comply with the Defence Australian Industry Capability (AIC) Policy for *procurements* valued at or above \$20 million (including GST), and in particular ensure that the successful *supplier* in the procurement implements the AIC plan.<sup>71</sup>

1.75 Additionally, exemptions made by the Defence Procurement Policy Directive D2 noted above, exempting provisions of Division 2 of the CPRs, would include exempting the requirement to conduct an open tender unless a number of prescribed conditions set out in paragraph 10.3 of the CPRs are met. The DPPM notes that this exemption mechanism is provided for in the Australia-US Free Trade Agreement and is consistent with other market access arrangements agreed by Australia in other free trade agreements:<sup>72</sup>

In the case of Defence, the AUSFTA (Chapter 15, Annex A) specifically provides for various Defence procurements to be exempt from the operation of the procurement rules in Chapter 15 of the AUSFTA (which rules are now mainly in Division 2 of the CPRs, and which are consistent with the procurement rules agreed by Australia in its other FTAs). This exemption is permitted on the grounds of 'essential security' (Article 22.2 of the AUSFTA). To give effect to this exemption, the Secretary has made a measure under paragraph 2.6 of the CPRs to determine that the procurement of the various goods or services listed in Table 1 above are exempt from the operation of Division 2 of the CPRs. The list in Table 1 replicates the list in Chapter 15, Annex A of the AUSFTA.<sup>73</sup>

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70 Department of Defence, *Defence Procurement Policy Manual*, Version 1.1, 19 December 2017, p. 13.

71 Department of Defence, *Defence Procurement Policy Manual*, Version 1.1, 19 December 2017, p. 38.

72 Department of Defence, *Defence Procurement Policy Manual*, Version 1.1, 19 December 2017, p. 30.

73 Department of Defence, *Defence Procurement Policy Manual*, Version 1.1, 19 December 2017, p. 31.

# Chapter 2

## Key issues

2.1 This chapter examines the key issues raised in relation to the Bill, including the arguments in favour of developing and sustaining a sovereign naval shipbuilding capability, participation, capacity and engagement with Australian industry including the potential cost impacts of mandating that naval vessels be constructed by Australian owned companies. The chapter also examines the retrospective application of the Bill, including the implications of the Bill for current and future shipbuilding programs. While some submissions and witnesses discussed the naval shipbuilding program broadly, the primary focus of this chapter is on the issues raised as they relate to the contents of the Bill.

### **Developing and sustaining a sovereign naval shipbuilding capability**

2.2 As outlined in Chapter 1, the purpose of the Bill 'is to ensure that Australia continues to develop and sustain a sovereign naval shipbuilding capability'.<sup>1</sup>

2.3 In an attempt to achieve this, the Bill mandates that agreements entered into for the construction of naval vessels exceeding 30 metres are, except in some exceptional circumstances, built in Australia by an Australian shipbuilder that is:

- incorporated in Australia;
- not controlled by one or more foreign persons; and
- not a subsidiary of a foreign entity.

2.4 The EM also states that the Bill:

...will not prevent foreign shipbuilders tendering to be the prime contractor in any shipbuilding program, but they will need to sub-contract the entire build to an Australian-controlled shipbuilder that meets minimum experience and performance thresholds.<sup>2</sup>

2.5 The Western Australian (WA) Government supported the intent of the Bill to require naval vessels to be built by Australian shipbuilders, which it suggested is an important step in building Australian capability. It also supported broadening the scope of the Bill to require naval vessels of any size to be built in Australia by Australian shipbuilders, not only those exceeding 30 metres in length.<sup>3</sup>

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1 EM, [p. 2].

2 EM, [p. 2].

3 *Submission 9*, pp. 1-2.

### ***Defining sovereign capability***

2.6 As noted in Chapter 1, the *Naval Shipbuilding Plan* details how the government will deliver its commitment to build a 'strong, sustainable and innovative Australian naval shipbuilding industry'.<sup>4</sup>

2.7 Evidence to the Inquiry discussed the matter of sovereign capability. Mr Martin Edwards, General Manager, Submarine Capability Development, ASC Pty Ltd explained sovereign shipbuilding as follows:

We see it as the ability to construct, maintain and sustain critical naval platforms without being overly reliant on overseas nations or suppliers.<sup>5</sup>

2.8 ASC also discussed sovereign defence capability in its submission:

A sovereign defence capability is the freedom to use military capabilities when needed, and a sovereign defence industry provides the ability to construct, improve and maintain the military assets when necessary, especially during times of conflict.<sup>6</sup>

2.9 The Submarine Institute of Australia (SIA) defines sovereignty as 'the full right and power of a governing (statutory) body over itself, without any interference from outside sources or bodies'.<sup>7</sup> More specifically, in relation to naval shipbuilding, the SIA included the following elements in a definition of Australian sovereignty:

- Independent – Australia must have ultimate control over its own destiny, which means retaining the ability to make major decisions relating to submarines (and other platforms) which are in the best interests of Australia's national security;
- The design, construction and sustainment of Australia's Future Submarines must not be conducted on the basis that Australia is beholden to some other country or company, including being subject to critical decisions being made by members of an overseas board which directly and indirectly controls the approach in Australia; and
- Australian sovereignty means a shipbuilder having Australian control over its Australian operations.<sup>8</sup>

2.10 The SIA considered the sovereign production, sustainment and operational capability of future naval vessels in Australia as critically linked to national security.<sup>9</sup> Consistent with the Bill, the SIA's view is that:

The strategic arguments for self-sufficiency and sovereign capability make a strong case for unambiguous government shipbuilding policy. Australian

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4 *Naval Shipbuilding Plan*, Foreword, p. 4.

5 *Committee Hansard*, 29 November 2018, p. 1.

6 *Submission 10*, p. 2.

7 *Submission 3*, p. 3.

8 *Submission 3*, pp. 3-4.

9 *Submission 3*, p. 2.

naval construction must take place in Australia by Australian companies with, not just consequential benefits for our defence industrial base, but also long-term strategic self-reliance and home-grown technical innovation to provide tactical advantage.<sup>10</sup>

...

Foreign shipbuilders should still be able to tender to be the prime contractor in any shipbuilding program, but they should be required to sub-contract the entire build to an Australian-controlled shipbuilder that meets minimum experience and performance thresholds.<sup>11</sup>

### ***Achieving sovereign capability***

2.11 While the EM emphasises the importance of the Bill to achieve sovereign capability, Defence explained that sovereignty can be delivered through a range of mechanisms, including:

- Australian ownership of sovereign assets (for example, the shipyards and systems used to design and build ships);
- suitable rights over intellectual property;
- the transfer of knowledge to Australians within the subsidiaries of prime contractors operating in Australia; and
- Australian involvement in the operation of subsidiaries to balance foreign control.<sup>12</sup>

2.12 Defence advised that this approach provides a number of advantages including flexibility for Australia to deliver and acquire cost-effective and fit for purpose capabilities. It cited the approach to the delivery of the Future Frigate Program as an example of adopting a broader approach that will still develop a sovereign capability:

ASC Shipbuilding will be transferred to BAE Systems to support the objective of developing a sovereign design and shipbuilding capability in Australia as part of the Government's continuous naval shipbuilding program. ASC Shipbuilding will be the prime contractor with responsibility for delivery of the Future Frigate program – an arrangement that will help maximise the future success of ASC and the Australian naval shipbuilding industry.<sup>13</sup>

2.13 Rear Admiral Tony Dalton, General Manager Ships, Department of Defence, explained Defence's approach to achieving sovereign capability at the public hearing on 8 November 2018:

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10 *Submission 3*, p. 5

11 *Submission 3*, p. 6.

