



Australian Government

Australian Government response to the
Senate Economics References Committee report:

Part III: Future of Australia's naval shipbuilding
industry – Long-term planning

March 2017

Recommendation 1

The committee reaffirms recommendation 1 from its initial report 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.

Government Response to Recommendation 1

Noted

This recommendation has been overtaken by events.

On 6 May 2016, the Government announced it has signed contracts with Navantia S.A. to build Australia's two replacement replenishment ships, avoiding a critical capability gap. Australia's current supply ship HMAS *Success* will reach end of life in 2021 and needs to be replaced as a matter of priority.

The two replacement replenishment ships are urgently required to avoid a critical capability gap and to meet the operational requirements of the Navy by the early 2020's. The decision to go offshore was based on the schedule and cost-premiums of an Australian build and imperative to replace HMAS *Success* in the 2021-22 timeframe. There are elements of the ships' systems that will require Australian content in the replenishment ships, including communications and situational awareness systems and quality of life requirements.

The contract with Navantia was signed following a limited tender between Navantia of Spain and Daewoo Shipbuilding and Marine Engineering (DSME) of Korea for the offshore construction of two replacement replenishment vessels based on existing designs, Cantabria (Navantia) and Aegir (DSME) respectively.

The key reasons for recommendation to limited tender for off-shore build:

- The significant cost premium for a local or hybrid build options, including considerable investment in shipbuilding infrastructure, and/or production/block redesign;
- Schedule premiums where, based on experience with the LHD project, a premium of approximately one year is likely for a 40% Hybrid build option. For a full Australian build, based on recent experience with the AWD, ANZAC and the Canadian Joint Supply Ship (JSS) projects, the period between approach to market and commencement of construction is likely to be up to five years; and
- The tender process remained in accordance with the accelerated schedule approved by Government at First Pass. There has been no delay to the schedule for Second Pass approval, contract award, construction or Initial Operational Capability of the replacement replenishment ships.

Recommendation 2

The committee recommends that the Government adopt the following procurement process to acquire 12 future submarines:

- a twelve to eighteen month procurement process, involving a Request for Proposal, followed by Request for Tender;
- invite the most prominent and relevant submarine designers to participate in the process, encompassing Germany, France, Japan and Sweden;
- conduct a Funded Project Definition Study; and
- down-select two submarine builders to provide full design definition and fixed priced contract bids.

The committee also reaffirms recommendation three from its report on future submarines that:

Given the weight of evidence about strategic, military, national security and economic benefits, the committee recommends that the government require tenderers for the future submarine project to build, maintain and sustain Australia's future submarines in Australia.

Also, given the national significance and complexity of the project to acquire the future submarine, the committee recommends that the government establish a Naval/Submarine Construction Authority as a 'non corporate Commonwealth entity with appropriate industry and Defence expertise and authoritative leadership to deliver the future submarine'.

The committee recommends further that Defence heed and apply the lessons learnt from the AWD regarding the transfer of knowledge and those of the Collins Class submarine about the consequences of being a parent navy to the future submarines.

Government Response to Recommendation 2

Noted.

This recommendation has been overtaken by events.

Informed by the outcome of the Competitive Evaluation Process, the Government announced on 26 April 2016 that DCNS of France has been selected as the preferred international partner to work with Australia on the design of a regionally superior Future Submarine. The Government also announced that all 12 Future Submarines will be built in Australia.

Sustainment in country, encompassing all upkeep, update and upgrade activities will also ensure that the Future Submarines can be kept at appropriate levels of availability without undue reliance on another country throughout their service life.

The lessons learnt from the Air Warfare Destroyer and Collins submarine programs, together with advice from naval shipbuilding experts, such as the RAND Corporation, will inform the development of the Naval Shipbuilding Plan.

Recommendation 3

The committee recommends that the Australian Government provide the committee with a copy of the 'forensic audit' of the AWD program.

The committee also repeats its recommendation contained in its first report that the government release the report of the independent review of the AWD program (also known as the Winter-White Report).

The committee understands that it may be appropriate for a public version of both documents to be released with classified material removed.

Government Response

Disagree.

