

Chapter 9

Limited tender

9.1 When announcing the limited tender for the new supply ships, the Minister for Defence explained that the Navy was in urgent need of large support vessels but the government had assessed that it was beyond the capacity of Australia to produce these ships competitively at this stage. He noted:

In this instance it would not serve anyone if we were to provide a challenge to industry that was beyond its capabilities.¹

9.2 In this chapter, the committee considers the government's decision to conduct a limited tender and not to test, through an open tender process, the various options put forward by Australian companies and, indeed, the assumptions underpinning the DMO's advice to government at first pass.

Reasons for limited tender—cost and resources

9.3 The committee has recorded the government's arguments in favour of the limited tender which relate to the urgent need to replace the existing vessels and the productivity and capacity of Australian shipyards. The government made the decision based on its belief that it would be more costly and timely to build the ships in full or in part in Australia. Further, that an Australian full or partial build of the supply ships would not help solve the potential 'valley of death'. Representatives of the defence industry in Australia who gave evidence to the committee did not hold these views. Indeed, they put forward options and proposals in support of having substantial Australian involvement in the acquisition of the two ships and argued that the government should have allowed builders to tender for the project on their merits.²

9.4 As noted in chapter 3, Mr King was the responsible authority for forming the opinion that Defence should undertake a limited tender and advised the government accordingly. When explaining his reasons for reaching such a view, Mr King referred to industry's concern about Defence offering tenders that they could not possibly win. He stated that he gets told very regularly and very fairly:

...why are you driving companies to tender for stuff you are never going to award them? In other words, I have to be mindful or practical.³

9.5 In seeking to explain further the underpinnings of his recommendation for a restricted tender, he emphasised the fact that Australian companies would not be able to meet Defence's requirements. He took the discussion back to the complexity and

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

2 See for example, Mr Glenn Thompson, *Committee Hansard*, 21 July 2014, p. 36.

3 *Committee Hansard*, 21 July 2014, p. 15.

time involved in securing the design from overseas and the major adjustments required in an Australian shipyard to accommodate that design:

...first of all, just to get into an arrangement to bid that job... the Australian company would have to team with a design owner. If you look at the submission from the Royal Institution of Naval Architects, they make exactly that point—that you would have to go to a designer. That designer, in all instances I can think of, is also a shipbuilder. So here you are in Australia saying, 'It is an open competition and it is an open tender. I want to tender your design', and this designer is also a shipbuilder wanting to tender that build of it...that design will have to be re-engineered in order to be built in the facilities that will exist in Australia.⁴

9.6 Mr King accepted that an open tender would allow the merits or otherwise of the various Australian proposals to be examined and assessed, but asked at what cost to industry. In this regard, he informed that committee that the costs for a company to tender depended on the proposal but it could be \$5 million or \$6 million.⁵ He cited occasions where industry has said, 'You knew we couldn't meet that, and we were put to this cost'.⁶

9.7 According to Mr King, the tender process would have been ineffective. He again reiterated the impediments to an Australian build that have already been presented throughout this report:

If we tender for an offshore supplier it typically takes... two years. If it is a hybrid build it is three years. If it is an onshore build it is four years. You have to get the designer, for example. I see the South Australian government has made a submission about the facilities they could increase. In order for that Australian company to effectively make a bid, it would have to team with a designer that was prepared, under reasonable terms, to release that design and it would have to do a lot of work with another government or another backing to come up with, maybe, \$200 million worth of infrastructure. It then has to put its bid together. So even if we said, 'I'm trying to get this ship in service by 2017'—very challenging, but as soon as we can—that would at least add, in my opinion, two years to the tender process, to be fair to them.⁷

9.8 He then reasoned that there was not much point in putting out a tender that is 'not fair'.⁸ Mr King stressed that if he were to put out a tender and say, 'You must have this solution to me in two years, they would not be able to do it'.⁹

4 *Committee Hansard*, 21 July 2014, p. 16.

5 *Committee Hansard*, 21 July 2014, p. 15.

6 *Committee Hansard*, 21 July 2014, p. 15.