12 *Submission 2*, [p. 2].

13 *Submission 2*, [p. 2].

You don't necessarily need to be Australian owned to provide a sovereign capability. The key point we would make in our submission is that we are setting in place a plan that will generate a sovereign shipbuilding capability in Australia. It doesn't necessarily need to be owned. BAE, for example, have had a presence in Australia for over 60 years now. They're embedded in our defence industry through a range of things, including highly sensitive programs that are considered sovereign, like the Jindalee over-the-horizon radar network. That is a program that BAE is now intimately involved in. So throughout our industry, not just in shipbuilding, there is a reliance on Australian operated companies that have an Australian chief executive officer and an Australian chairman, that employ Australians and that spend money in Australia but that are ultimately owned by a company like BAE, Raytheon or Lockheed Martin.<sup>14</sup>

2.14 Naval Group Australia, a subsidiary of French shipbuilding company Naval Group, advised that Australian sovereignty is being developed in existing shipbuilding programs including the Future Submarine Program.<sup>15</sup> Naval Group Australia is the Australian Government's design and build partner for that program.

*Future Submarine Program (SEA 1000)*

2.15 Under the Future Submarine Program, 12 military-off-the-shelf design diesel-electric submarines will be built, replacing the existing diesel-electric Collins Class submarines. The submarines will be constructed at the Osborne Naval Shipyard in South Australia, commencing from 2022 to 2023, with the first submarine expected to enter service in the early 2030s.

2.16 In its submission, Naval Group Australia advised that the design and build structure of the Future Submarine Program exemplifies how the current framework is delivering Australian sovereignty for naval shipbuilding capability. Naval Group Australia stated that 'Australian sovereignty is written into the very DNA of the Future Submarine Program'.<sup>16</sup>

2.17 Naval Group Australia also highlighted the features of the Future Submarine Program which deliver Australian sovereignty:

The fleet of 12 submarines will be built in Adelaide at the Submarine Construction Yard, with a predominantly Australian workforce and wherever possible, Australian suppliers...

...

As the program matures, French expertise will be gradually drawn back to France and replaced by an established Australian capability.

This transition is covered by the Transfer of Technology agreement endorsed by both the Australian and French governments. This agreement obliges the French Government to transfer all aspects of Future Submarine

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14 *Committee Hansard*, 8 November 2018, p. 20.

15 *Submission 8*, p. 1.

16 *Submission 8*, p. 1.

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technology to Australia to enable the establishment of a sovereign submarine sustainment capability.<sup>17</sup>

2.18 At a public hearing, Mr Jean-Michel Billig, Executive Vice President, Naval Group, explained that 'for industry, the goal of the Future Submarine program is to create and maintain a sovereign domestic industrial capability for decades to come'.<sup>18</sup> Furthermore, Mr Billig advised the Committee:

During the competitive evaluation process, the Australian Department of Defence outlined three broad strategic objectives as part of the Future Submarine operating concept which all bidders had to satisfy as part of their proposals: (1) capability, (2) national security and sovereignty, and (3) industry.

Capability means ensuring the Future Submarine has the range, the endurance, the [s]ensors, the performance, the stealth characteristics, and the combat and weapons systems needed to meet Australia's defence needs, capabilities which ourselves and Lockheed Martin Australia, as the combat systems integrator, will work with each other and the Commonwealth of Australia to deliver.

The concepts of national security and sovereignty were considered inseparable to creating a body of sustained critical knowledge to maintain and sustain Australia's submarine capability within Australia. And, for industry, the goal of the Future Submarine program is to create and maintain a sovereign domestic industrial capability for decades to come. We consider these as ambitious but achievable goals...<sup>19</sup>

2.19 Mr Billig also explained that the commitment by Naval Group to a sovereign Australian submarine capability is set out in their contract as well as Defence guidance documents:

Naval Group understands this [the Australian Government's commitment to sovereign capability] and we are committed to delivering sovereignty to Australia because that is what we have been contracted to do by the Commonwealth as its international partner for the design and build of 12 regionally superior submarines. This commitment to a sovereign Australian submarine capability is now set in stone not only in our contract with the Commonwealth but also in critical defence guidance papers such as the Australian defence white paper and enshrined in an intergovernmental agreement between the Commonwealth of Australia and the French Republic.<sup>20</sup>

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17 *Submission 8*, pp. 1-2.

18 *Committee Hansard*, 8 November 2018, p. 8.

19 *Committee Hansard*, 8 November 2018, p. 8.

20 *Committee Hansard*, 8 November 2018, p. 9.

*Operational sovereignty*

2.20 Mr Graeme Dunk submitted that while the Bill may support some sovereignty aspects, it will not guarantee the required operational sovereignty 'that is ultimately required to enable the Royal Australian Navy to undertake required missions and tasks as, when, where, and for the period required'.<sup>21</sup>

2.21 When explaining the importance of 'operational sovereignty', Mr Dunk submitted that 'naval platforms are typically categorised in terms of the ability to float, move and fight'. Mr Dunk explained that it is the float and move aspects that keep the fight components 'out of the water and able to move into a location where the operation occurs'. It was noted that the Bill 'focuses on the float and move aspects of shipbuilding but avoids mention of the sovereign aspects of the ability to fight: arguably the most important aspect'.<sup>22</sup>

2.22 To address this gap, Mr Dunk suggested there should be a 'greater focus on the domestic development of the combat management aspects of naval fighting vessels...'.<sup>23</sup>

2.23 Mr Dunk also argued that the Bill will not ensure that the intellectual property associated with combat systems is resident within Australia and available for independent use.<sup>24</sup> He advised that:

Whilst the Bill will go some way to providing independent action by Australia in the face of increasing strategic uncertainty, operational sovereignty may still be adversely impacted by an overall inability to undertake independent industrial action with respect to the fight aspects of naval vessels.<sup>25</sup>

2.24 Mr Dunk also raised concerns about the protection from overseas acquisition of Australian companies operating in sectors of defence industry which have been identified as priority areas. He advised that the Bill does not address this aspect of sovereignty and he proposed a legislative approach to address this issue:

By definition companies that operate in the SICP [Sovereign Industrial Capability Priorities] areas are closely aligned to operational sovereignty and the ability of the ADF to operate as, when, where, and for the period required, and should not be able to be simply acquired by overseas companies. Enactment of something akin to the QANTAS Sale Act to ensure that majority control is maintained in Australia is required if sovereignty is to be retained.<sup>26</sup>

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21 *Submission 4*, p. 1.

22 *Submission 4*, p. 1.

23 *Submission 4*, p. 2.

24 *Submission 4*, pp. 1-2.

25 *Submission 4*, pp. 1-2.

26 *Submission 4*, p. 2.



