

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 2018.¹ On 15 October 2018, the Senate agreed to extend the reporting date to 5 December 2018.² On 26 November 2018, the Senate agreed to a further extension until the last sitting day in the first sitting week in February 2019.³

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.⁴

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 2018.⁵

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.

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,⁶ 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.⁷

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.⁸ 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.⁹

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.

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.¹⁰

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.¹¹

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.¹²

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',¹³ 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.¹⁴

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.¹⁵

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.¹⁶

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.¹⁷

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 44th 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.¹⁸ 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.¹⁹

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*

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.²⁰

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.²¹

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

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.²³

Recommendation 1

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

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.

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.²⁴

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.²⁵ 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

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.²⁶

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.²⁷

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.²⁸ This recognition therefore requires Defence to consider the industrial capability and capacity of Australian businesses to deliver defence capability. Naval

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.

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

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'.³⁰

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.³¹

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'.³² The plan sets out the key future naval capabilities, acquisition and sustainment to meet Australia's strategic requirements.³³ 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.³⁴

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.³⁵

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.³⁶

...

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.³⁷

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.³⁸

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.³⁹

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

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.⁴⁰

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.⁴¹

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.⁴²

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.⁴³

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.⁴⁴

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.⁴⁵ 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.⁴⁶ 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.

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.⁴⁷

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.⁴⁸

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.⁴⁹

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;

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.⁵⁰

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.⁵¹ 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.⁵²

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...⁵³

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).

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.⁵⁴

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.⁵⁵ 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.⁵⁶

1.55 Initiatives and investments under the Strategy include:

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.⁵⁷

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.⁵⁸

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.⁵⁹

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-2019.⁶⁰

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.

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.⁶¹

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.⁶²

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 2019.⁶³

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.⁶⁴

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.

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.⁶⁵

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.⁶⁶

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

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 \$80,000.⁶⁷ 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.⁶⁸

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.⁶⁹

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

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.⁷⁰

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.⁷¹

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.⁷²

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.⁷³

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.