Australian Government

Australian Government response to the Senate Economic References Committee report:

Part I - Inquiry into the Future of Australia's Naval Shipbuilding Industry Tender Process for the Navy's New Supply Ships

April 2015

Recommendation 1

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.

Government Response - Disagree

Part 1 – "be opened up to allow all companies, including Australian companies, to compete in the process"

The key determinants in reaching the decision to go off-shore were the schedule and cost impact of an Australian build and the imperative to replace HMAS *Success* in the 2021-22 timeframe.

The replacement of both HMA Ships *Success* (in particular) and *Sirius* is Navy's highest priority because they are essential enablers of operational capability.

It is important to note that Defence has commenced a program to improve *Success*'s materiel state, allocating around $365 million to sustain the ship to financial year 2021-22 (forecast Initial Operational Capability of the first replacement ship). This work is being undertaken by companies in Australia. Activities to sustain *Success* even further past its planned withdrawal from service, to accommodate an open tender process, are yet to be assessed. However, due to the obsolescence of equipment fitted to HMAS *Success*, these activities are likely to come at a considerable cost above what has already been committed.

The Government's decision regarding a limited tender for the replacement replenishment ships was announced simultaneously with its decisions to bring forward work to keep open the option of building the Future Frigates in Australia; an open competition with Australian industry to construct the replacement Pacific Patrol Boats; and the development of an enterprise-level Naval Shipbuilding Plan as part of the White Paper 2015 process.

Defence is continuing to pursue all three of these activities to allow the Government to consider competitive Australian business to participate in future naval shipbuilding, sustainment and upgrade projects.

Schedule Impact

Defence has advised that the extended schedule associated with the construction of a supply ship in Australia is highly unlikely to meet the required in-service date for *Success*'s replacement leading to the risk of a gap in the Royal Australian Navy's capability to deploy combat power.

It is also assessed that, given the lead time to commence construction of an Australian build, a decision to conduct an open tender would have no impact on impending job losses in Australian shipyards.

Experience with AWD and the ANZAC Ship Projects and more recently the Canadian Joint Support Ship (JSS) Project (two supply ships for the Canadian Navy) suggests five to six years is required from the initial approach to industry for a design through to the contract award and "cut steel". For example:

- The initial Risk Reduction studies for AWD were commenced in early 2004, yet construction did not start until Jan 2010.
- Designs for the ANZAC Ship Project were tendered in 1986, with Defence selecting Blohm+Voss (Germany) as the designer. Work (cut steel) started approximately six years later in March 1992 (Note: production started well before the detailed design was completed in September 1993, resulting in significant rework). Although delivered in March 1996, HMAS *ANZAC* was not accepted into naval service until mid-2000.
- In November 2010, Canada announced a decision to commence design studies through release of a Request for Proposal to Navantia and TKMS for the JSS Project. The JSS specification is closely aligned with that produced for SEA1654-3. The JSS build contract is currently scheduled for December 2016.

These extended schedules for construction of a supply ships are associated with the requirement to adapt the design and where appropriate the shipyard facilities to achieve productivity gains associated with larger block construction.

Based on this, Australian industry would be unable to deliver the capability sought by SEA1654-3 prior to 2022-23; whereas unsolicited proposals from Navantia and DSME for an offshore design and build suggest 2019-20 delivery is achievable.

Cost Impact

In 2007 Defence commissioned a report by Appledore International from the UK to undertake an assessment of Australia's capacity to build the forward section of the LHD. In 2013 Defence commissioned a further report (by leading internationally recognised consultancy within Royal Haskoning DHV, First Marine International (FMI)) to undertake an assessment of the Australian shipyards' capacity to support construction of the supply ships.

The conclusions of both the Appledore and FMI reports was that "Australian Shipyards currently do not have the capacity to build these ships at similar productivity levels to those achieved during the construction of the Spanish Supply Ship Cantabria without making a significant investment in infrastructure, which is unlikely to be amortized over a two ship build".

Defence SA has previously advised that upgrade options (to support construction of the supply ships) for the shiplift include a $20m upgrade for lift capacity increase, a $50m upgrade for lift and length capacity increase and up to a $175m upgrade for the shiplift to be useful for sustainment of any naval ship. It is acknowledged that there would be some return on investment in facilities for future sustainment of the ships; however experience on the ANZAC Ship Project suggests that productivity saving associated with learning curve effects including facilities upgrades will not be realised with a two-ship build.