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### ***Intellectual property rights***

2.25 Another condition on agreements entered into under the Bill requires the provision, grant or conferral by the shipbuilder to the Commonwealth of intellectual property (IP) rights relating to the vessel for the purposes of maintaining, repairing or modifying the vessel.<sup>27</sup>

2.26 The SIA considered possession of intellectual property by the Australian government an important element for sovereign independence for naval shipbuilding. Its view is broadly consistent with the requirements in the Bill in relation to intellectual property:

To achieve sovereign independence, the Australian Government must ensure Australia obtains a licence to all the intellectual property rights that are needed for the full life cycle of construction, operation, sustainment...also ultimate disposal...This licence might not include the rights to export further units to the same design but could include the rights to derive/design later generation.<sup>28</sup>

If the technology and IP of future shipping programs is not transferred to an Australian-controlled company (rather than a subsidiary company of a foreign entity), there will be ongoing exposure to foreign corporate risk in relation to naval construction projects of great importance to national security. Australia must be particularly conscious of the importance of having our own capability to upgrade our warships and [submarines] in a time of conflict.<sup>29</sup>

2.27 Mr Dunk considered that implementation of the Bill may have a positive impact on intellectual property aspects of the ships. He highlighted the importance of appropriate control of intellectual property in relation to export matters:

...unless Australia gains control over the intellectual property associated with ship and submarine design, and limits exposure to the International Traffic in Arms Regulations (ITAR), our ability to export complete naval systems will remain somewhat problematic.<sup>30</sup>

2.28 In its submission Defence advised that appropriate consideration and management of IP matters are already being addressed in the engagement of international ship designers and builders in the delivery of naval shipbuilding programs:

...the Government is identifying and mandating the technology, intellectual property, business processes and workplace cultures that must be transferred to Australian industry in order for a sovereign Australian naval shipbuilding enterprise to be delivered.<sup>31</sup>

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27 EM, [p. 3].

28 *Submission 3*, p. 4.

29 *Submission 3*, p. 6.

30 *Submission 4*, p. 2.

31 *Submission 2*, [p. 4].

2.29 As noted in Chapter 1, in response to a recommendation of the Joint Standing Committee on Treaties' *Report 169 Future Submarine Program–France, Classified Information Exchange–France*, the government provided assurance that IP rights would be well managed under the Future Submarine Program:

The Future Submarine Program's approach to intellectual property has been predominantly driven by the lessons learnt from the Collins Submarine Program. From the outset of the Competitive Evaluation Process, a prime objective of the Future Submarine program has been to establish a sovereign capability to operate and sustain the Future Submarine.

In the Framework Agreement with France and under the Design and Mobilisation Contract between the Commonwealth and DCNS, appropriate intellectual property rights to achieve this objective have been established.<sup>32</sup>

2.30 At a public hearing, Defence officials advised that 'it is very unusual for Defence to actually own IP'. With reference to the Hobart class destroyers, Defence confirmed that under its IP licence, the Government has 'access to all the IP we need to operate, maintain, modify and upkeep' those vessels.<sup>33</sup>

2.31 Rear Admiral Dalton emphasised that Defence is not inhibited by not owning IP, noting that 'owning the IP comes with quite an overhead in itself that the Commonwealth would like to avoid in most cases'.<sup>34</sup>

### **Australian industry**

2.32 The Bill requires that naval construction must take place in Australia by Australian shipbuilders. While foreign shipbuilders will be permitted to tender to be the prime contractor, they will be required to subcontract the entire build to an Australian controlled shipbuilder. The EM explains:

Construction of Royal Australian Navy Vessels in Australia by Australian shipbuilders will serve Australia's national security interests and maximise the economic benefit of the naval construction program to Australia'.<sup>35</sup>

2.33 Evidence to the Committee discussed the implications of these requirements, the participation of Australian industry under the existing framework as well as the current and future capacity of the shipbuilding workforce.

### ***Participation of Australian industry***

2.34 As noted in Chapter 1, a framework was developed to identify the Sovereign Industrial Capability Priorities. These are capabilities critical to Defence and under the framework must be developed or supported by Australian industry and Australia must

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32 Australian Government response to the Joint Standing Committee on Treaties: *Report 169 Future Submarine Program–France, Classified Information Exchange–France*, November 2017, [pp. 2-3].

33 Rear Admiral Dalton, *Committee Hansard*, 8 November 2018, p. 16.

34 *Committee Hansard*, 8 November 2018, p. 16.

35 EM, [p. 2].

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therefore have access to, or control over, the essential skills, technology, intellectual property, financial resources and infrastructure as and when required:<sup>36</sup>

Defence will...develop an implementation plan for each Sovereign Industrial Capability Priority that outlines the level of access and control Australia needs for each Priority and how they will be developed and supported across Defence planning to maintain capacity and resilience.<sup>37</sup>

2.35 The continuous shipbuilding program (including the rolling submarine acquisition) was identified in the initial list of Sovereign Industrial Capability Priorities:

Australian industry must have the technical, managerial, heavy engineering and advanced manufacturing capabilities required to build an innovative, cost-competitive, sustainable and continuous program that delivers Australia's future submarines, major surface combatants and minor war vessels. Australian industry will need to be integrated into global supply chains, have modern, productive and secure shipyards, and employ a highly skilled workforce both for shipbuilding and sustainment. Establishing 21st century shipyards for design, construction and optimal production efficiency of our future submarines, frigates and minor war vessels is critical to achieve the capability, reform and efficiency dividends required, as is having a workforce in place with the right skills when needed.<sup>38</sup>

2.36 The Defence submission reiterated the government's commitment to utilise Australian industry in current and future naval shipbuilding programs:

The Government's vision to maximise Australian industry involvement in the national shipbuilding enterprise will, over time, see Australian industry actively involved to the greatest extent possible across the spectrum of the enterprise – from capability design to complex program management, construction and sustainment activities.<sup>39</sup>

2.37 Additionally, the government is committed to ensuring that Australian industry has the maximum opportunity to engage at all points of a program and is supported by a range of initiatives which have been outlined earlier in the report, including the Australian Industry Capability Program. Defence advised the Committee that:

The establishment of subsidiary business operations in Australia with an appropriately skilled and competitive workforce is key to the Australian Industry Capability (AIC) Program objectives. The AIC Program is the major lever for Australian industry to support Defence capability and the long-term development of our defence industry. This will provide the

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36 *Defence Industrial Capability Plan*, p. 17.

37 *Defence Industrial Capability Plan Fact Sheet*, p. 4.

38 *Defence Industrial Capability Plan*, p. 37.