The 'forensic audit', into the Air Warfare Destroyer project has not been undertaken by the Department of Defence. Rather, the Department undertook a Comprehensive Cost Review (CCR), in late 2014. The CCR was undertaken by the Air Warfare Destroyer (AWD) Alliance and is Commercial in Confidence. The CCR reviewed the cost and schedule of the shipbuilding score of the AWD Program and informed the AWD Reform Strategy.

The CCR report cannot be released as it contains information that is commercially sensitive to the Commonwealth and some third parties and is subject to strict confidentiality arrangements to protect the intellectual property of the parties involved. Accordingly, the report will not be publicly released as to do so would prejudice the Commonwealth's commercial and legal interests.

Similarly, the Winter-White Report cannot be released in any form as it contains sensitive commercial information. Its release could damage the interests of the Commonwealth and shipbuilding organisations as its contents relate to a range of commercial negotiations that are currently underway. The Minister for Finance and then Minister for Defence summarised the report in their announcement AWD Reform dated 4 June 2014, which is available on the Minister for Finance's website.

Recommendation 4

The committee recommends that the Australian Government take measures immediately to reverse the perilous downturn in Australia's naval shipbuilding industry, reduce the impact of the 'Valley of Death' and enable a program of continuous build by:

- mandating a hybrid build for the first Auxiliary Oil Replenishment Ship and an onshore build for the second;
- mandating that all 12 of the future submarines be built in Australia;
- fast tracking the build of the Pacific Patrol Boats and the replacement of the Armidale Class Patrol Boats; and
- bringing forward the construction of the Future Frigates.

Government Response

Noted.

On 6 May 2016, the Government announced it has signed contracts with Navantia S.A. to build Australia's two replacement replenishment ships, avoiding a critical capability gap. Australia's current supply ship HMAS *Success* will reach end of life in 2021 and needs to be replaced as a matter of priority. Please see response to recommendation 1 for further information on the offshore build of the Auxiliary Oil Replenishment Ship.

On 5 May 2016, the Government signed a contract with Austal Ships Pty Ltd to build and sustain up to 21 steel-hulled vessels to replace the existing fleet of Pacific Patrol Boats as part of Australia's new Pacific Maritime Security Program. The Pacific Patrol Boat project represents a

significant investment in Australian Defence industry with the boats to be built in Australia to be worth around \$600 million, in addition to through-life-sustainment and personnel costs, which are estimated at around \$1.4 billion over 30 years.

The Government announced on 4 August 2015 the centrepiece of its strategy for delivering a long-term strong and sustainable Australian naval shipbuilding industry – the establishment of continuous build programs in Australia for the construction of the Navy’s Future Frigates and Offshore Patrol Vessels. This approach was been reaffirmed by the Prime Minister in his speeches on 18 and 26 April 2016. This is the first time that any Australian Government has committed to a permanent naval shipbuilding industry for Australia.

The Future Frigate construction to replace the ANZAC class frigates will commence in 2020 – three years earlier than scheduled under the previous Labor Government’s Defence Capability Plan. The Government has also committed to bringing forward by two years the construction of the Offshore Patrol Vessels commencing in 2018 to replace the Armidale class patrol boats.

Over the coming decades, the Government’s naval shipbuilding strategy will invest in Australia’s naval capability and shipbuilding industry, putting it onto a sustainable long-term path, giving certainty into the future.

Recommendation 5

The committee recommends that the 2015 White Paper is prepared in such a way that all procurement proposals are costed and scheduled realistically, and informed by the need to have a continuous build program for naval ships.

The committee understands that, following the release of its 2015 Defence White Paper, the government will also publish a Defence Investment Plan and an enterprise-level Naval Shipbuilding Plan.

The committee recommends that both documents take note of the evidence provided in this report about the importance of having a continuous build program that will sustain a viable naval shipbuilding and repair industry.

Further that both documents, provide:

- a schedule of anticipated timelines for the construction and delivery of all Defence Capability Plan (DCP) projects, with continuity of production the paramount feature;
- a discussion about the nation's future strategic capability requirements that identifies the industrial capabilities deemed to be strategically important and Defence's expectations for Australia's naval shipbuilding industry;
- an assessment of the nation's existing shipbuilding and repair facilities, including the shipbuilding supply chain, and predicted investment needs;
- a comprehensive statement providing accurate and reliable information on Defence's future plans for its naval acquisition program that goes beyond ten-year projections;
- a detailed explanation on the acquisition schedule indicating the reasoning behind it and the major factors influencing demand flows; and
- reliable cost estimates.