Preliminary analysis of unsolicited proposals from Navantia/BAE, Navantia and DSME indicate an approximately 40 percent cost premium, compared with a full off-

shore build, if 40 percent of the build was undertaken in Australia. Noting that the specific details of the unsolicited proposals remain commercial-in-confidence, Defence has not quantified the additional cost premium associated with fully building the supply ships in Australia.

Part 2 – "make clear that a high value will be placed on Australian content in the project."

Defence has sought to influence the designer's commitment to Australian content through the "commonality" requirements set out in the Risk Reduction Design Study statement of work:

The ship design shall investigate commonality with equipment currently in service, or planned to be in service in the Royal Australian Navy.

- This may include areas of commonality leading to lower life-cycle costs, such as with training requirements, through life support (including sustainment) and other areas that would contribute to lowering the cost of ownership of the capability.

Prospects for Australian content include, but are not limited to:

- design and installation of C4I systems,
- specialist Integrated Logistics Support (ILS) Systems,
- development and support of Royal Australian Navy-specific 'support products'.

Recommendation 2

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

Government Response - Disagree

The Government is supportive of open tendering whenever it is assessed as the best procurement method available to attain the core principle of achieving value for money for the Australian taxpayer.

However, in the case of the Future Submarine Program an open tender process which involves approaching all submarine producers is clearly not an option.

A formal request for tender to design and build the future submarine would be a lengthy process. It would involve extensive work to fully define submarine specifications against which competitors would then have to develop detailed designs that could be evaluated for performance and then priced with any degree of reliability.

All of this would take at least five years before reaching the point of selecting the international design partner. The competitive evaluation process for the Future Submarine Program as recently announced by the Government will run for at least 10 months after which the international partner will be selected. A competitive evaluation process is the only way forward that ensures that a submarine capability

gap will not occur while at the same time delivering the best capability to the ADF and value for money to Australian taxpayers.

Moreover, to require that all future naval acquisitions occur via open tender would limit the ability of the Government to choose to go directly to Australian Industry as was the case with the Landing Helicopter Dock (LHD), Air Warfare Destroyer (AWD) and ANZAC Frigate procurements. In addition, this decision would also impact the current procurement activities in support of ANZAC Class and Future Frigates, which are specifically supporting Priority Industry Capabilities within Australia with studies such as the CEA Technologies Phased Array Radar.

Pacific Patrol Boat replacement is also planned to be a limited tender to Australian Industry which, as identified in Senator Edwards' Dissenting Report, would be impacted.

Without the ability to limit tenders through the use of the Commonwealth Procurement Rules there is a potential that the cost of tendering for industry will increase. This is a constant concern expressed by industry in relation to DMO procurement. Procurement strategies are developed on a case-by-case basis in consideration of the global market and the ability of industry to deliver the capability that is required on time and on budget. The ability to limit tenders is also paramount to Commonwealth National Security, with sensitive capability requirements and considerations being classified, and specifically quarantined from non-allied nations.

An inability to use limited tender will also impact interoperability and the ability for the Commonwealth to meet international obligations. Specifically, we would be unable to draw on Government to Government procurement arrangements for supply of naval weapons, and communications systems.

Recommendation 3

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.

Government Response - Agreed in principle

Prospects for Australian content include:

- design and installation of C4I systems,
- specialist Integrated Logistics Support (ILS) Systems,
- development and support of RAN specific 'support products'.

Overall, decisions on industry options will consider Value for Money assessments and the trade off between enhancing local industry capability and the delivery of the required capability on time and within budget.

In accordance with Defence's Australian Industry Capability policy, Defence continues to encourage and support Australian industry. Prospects for Australian content in Project SEA1654-3 will be further developed during the preparations leading up to the release of Requests for Tender for both the Prime Acquisition and Sustainment contracts. It is expected that both designers will engage with Australian industry during the development of their responses to the Prime Acquisition and Sustainment RFT's.

Recommendation 4

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.

Government Response - Disagree

Release of the independent report (Winter / White Report) could damage the commercial interests of the Commonwealth, as its contents relate to a range of sensitive commercial negotiations that are currently underway. The Government considers the report is highly sensitive in relation to current and future shipbuilding tenders and negotiations.