39 *Submission 2*, [p. 4].

appropriate assurance to Defence capability and represents a pathway to export opportunity.<sup>40</sup>

2.38 While noting a commitment to maximise Australian industry engagement, Defence also pointed out that reform of the industry is crucial in order to deliver future naval capability; and cautioned that this needed to be achieved within resources available:

Australia cannot afford a naval shipbuilding industry at any price. Such reshaping and reform of the industry is crucial to deliver the future naval capability Australia needs, at [a] price the nation can afford. The nation needs to move progressively and on affordable terms to a sovereign ship building capability in an evolutionary approach. The provisions of this bill would restrict the Government's ability to deliver these reforms, and would introduce significant commercial, schedule and performance risk to the national shipbuilding endeavour.<sup>41</sup>

2.39 Naval Group Australia advised that the current Future Submarine Program is providing maximum opportunity for local industry engagement. Naval Group Australia reported that it has engaged with 939 companies nationally through the Industry Capability Network online database as at end of June 2018. Additionally, it advised that it has been closely engaged with ASC Pty Ltd on possible areas of cooperation and collaboration through and 'Engagement Framework' agreement.<sup>42</sup>

#### *Maximising the benefits for the Australian industry*

2.40 Defence noted that in 2017 seven of the top ten defence contractors by revenue were subsidiaries of foreign owned companies.<sup>43</sup> Defence indicated the benefits to Australian industry which stem from this arrangement:

Foreign investment represents confidence in Australian industry to deliver world-class products and services, signals growth prospects for the economy and provides Australian industry with access to greater resources and technical expertise.<sup>44</sup>

2.41 The submission from the Australian Industrial Transformation Institute (AITI) at Flinders University also noted the significant economic and employment outcomes from investment in Defence maritime projects. In particular, it discussed the range of 'spillovers' that can be generated from these projects, which were defined as the:

...economic and social benefits that cannot be easily captured by the firms directly involved in the delivery of a major project. This includes knowledge, technologies, enterprise capabilities and workforce skills

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40 *Submission 2*, [p. 2].

41 *Submission 2*, [p. 4].

42 *Submission 8*, pp. 2-4.

43 *Submission 2*, [p. 2].

44 *Submission 2*, [p. 2].

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developed or applied during the course of a major defence project that have commercial application.<sup>45</sup>

2.42 The AITI advised that sectors such as health and ageing, mining, transportation, agriculture and horticulture, and construction may potentially benefit from the application of the advanced technologies and processes developed in complex Defence maritime projects. The AITI submission acknowledged the government initiatives in place which aim to utilise Australian industry participation in Defence projects to the greatest extent. However, it proposed that a strategic approach was necessary in order to maximise the beneficial spillovers, and that industry transformation and diversification could not be taken for granted. The following strategic measures were suggested to maximise spillovers:

- embedding government as a sophisticated and demanding customer in project contracts, with mutually reinforcing reciprocal obligations alongside contractors to deliver the highest quality outcome for Defence while maximising industry participation and wider industry development opportunities for Australian companies.
- ensuring that defence project contracts and subcontracts include clear expectations of knowledge, technology and skill transfer from defence to commercial applications and mechanisms that enable this to be realised in practice.
- systematic and sustained mapping of potential multi-sector commercial applications of knowledge, technologies and skills present in defence projects.
- building the absorptive capacity of companies both within and outside the defence project supply chain to adopt new technologies, knowledge, workplace innovations and skills.
- developing a dedicated defence technology, knowledge and skills commercialisation and financing capability.
- developing strong industry, government and research partnerships and collaborative processes that underpin active exploration of commercial applications of defence technologies and the knowledge, processes and skills acquired during the implementation of major projects.<sup>46</sup>

### ***Definition of Australian owned as contained in the Bill***

2.43 As noted in the EM, the Bill will amend the Defence Act to require new vessels to 'be built in Australia by a well-established, high performance Australian owned and controlled shipbuilder'.<sup>47</sup>

2.44 The Committee explored what impact this definition may have to limit the number of existing shipbuilders that would be eligible to undertake the building of

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45 *Submission 1*, p. 1.

46 *Submission 1*, p. 8.

47 EM, [p. 1].

new vessels. To illustrate this point, while acknowledging that the organisation was not a shipbuilder<sup>48</sup>, the Committee discussed with representatives from AkzoNobel that despite being an Australian registered company, which manufactures in Australia, employs 350 employees and collaborates with government agencies on products, the fact that the company is internationally owned would mean that they could not meet the definition.<sup>49</sup>

2.45 Mr David Baker, Navy, Technical and Key Account Manager, AkzoNobel also highlighted:

While the idea of Australian sovereign shipbuilding is appealing, it may be that, like with coating manufacturing, a multinational company based in Australia and registered in Australia could draw on its experience from overseas but manufacture here in Australia with local content. Local manufacture would ensure timely delivery and supply of goods in turbulent times and would prevent other customers from taking priority.<sup>50</sup>

2.46 Furthermore, the Committee considered the extent to which current Australian owned and controlled shipbuilders, as mandated in the Bill, would be capable of delivering Australia's future naval capability requirements. Rear Admiral Dalton advised the Committee that some ships could be built by companies that meet the requirements of the Bill, but not all:

I don't think, at the moment, there is an Australian owned shipbuilder with experience in designing and building complex steel ships...

I think we could build some of our ships through an Australian owned shipbuilder. I don't think we could build all of our ships.<sup>51</sup>

2.47 Mr Dan Fankhauser, Branch Manager, National Naval Shipbuilding Office, Defence also advised:

... as we've put in our submission, the wording as it's contained in the bill is problematic because it would severely restrict the number of entities that would fit that very narrow definition.<sup>52</sup>

2.48 Naval Group Australia noted that a requirement for 'Australian owned would preclude many companies, particularly those that are publicly traded'.<sup>53</sup>

### ***Potential cost impacts***

2.49 Defence explained potential cost impacts that may result should the Bill be passed:

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48 AkzoNobel makes paints and coatings and has developed a polysiloxane coating for ship sides.

49 *Committee Hansard*, 8 November 2018, pp. 5-6.

50 *Committee Hansard*, 8 November, p. 1.

51 *Committee Hansard*, 8 November 2018, p. 19.

52 *Committee Hansard*, 8 November 2018, p. 19.

53 *Submission 8*, p. 1; see also *Committee Hansard*, 8 November 2018, p. 13.

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The provisions of the Bill would jeopardise business models being established by Naval Group Australia, Luerksen Australia and other large multinational companies investing in Australia. Instead, foreign designers would be mandated to subcontract the build to a very restricted number of Australian shipbuilders, who may lack the experience, workforce, infrastructure and capacity to successfully execute complex warship build programs. Until the workforce base has the capacity, Defence will incur a further premium competing for the limited resources available.<sup>54</sup>

2.50 Defence referred to the analysis undertaken by the RAND Corporation on behalf of the Commonwealth and presented in the 2015 report *Australia's Naval Shipbuilding Enterprise—Preparing for the 21<sup>st</sup> Century* which advised that:

...Australia had become one of the most expensive places to build complex naval vessels and that the Australian defence budget could not afford to pay such a premium and still deliver the naval capabilities needed for the future. RAND also identified that Australia possesses limited domestic capability to design warships larger than patrol vessels.<sup>55</sup>

2.51 The issue of an increased premium for Australian built ships was also addressed by Mr Dunk who, while noting that the economic impact of the Bill was outside the scope of his submission, suggested that the overall impact to the Australian government of implementing the requirements in the Bill would be minimal. Mr Dunk observed that the estimated premium for Australian built ships suggested in the 2015 RAND Corporation report could be potentially offset by the potential return to government in the form of taxes and other payments:

...there is a certain symmetry between the 30% "premium" for Australian ships as noted by the RAND Corporation, and a study undertaken for the Royal United Services Institute in the UK that found that over 30% of the money spent on defence inside the UK was returned to the Government in the form of taxes and other payments. The impact to the Defence budget therefore becomes an accounting problem rather than an affordability problem. The ongoing overall impact to the Australian Government from adopting this bill may therefore be minimal; given sufficient ships, and with sufficient commonality, such that lessons learnt can be applied to follow-on vessels.<sup>56</sup>

2.52 If Defence was constrained by the provisions of the Bill and limited to contracting Australian shipbuilders, it was suggested that the restricted competition could reduce incentives for the shipbuilder to drive efficiencies and innovation.<sup>57</sup> Additionally, it may also increase the risk to performance by prime contractors which

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54 *Submission 2*, [p. 3].