7 *Committee Hansard*, 21 July 2014, p. 16.

8 *Committee Hansard*, 21 July 2014, p. 16.

9 *Committee Hansard*, 21 July 2014, p. 16.

9.9 In his view, industry, whether overseas or in Australia, requires a reasonable prospect of winning and reasonable costs in tendering. In response to the proposals that industry had put to Defence, he stated that for a hybrid build alone, the unsolicited offers 'came back with a 40 per cent increased cost and delayed delivery'. He explained:

An unsolicited proposal is about your lowest degree of certainty about the offer. It is somewhere between marketing and a tender, but it is certainly not tender quality. Invariably, between the unsolicited proposal and the tender things, whatever they may be, get worse—schedule, price, whatever. What prospect against having to balance our budget, against the advantages for the shipbuilding industry to do hybrid...it was not the whole ship...What prospect of success would an Australian company have in an open tender, even had they secured their design rights?¹⁰

9.10 Mr King repeated his argument that the request for tender has to be legitimate—to really give them a chance to bid.' He then again explained the process; the impediments for potential Australian bidders to tender; and their inability to meet Defence's requirements:

...we would have to do add a year to the tender process for a hybrid build and probably another year for an onshore build. So you are going to extend the tender period. You are then probably, from experience, extend the contract period and then you are going to extend the build period. When we extend the build, if we did a hybrid, somehow they [are] going to have to get access to a design that is competitive. Secondly, we are going to take longer to get to tender, longer to get to contract and longer to do the job. In addition to those costs, I am going to have the additional cost of keeping *Success* at sea at somewhere between \$20 million and \$50 million a year for every year it continues.¹¹

9.11 He concluded that he could not be honest to industry and 'satisfy government's and taxpayer's reasonable expectations of value for money'. In essence, according to Mr King, it would be 'misleading industry to say it stands much prospect'.¹²

9.12 As he had done on a number of occasions during the hearing, Mr King stressed the importance of placing the tender process for the supply ships in the broader context of the package of decisions:

- procurement of the AORs through a limited tender;
- consideration of the feasibility of a replacement frigate program continuing on from the air warfare destroyer effectively using that current hull but with different equipment; and
- an open tender to Australia to supply Pacific patrol boats.¹³

10 *Committee Hansard*, 21 July 2014, p. 25.

11 *Committee Hansard*, 21 July 2014, p. 25.

12 *Committee Hansard*, 21 July 2014, p. 25.

9.13 Mr King noted that the three decisions relating to the acquisition of naval ships were made concurrently but with a different focus and, when taken as a whole, made sense.¹⁴ He placed a heavy emphasis on the proposed future frigates as an answer to industry's concerns about the loss of jobs and skills and the possible demise of Australia's naval shipbuilding industry. Indeed, as noted in the report, Mr King envisaged the future frigate project as an opportunity to lay the foundations for a truly strategic shipbuilding industry and to ensure the continuity of work and retention of skills.¹⁵ While keenly supporting the prospect of building the frigates in Australia as a follow-on project from the AWDs, Industry's resounding response was that the frigate build was only 'a prospect'. Their immediate concern was ensuring that Australian companies had the opportunity to participate in the construction of the replenishment ships.

9.14 Industry saw Australian involvement in the supply ship build as a means of sustaining a naval shipbuilding industrial base in Australia, thereby bringing a range of economic and innovation benefits to the economy and protecting the country's national security. It did not support the limited tender for the supply vessels.¹⁶ For example, the Adelaide Ship Construction International argued that:

...it is highly feasible that Australian industry participants could easily have been invited to contribute to the tender process, prior to the Government's decision. It would have been a far better approach for the Government, to have Australian industry plead their case to build the auxiliary supply ships in Australia; rather than make the decision without the industry's input, and defend it later down the track, as they are being forced to do now.¹⁷

9.15 While the government has made it clear that Australian companies would not be able to bid, Defence has indicated that there would be Australian content, which could be as low as 10 per cent.