The committee recommends the establishment of an ongoing naval shipbuilding industry advocate to work with the Australian Government and the shipbuilding industry, including supply chain and SMEs. The shipbuilding industry advocate should advise Defence and industry during the development of the Defence Investment Plan and Naval Shipbuilding Plan.

Government Response

Agree in principle.

As noted in the response to recommendation 4, the Government recognises the significant value to Australia of having a skilled naval shipbuilding industry and is committed to ensuring the industry's long-term sustainability. Government has announced its strategy for delivering a long-term strong and sustainable Australian naval shipbuilding industry through the establishment of continuous build programs in Australia. As announced by the Prime Minister on 18 April 2016 and 26 April 2016, two shipyards have been identified to implement the Government's commitment to a continuous build of naval vessels – Osborne in South Australia for the construction of major surface vessels and submarines, and Henderson in Western Australia for the construction of minor surface vessels. These decisions are consistent with the RAND recommendations.

The 2016 Integrated Investment Program and the Defence Industry Policy Statement were released with the 2016 Defence White Paper, which together present the Government's policy with respect to the strategic Defence and national security issues facing Australia, as well as the capabilities (both material and enabling) and Defence industry policy that will be required to address those issues. The Naval Shipbuilding Plan will bring together all of the elements of the Government's continuous naval shipbuilding strategy to:

- support the strategic and capability needs of Defence;
- provide a viable, permanent naval shipbuilding industry;
- provide certainty for the naval shipbuilding workforce;
- deliver value for money;
- build commercial confidence; and
- promote the use of global best practice.

Recommendation 6

The committee recommends that, given requisite capital investments have already occurred, and as the industry's only effective client, the Australian Government adopt an approach to domestic shipbuilding that ensures sustainable demand in order to realise returns on these investments.

The committee also recommends that, during the development of the forthcoming Strategic Naval Shipbuilding Plan, the Australian Government ensure that the Plan recognises the holistic economic value of any domestic shipbuilding project. It is the strong view of the committee that the Plan must also acknowledge the economic multiplier effect of domestic shipbuilding, including that expenditure generates a level of economic expansion beyond its initial value.

Government Response

Agree in principle.

The Government is committed to releasing a Naval Shipbuilding Plan. The Plan will focus on the delivery of continuous shipbuilding rather than modelling the economic affects of shipbuilding.

The RAND of Australia's Naval Shipbuilding Enterprise, released by the Government on 16 April 2015, noted that the cost of building naval surface ships in Australia is 30-40 per cent greater than United States benchmarks, and even greater against some other naval ship building nations.

RAND suggested that this premium can be reduced through reforms in Defence procurement and in the Australian naval shipbuilding industry.

The Government has already commenced the necessary reforms of Defence procurement activities through the First Principles Review of Defence, and through the August 2015 announcement of the long term commitment to naval shipbuilding for ships and submarines in Australia, as detailed in the 2016 Defence White Paper.

Australia cannot afford a naval shipbuilding industry at any price.

In return for the commitment to continuous build, Australia's naval shipbuilding industry must improve productivity and become more cost-competitive against international benchmarks.

The Government's continuous build strategy, and the adoption of the RAND principles for future naval shipbuilding programs, will help to reduce the Australian cost premium by up to half.

The conclusions of the *Productivity Commission's Trade and Assistance Review 2014-15* are premised upon a cost premium of 30 per cent for a domestically built submarine. However the report states that the figure of 30 per cent is hypothetical; the Government has already identified that the premium will drop, by committing to the implementation of reforms of the naval shipbuilding industry, including:

- committing to the establishment of a continuous naval shipbuilding program for ships and a rolling acquisition program for submarines;
- reforming the Air Warfare Destroyer program, to demonstrate that the productivity of the shipbuilding workforce can be improved; and
- a commitment to undertake further reform of the naval shipbuilding industry to ensure Australian shipbuilding is best structured to support a continuous build program.