55 *Submission 2*, [p. 1].

56 *Submission 4*, p. 1.

57 Defence, *Submission 2*, [p. 3].

may result in either lessening the accountability they would accept under the contract or increasing the costs to cover the risk of underperformance.<sup>58</sup>

2.53 Defence further observed that the provisions of the Bill would have 'profound implications' for the affordability of delivering the *Naval Shipbuilding Plan* and that:

Further analysis would be necessary to clarify the full financial implications, but they would likely include significant cost increases in amending and renegotiating current agreements.<sup>59</sup>

### ***Industry capacity***

2.54 The issue of limited industry capacity potentially impacting cost and scheduling of naval shipbuilding programs was also raised by Defence in the example of the challenge of procuring large vessels on an infrequent basis and in low numbers under the provisions of the Bill:

...such as the Landing Helicopter Dock and Auxiliary Oiler and Replenishment vessels, where the feasibility of using an Australian-owned shipbuilder would depend on the kind of capability required, the level of expertise within Australia and industry capacity at the time.<sup>60</sup>

### ***Shipbuilding workforce***

2.55 The EM argued that the engagement of Australian companies to build naval vessels is important for a number of reasons, including to 'ensure the shipbuilding workforce can be better managed'.<sup>61</sup> Shipbuilding workforce planning and capacity was an issue raised in submissions.

2.56 Mr Dunk suggested that the Bill would have a positive effect on the shipbuilding workforce, including on the ability to attract, develop and maintain necessary shipbuilding skills.<sup>62</sup>

2.57 While supporting the intent of the Bill to grow industry capacity, the WA Government advocated for broader industry strategies. It noted the importance of maintaining an ongoing shipbuilding capacity and skills in locations across Australia which, even in a continuous build program, may experience high and low periods across different sectors. It suggested the development of multi-industry precincts to achieve this:

These skills can be used in other [co-located] industries as occurs at Henderson in Western Australia, where oil and gas subsea projects, heavy engineering, mining infrastructure and commercial boat building provide

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58 Defence, *Submission 2*, [p. 3].

59 *Submission 2*, [p. 1].

60 *Submission 2*, [p. 1]. Note: ASC detailed the areas where they need to go offshore for certain expertise and equipment. See answer to questions on notice, 29 November 2018 (received 25 January 2019), [p. 1].

61 EM, [p. 2].

62 *Submission 4*, p. 2.



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opportunities for retention of a skills and capability base, as well as revenue streams for businesses in the supply chain.<sup>63</sup>

2.58 To support the viability of various shipbuilding industry sectors across periods of peaks and troughs, the WA Government also proposed other legislative initiatives, in addition to the provisions of the Bill, to ensure capability is retained in strategic industries. The WA Government submission lists a range of legislation in the United States which covers both naval purchasing and commercially purchased ships, which seek to build sovereign capability and support capacity retention in periods between major naval building programs.<sup>64</sup>

2.59 Naval Group Australia detailed the shipbuilding workforce that is currently being developed. It is estimated that a workforce of approximately 1500 employees will be delivered by 2028–29 under the Future Submarine Program. Once fully underway it is expected that the Future Submarine Program will maintain an annual average of approximately 2800 jobs in Australia, comprised of 1100 direct and 1700 in the supply chain.<sup>65</sup> As noted above, evidence from Naval Group Australia indicated that local industry has already been actively engaged through the Industry Capability Network.<sup>66</sup>

2.60 Naval Group Australia and ASC Pty Ltd provided examples of collaboration taking place between their organisations with respect to developing and maintaining workforce capacity. The two parties have agreed to share their respective lists of required competencies 'with the aim of pooling [their] skilled resources'.<sup>67</sup> It was also noted that selected Naval Group Australia staff could be seconded to ASC 'to help develop critical skills in areas where gaps have been identified'.<sup>68</sup>

2.61 ASC Pty Ltd detailed their collaboration with Naval Group Australia and a number of the major suppliers of the Future Submarine Program:

For us, it's about developing our workforce, but also providing them some certainty. It's about collaborating with Naval Group, so they understand that they have a pathway and a close collaboration with that program. Our company has also recently announced some collaboration agreements with a number of the major suppliers of the Future Submarine program, which enables us to build with our workforce and some of the French suppliers into the Future Submarine program. We see that part of our responsibility is to build a future, not just around Collins but with a number of the suppliers to the Future Submarine program and with Naval Group as well.<sup>69</sup>

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63 *Submission 9*, p. 1.

64 *Submission 9*, pp. 1-2.

65 *Submission 8*, p. 2.

66 *Submission 8*, p. 2.

67 *Submission 8*, pp. 3-4.

68 *Submission 8*, p. 4.

69 Mr Martin Edwards, *Committee Hansard*, 29 November 2018, p. 7.

## **Retrospective application of the Bill**

2.62 Under Item 2 of the Bill, the amendments would apply to relevant agreements entered into on or after 9 May 2018. Therefore, if this bill was passed, the amendments would apply to any arrangements entered into during the period from 9 May 2018 to the date of enactment. The EM states the purpose of this provision:

...is to ensure that all future naval construction programs that are currently under the consideration by the Commonwealth, and likely to be subject to agreements in the period following the introduction of the 2018–19 Budget, are subject to the provisions of this Bill.<sup>70</sup>

2.63 Defence and Naval Group Australia provided evidence that this provision would impact current and future shipbuilding programs.

### ***Impact on current and future shipbuilding programs***

2.64 Defence advised the Committee that the retrospective application of the Bill would have considerable impact on both current and future shipbuilding programs:

The retrospective aspects would have profound implications for ongoing contract negotiations with Naval Group on the Future Submarine Program. This would necessarily delay the schedule of this program and extend the timeframe substantially for the delivery of the Future Submarine.<sup>71</sup>

2.65 Furthermore, Defence was also concerned that market confidence would be undermined:

...the retrospective enactment of the Bill would also undermine market confidence in doing future Defence business in Australia, which would be detrimental to the delivery of the Defence capability and the development of Australian industry in the future. This loss of trust would increase risk to future contracts and have premiums applied to mitigate those risks further increasing costs.<sup>72</sup>

2.66 Mr Billig, of Naval Group, confirmed that, if enacted, the Bill would impact Naval Group's current contractual arrangements with the Commonwealth for the Future Submarine Program.<sup>73</sup>

### ***Government owned naval shipbuilding infrastructure***

2.67 Defence raised the status of the Osborne Naval Shipyard, currently under the ownership of Australian Naval Infrastructure Pty Ltd (ANI) as a Government Business Enterprise, as being at variance with the Bill's requirements that the construction of all naval vessels must be by Australian shipbuilders. It suggested

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70 EM, [p. 5].

71 *Submission 2*, [p. 3].

72 *Submission 2*, [p. 3].

73 *Committee Hansard*, 8 November 2018, p. 13.