Recommendation 1

9.16 The committee recommends that the tender process for the two replacement replenishment ships:

- **be opened up to allow all companies, including Australian companies, to compete in the process; and**
- **make clear that a high value will be placed on Australian content in the project.**

13 *Committee Hansard*, 21 July 2014, p. 12.

14 *Committee Hansard*, 21 July 2014, p. 12.

15 See paragraphs 8.35–8.38.

16 See for example, Mr Graeme Dunk, *Committee Hansard*, 21 July 2014, p. 43.

17 *Submission 8*, p. [2].

Recommendation 2

9.17 The committee recommends further that the government require that an open tender process be used for any future naval acquisitions.

Recommendation 3

9.18 The committee notes that Defence has identified areas where potential exists for Australian industry to become involved as sub contractors in the replenishment ship project. In this regard, the committee recommends that Defence become actively involved in encouraging and supporting Australian industry to explore such opportunities.

Recommendation 4

9.19 The committee recommends that the government release the report of the independent review of the AWD program undertaken by Professor Don Winter and Dr John White.

9.20 Some themes emerged during this short inquiry that have relevance for the committee's broader inquiry into the future sustainability of Australia's strategically vital naval ship building industry. They go to matters such as:

- Defence's understanding of the capacity of Australia's major shipyards and the extent to which their facilities and infrastructure are used for both naval and commercial activities;
- shipyard infrastructure that is or should be regarded as a fundamental input to capability and the need and potential for future investment for critical infrastructure;
- the connection between building a ship and maintaining that ship throughout its operational life;
- the basis for the minister's statement about poor productivity with regard to the AWD project and its relevance to Australia's shipbuilding industry as a whole;
- lessons to be learnt from the AWD project and how they are and should be applied to Australia's future acquisitions;
- the extent to which broader economic benefits of naval shipbuilding are understood and factored into decisions regarding the acquisition of major naval ships;
- current government and industry skills initiatives to mitigate risks to upcoming naval construction project costs and schedules;
- government and Defence strategies to identify and retain required critical skill sets for through-life support and for future projects;
- early engagement of industry in the life of a project and any impediments to this engagement;
- defence industry policy and where it should reside in Defence;

- opportunities for Australian companies to compete for shipbuilding and repair contracts and for increasing Australian content in major shipbuilding projects; and
- the importance of, and difficulties in, developing a long-term naval strategic shipbuilding plan that can cost-effectively support the needs of the Navy while sustaining an industrial shipbuilding base in Australia.

Conclusion

9.21 Although the committee has only started its inquiry into the future sustainability of Australia's strategically vital naval ship building industry, its consideration of the tender process so far for the supply ships has highlighted a number of concerns. They relate to the lack of contestability and competition in the limited tender, the level of industry engagement in the process so far and the absence of long-term strategic planning that led to the decision.

9.22 Decisions, such as the acquisition of the supply ships, are extremely important for both Defence capability and for the sustainability of Defence industry in Australia. They involve huge amounts of taxpayers' money and have long-term implications stretching out for decades. Such decisions should be well-considered and based on sound research, analysis and robust testing. The committee is not convinced that a limited tender involving only two companies is the best way to obtain the necessary information to proceed to second pass.

9.23 A local vibrant and sustainable industry able to support navy vessels throughout their operational lives is critical to Australia's national interest. In this regard, the prime contractors in Australia and the many SMEs engaged in naval shipbuilding need to have certainty and the confidence to continue to invest and participate in the industry. The way in which the tender process was announced and the exclusion of Australian industry from this process has clearly undermined this confidence. Thus, whatever the merits of the decision to opt for a limited tender, the way in which the decision was taken and announced conveyed an unfortunate message to Australian industry. The lack of consultation was at odds with Defence's stated industry policy objectives, which seek to promote a competitive, collaborative and innovative industry.

9.24 Finally, the urgency attached to procuring these vessels highlights the importance of government having a practical, reliable long term strategic plan for naval acquisitions that takes account of the important contribution that local industry has and can make to Defence capability.

Senator Sam Dastyari
Chair