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therefore that this requirement infers the sale of this facility to a privately owned Australian shipbuilder.<sup>74</sup>

2.68 Similarly, in the case of the Future Frigate Program and the Future Submarine Program, Defence suggested that the retrospective application of the Bill would require the sale of the ANI to the preferred program suppliers for those programs in order to meet the new requirements.<sup>75</sup>

## **Other issues**

### ***Intervention options***

2.69 Defence noted that the requirements under the Bill would limit intervention options for current programs which encountered difficulties, such as cost and scheduling overruns, and where the option of engaging a foreign company may be the most effective solution:

For example, the Government decided in 2015 to appoint Navantia (a foreign owned company with deep expertise) as the Shipyard Management Services contractor to oversee the completion of construction of the Air Warfare Destroyers after the program encountered schedule slippage and significant increase to cost.<sup>76</sup>

2.70 Defence advised that 'if the proposed mandate were in place, the Government would not have been in a position to take this action'.<sup>77</sup>

### ***Overseas procurement of constructed vessels***

2.71 Defence submitted that, if enacted, the Bill's new requirements concerning the acquisition of a vessel are ambiguous in relation to the overseas procurement of vessels already constructed. Section 117AJ(2) of the Bill states that the requirements of the Bill will not apply in time of war or during a time of defence emergency, and therefore allow the overseas procurement in such circumstances, but only with regard to the construction and build of vessels. However, it is Defence's view that the Bill lacks clarity and does not specifically provide for the acquisition of vessels already constructed. It noted with concern that this option has been utilised in the past and that prohibiting this approach:

...may limit the operational effectiveness of the RAN when the rapid acquisition of a vessel is required to meet urgent capability requirements. For example, Australia conducted a rapid acquisition of HMAS *Choules* in 2011 following the early retirement of former amphibious transports HMA Ships *Manoora* and *Kanimbla*, where a construction process would have left a significant capability gap.<sup>78</sup>

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74 *Submission 2*, [p. 4].

75 *Submission 2*, [p. 4].

76 *Submission 2*, [p. 3].

77 *Submission 2*, [p. 3].

78 *Submission 2*, [p. 5].

### **Committee view and recommendation**

2.72 The Committee notes that the evidence received largely provided broad views on Australian shipbuilding and did not specifically address the provisions of the Bill.

2.73 The Committee appreciates the intent of the Bill to ensure Australia continues to develop and sustain a sovereign naval shipbuilding capability. The Committee recognises the importance of a strong sovereign naval shipbuilding capability, not only for Australia's national defence in an uncertain strategic future, but also for the growth of the economy. However, it does not consider the proposed amendments in the Bill to be necessary for this to be achieved.

2.74 The Committee received evidence noting a number of genuine and practical concerns with this Bill. In particular, it was unclear whether the requirements in the Bill would be effective in delivering and sustaining a sovereign naval shipbuilding capability. The Committee is concerned that the proposed requirement for projects to be undertaken only by Australian owned and controlled shipbuilders would not provide sufficient flexibility and would result in the Australian Government not being able to deliver Australia's future naval capability requirements.

2.75 Importantly, the Committee accepts the evidence that the requirements imposed by the Bill may be detrimental to, not only achieving naval shipbuilding capability, but could also potentially negatively impact existing shipbuilding programs in terms of costs and scheduling.

2.76 Item 2 of the Bill would apply to relevant agreements entered into on or after 9 May 2018. As noted by Defence with particular reference to the Future Submarine Program, the Committee is concerned that the retrospective aspects would have implications for ongoing contract negotiations which would delay the schedule of the Future Submarine Program.

2.77 The existing policy framework outlined in Chapter 1 demonstrates the Australian Government's strong commitment and broad approach to achieving Defence sovereign capability as opposed to the more narrow approach of the Bill. The Committee notes there are already a range of measures in place to maximise opportunities for participation from and development of Australian industry, while providing value for money.

2.78 The efficacy of the existing policy framework is particularly demonstrated by the success of the negotiations for the Future Submarine Program. This program, which involves a range of stakeholders, will see 12 new submarines constructed in South Australia.

2.79 Ultimately, the Committee considers that the comprehensive framework already put in place by the Government will deliver an Australian sovereign naval shipbuilding capability while providing sufficient flexibility without the need for the Bill.

**Recommendation 1**

**2.80 The Committee recommends that the Senate does not pass the Bill.**

**Senator the Hon Eric Abetz**

**Chair**



# **Dissenting Report by Senator Rex Patrick**

## **Sovereign Naval Shipbuilding Sunk**

### **The Work of the Committee**

1.1 I thank the committee and secretariat for the work that has been done in relation to this inquiry.

1.2 I note that the Committee says it "appreciates the intent of the Bill to ensure Australia continues to develop and sustain a sovereign naval shipbuilding capability". The Committee further states that it "recognises the importance of a strong sovereign naval shipbuilding capability".

1.3 Unfortunately, however, the Committee is supportive of Australian sovereignty in name only.

1.4 The report sells out Australian shipbuilders and, along with it, national security.

### **Internationalising the Australian Shipbuilding Landscape**

1.5 This Government has made an unambiguous shift away from the use of local shipbuilders in Australian naval and maritime construction programs.

1.5.1 The RAN's French designed Durance Class supply ship was built by an Australian-controlled company. The RAN's two replacement supply ships are now being built in Spain by a Spanish company.

1.5.2 The RAN's Swedish designed Collins Class submarines were built by an Australian-controlled company. The RAN's new submarines will be built in Australia by a French-controlled company.

1.5.3 The RAN's Armidale Patrol Boats were built in Australia by an Australian-controlled company. The RAN's new Offshore Patrol Boats will be built in Adelaide and Perth led by German company Luerssen.

1.5.4 The RAN's German designed ANZAC frigates were built in Australia by an Australian-controlled company, as were the RAN's Spanish designed Air Warfare Destroyers. The RAN's new frigates will be built in Australia by a UK-controlled company.

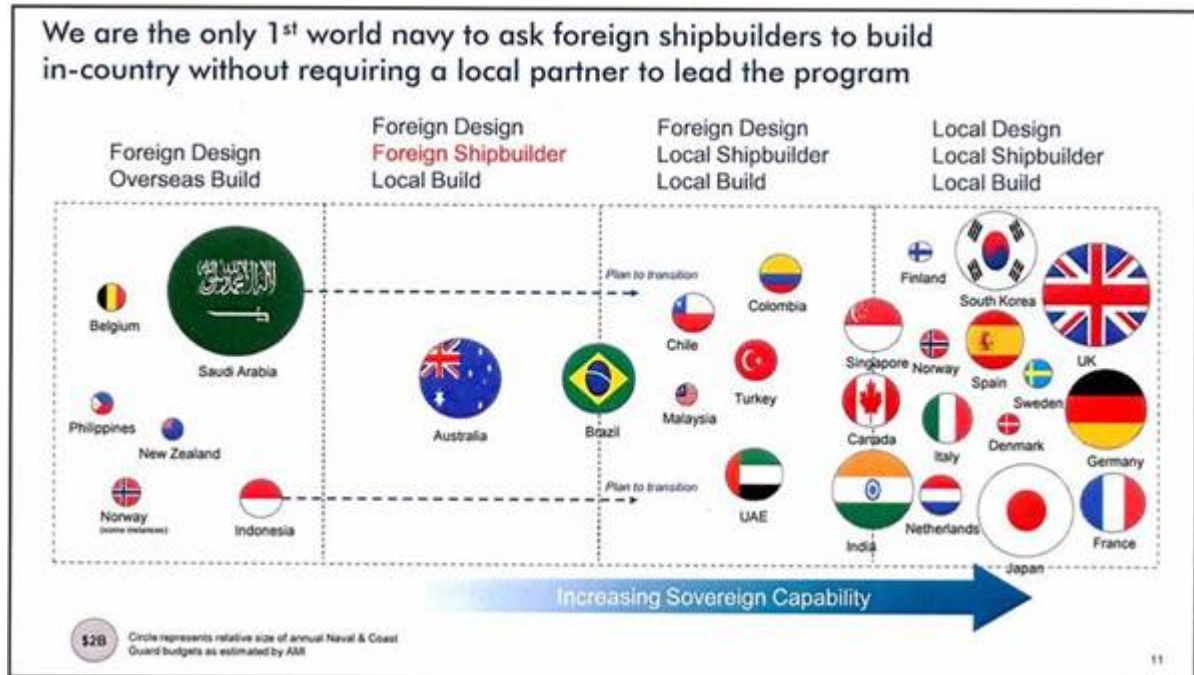
1.5.5 Aurora Australis, the Antarctic Division's Icebreaker was built in Newcastle by an Australian-controlled company. Australia's new icebreaker, RSV *Nuyina*, is being built by a Dutch company in Romania.

1.6 It is hard to avoid the conclusion that Defence bureaucrats advising Government are determined to see the quiet death of a sovereign shipbuilding

capability in Australia and its replacement with foreign entities operating on Australian waterfront real estate.

1.7 This approach is in contrast to the rest of the world, as illustrated by Figure 1. This approach is in contrast to the rest of the world, as illustrated by Figure 1.

**Figure 1**



Source of image: Austal submission to the Senate Inquiry into the Future of Australia's Naval Shipbuilding Industry

1.8 Ultimately a sovereign shipbuilding sector will need to be largely self-sustaining. This point has been made by Austal's chief executive, David Singleton:

...we need to work on creating an industry that stands on its own two feet, free of government subsidy. We cannot afford for the naval shipbuilding industry to be addicted to government welfare for its survival. The key lies in exports and the key to exports lies in Australian companies owning the intellectual property behind every ship they build. The ability to conceive new ship designs, develop them and build them in Australia needs to be a clear focus of the future Australian shipbuilding industry.

1.9 It is absolutely vital that, through our very large investment in submarines, frigates and patrol boats, the Federal Government secures the intellectual knowledge in the minds of Australians, resident in Australia and working in Australian companies, so that we have the capacity to design new ships for ourselves and for our export markets, and to maintain and sustain our new warships.

1.10 Yet the Government's approach is to see foreign companies take the lead in these nationally significant programs; foreign companies that will control the programs, foreign companies that will install their own management teams in Adelaide and elsewhere, foreign companies that will control the intellectual property and determine our shipyards' strategic direction.



1.11 When an export opportunity arises, it won't be for the Australian shipbuilder and shipyard to determine if we can export; the decision will be made in the context of the corporate plans of executives in Paris, Bremen, London and Madrid. These will be decisions that will be made on the basis of the global commercial perspectives of those companies without Australian government consultation or control.

1.12 The Government's decisions to implement our naval construction programs in this way have been fundamentally flawed. This approach will not serve Australia in the long term.

### **A Case Study in Destroying a Sovereign Naval Shipbuilding Capability**

1.13 ASC provides the perfect example of the internationalisation of Australia's otherwise sovereign naval shipbuilding capability.

#### Building A Capability

1.14 ASC, then the Australian Submarine Corporation, was conceived in 1985 by a consortium to tender for the design and build of what would later become the Collins Class submarines. In 1987 ASC won the \$5 billion dollar contract and in 1989 the Osborne shipyard was opened by Prime Minister Bob Hawke.

1.15 Construction of the Collins Class submarines began and in 1996 the first submarine was delivered to the RAN. The remaining five submarines were delivered in 1997, 1999, 2000, 2000 and 2003. During the build, in 2000, the Government acquired 100% of the company.

1.16 While the Collins Class submarines were plagued with reliability issues, this was not attributable to the build quality of the boats, rather the design and the submarine enterprise.

1.17 In 2003 ASC were awarded a 25 year contract for through life support of the Collins Class submarines. The first Full Cycle Docking (FCD) on HMAS Farncomb was completed in August 2004.

1.18 In 2004 the name of the company was changed from the Australian Submarine Corporation to ASC in preparation for being selected as the shipbuilder for Australia's Hobart Class Air Warfare Destroyer (AWD), which occurred in 2005.

1.19 In 2010 shipyard upgrades were completed and construction of the AWDs commenced in earnest in three shipyards across Australia; in Newcastle, Port Melbourne and Osborne. The keel of the first AWD arrived at Osborne in 2011, with the keel laying occurring in 2012. By 2015 the first AWD was launched. The second was launched in 2016, the third in 2018.

#### World's Best

1.20 According to the company's public statement, by the time the third AWD was launched in May 2018, ASC had reached world benchmarks for both submarine sustainment and shipbuilding. The shipyard was nothing but a success and was a truly sovereign capability.

#### Death by a Thousand Cuts

1.21 Unfortunately plans to kill off ASC were well underway by 2018.

1.22 In 2016 the Government announced the breakup of ASC into three parts - submarine sustainment, shipbuilding and infrastructure.

1.23 Infrastructure was sold off to a new entity, Australian Naval Infrastructure, to gut ASC of its shipyard facilities in preparation for the upgrading and ultimate leasing of larger shipyard facility to foreign entities. This effectively allowed foreign entities to compete with ASC on unfair terms. The planned death of ASC Shipbuilding was signalled when the Future Frigate tender was released with the following direction to the overseas ship designers selected for the program:

Tenderers should be aware that the Commonwealth has selected the Tenderers on the basis of their Reference Ship Designs and their ability to undertake the design and build of the Ships. As such, the Commonwealth's expectation is that the core design work relating to the Ships and the management and supervision of build activities will be undertaken by the successful Tenderer (or its Related Bodies Corporate) and **not** subcontracted to a third party entity. In particular, while the successful Tenderer may decide to engage a Subcontractor to provide shipbuilding labour resources, the Commonwealth expects the successful Tenderer (or its Related Bodies Corporate) to personally and directly manage and supervise the workforce and, in particular, the shipbuilding activities.

1.24 This paragraph was an act of sovereign shipbuilding treachery only to be outdone by Minister Pyne in May 2017 when he wrote to Naval Group advising that:

The Government of Australia has formally decided that DCNS will be the builder of the future submarine fleet, which will be constructed in Australia as previously announced.

1.25 In writing to DCNS, Minister Pyne made it absolutely clear that DCNS will have *"operational control of the [Government funded] future submarine program shipyard facilities"* and *"will be responsible for selecting and managing its subcontractors for the for the purpose of Future Submarine Program"*.

1.26 This decision was made despite the fact, as confirmed by Defence in response to an October 2018 Estimates question, that Naval Group had offered to partner with ASC on the build of the future submarine. They had done so during the Future Submarine Competitive Evaluation process and had reaffirmed the offer in the months after they had won the job.

1.27 Instead of building on the hard won success of ASC, Minister Pyne was determined to sink the company, along with a truly sovereign capability.

1.28 With the only substantive task left for ASC at Osborne being submarine FCDs, that too is in the process of being secretly killed off.

1.29 The first recorded thoughts of shifting FCDs to Western Australia first emerged in 2011 in a paper by Commander D.L. Stevens RANR entitled *FSM BASING STUDY*. Behind closed doors and out of sight, Defence has slowly worked on the shift. In 2016 they commissioned a study to look at moving FCDs to the west, stopping and re-starting the study's progress in response to media questioning, Estimates timetables and South Australian elections.

1.30 In October 2018 Defence were questioned on the likely use of ASC North for building of the Future Submarines, the location of the current FCD work. The exchange went as follows:

**Senator PATRICK:** *The other discussion that took place yesterday with Mr Whiley, was to do with the submarine infrastructure review team, looking at how to facilitate the build of the Future Submarine. He confirmed at a very top level that there have been discussions, that ASC North, where the current full cycle dockings are done on submarines, that area may be required for the Future Submarine build. Can you confirm whether there's discussions taking place with Defence in that regard?*

**Rear Adm. Sammut:** *I can confirm that we have developed a number of options for the submarine construction yard. We've looked at the way that we best optimise construction of the Future Submarines. We have looked at some of those options. We've also mentioned in the past in Senate estimates that we are continuing to investigate how we can best manage the ongoing sustainment of the Collins class alongside the build of the Future Submarine so that we ensure that we have efficient production of the Future Submarine in a shipyard that is best suited to coming down the learning curve and getting maximum efficiency in the build, alongside the requirement to ensure that we can continue to sustain Collins. No firm decisions have been made on those as yet.*

**Senator PATRICK:** *I've seen some documents relating to basing of submarines where it was talked about FCDs being shifted to WA.*

**Rear Adm. Sammut:** *Options.*

**Senator PATRICK:** *I understand, but I'm just joining a few dots. I have now seen a study that's been done by Defence to shift it, and now I'm hearing that ASC North may well be the site for construction of the Future Submarine, which would be inevitable ending to full cycle dockings in South Australia.*

**Rear Adm. Sammut:** *Depending on which options are taken. It wouldn't say that it's just the ASC North site that ASC currently occupies. It will be a larger area of the Osborne precinct that will be required for the construction of the Future Submarines.*

**Senator PATRICK:** *Perhaps on notice, could you provide what the list of options are, just at the very high level?*

**Rear Adm. Sammut:** *We'll take that on notice. To the extent that we can provide the information, we certainly shall.*

1.31 No definitive answer has been received, but Defence's intended path is clear.

1.32 Meanwhile Minister Pyne, a South Australian MP, and South Australian Premier Marshall appear content to let this assassination of ASC occur.

### **The Committee's view**

1.33 The Committee has uncritically accepted the Defence Department's submissions in favour of its preference for foreign shipbuilders. In doing so it has

accepted a policy framework that provides for an Australian sovereign naval shipbuilding industry in name only.

1.34 The Committee expresses concern about the provisions of the bill in so far as they would apply to the naval construction programs the government has committed to before and more particularly since the introduction of the Bill. This is a consequence of the Committee's uncritical acceptance of the existing policy framework which amounts to a fraudulent claim of Australian sovereign capacity.

1.35 The reality is that, in the absence of the framework provided by the Bill, Australia will remain critically dependent on foreign designers, builders and suppliers to support the Australian Navy and will lack a truly national naval construction capability to meet our own defence needs and pursue export opportunities.

### **Opportunity Lost**

1.36 Nearly one hundred and ten years ago the then Prime Ministers Alfred Deakin and Andrew Fisher committed the funds and signed the contracts for the acquisition of the first vessels for the Royal Australian Navy.

1.37 Contrary to the wishes of some who argued that the Navy's new ships should be built at the cheapest possible price in British shipyards, the Deakin and Fisher Governments took a different path.

1.38 While those early contracts provided for the purchase of a number of vessels from British shipbuilders, they were also designed to lay the foundations for naval construction in Australia by specifying that one of Australia's new ships, a torpedo boat destroyer, HMAS *Warrego*, would be assembled not in the United Kingdom but at the Cockatoo Island dockyard in Sydney, thereby ensuring the transfer of new shipbuilding skills and capabilities to Australia.

1.39 It was recognised then, by Deakin and Fisher, that the new Royal Australian Navy had to be supported by a sovereign Australian shipbuilding industry.

1.40 More than a century later, this Bill seeks to give effect to that vision—an Australian Navy built in Australia by Australians.

1.41 Australia's uncertain strategic future demands a much greater measure of national self-sufficiency as a Pacific naval power, supported by a sovereign naval shipbuilding and support sector.

1.42 The Defence Amendment (Sovereign Naval Shipbuilding Bill) 2018 is designed to inject the concept of sovereignty back into the Australia's purported 'sovereign' Naval shipbuilding program.

1.43 The bill can be a turning point. It should be passed.

**Senator Rex Patrick**

**Senator for South Australia**

# **Appendix 1**

## **Submissions**

- 1 Australian Industrial Transformation Institute, Flinders University
- 2 Department of Defence
- 3 Submarine Institute of Australia Inc
- 4 Mr Graeme Dunk
- 5 Confidential
- 6 Confidential
- 7 Confidential
- 8 Naval Group Australia
- 9 Government of Western Australia
- 10 ASC Pty Ltd



## **Appendix 2**

### **Tabled documents, Answers to questions on notice**

#### **Tabled documents**

- 1 Opening statement tabled by Mr Jean-Michel Billig, Executive Vice President, Naval Group, at a public hearing in Canberra on 8 November 2018.
- 2 Section 5.1 from Australian Future Submarine Program: Australian Steel Development and Qualifications Final Version for Approval, provided by the Minister for Defence on 25 October 2018, tabled by Senator Rex Patrick at a public hearing in Canberra on 8 November 2018.
- 3 Department of Defence, Report MRL-R-1149 – Properties of HY-100 Steel for Naval Construction, 1988, tabled by Senator Rex Patrick at a public hearing in Canberra on 8 November 2018.
- 4 Document tabled by Senator Rex Patrick at a public hearing in Canberra on 8 November 2018.

#### **Answers to questions on notice**

- 1 ASC Pty Ltd, Answers to questions taken on notice (Q1-7) at 29 November 2018 hearing in Canberra, received 25 January 2019.





## **Appendix 3**

### **Public hearings and witnesses**

**Thursday 8 November 2018, Canberra, Australian Capital Territory**

**AkzoNobel**

Mr David Baker, Navy, Technical & Key Account Manager

**Naval Group Australia**

Mr John Davis, Chief Executive Officer

Mr Jean-Michel Billig, Executive Vice President, Naval Group

**Department of Defence**

RADM Tony Dalton, General Manager Ships

Mr Peter Chesworth, First Assistant Secretary National Naval Shipbuilding Office

Mr Dan Fankhauser, Branch Manager, National Naval Shipbuilding Office

CDRE Stephen Hughes, Director-General Navy Littoral

**Hofmann Engineering Pty Ltd**

Mr Erich Hofmann, Managing Director

**Thursday 29 November 2018, Canberra, Australian Capital Territory**

**ASC Pty Ltd**

Mr Martin Edwards, General Manager, Submarine Capability Development

