

# Chapter 2

## Key issues

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

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

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

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

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

2.4 The EM also states that the Bill:

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

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

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1 EM, [p. 2].

2 EM, [p. 2].

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

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

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

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

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

2.8 ASC also discussed sovereign defence capability in its submission:

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

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

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

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

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

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

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

6 *Submission 10*, p. 2.

7 *Submission 3*, p. 3.

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

9 *Submission 3*, p. 2.

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

...

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

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

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

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

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

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

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

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10 *Submission 3*, p. 5

11 *Submission 3*, p. 6.

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

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

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

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

*Future Submarine Program (SEA 1000)*

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

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

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

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

...

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

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

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

15 *Submission 8*, p. 1.

16 *Submission 8*, p. 1.

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

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

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

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

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

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

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

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

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

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

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

*Operational sovereignty*

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

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

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

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

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

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

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

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21 *Submission 4*, p. 1.

22 *Submission 4*, p. 1.

23 *Submission 4*, p. 2.

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

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

26 *Submission 4*, p. 2.

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

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

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

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

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

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

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

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

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

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27 EM, [p. 3].

28 *Submission 3*, p. 4.

29 *Submission 3*, p. 6.

30 *Submission 4*, p. 2.

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

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

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

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

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

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

### **Australian industry**

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

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

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

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

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

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

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

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

35 EM, [p. 2].



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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45 *Submission 1*, p. 1.

46 *Submission 1*, p. 8.

47 EM, [p. 1].

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

56 *Submission 4*, p. 1.

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

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

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

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

### ***Industry capacity***

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

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

### ***Shipbuilding workforce***

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

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

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

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

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

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

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

61 EM, [p. 2].

62 *Submission 4*, p. 2.

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

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

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

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

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

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

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63 *Submission 9*, p. 1.

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

65 *Submission 8*, p. 2.

66 *Submission 8*, p. 2.

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

68 *Submission 8*, p. 4.

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

## **Retrospective application of the Bill**

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

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

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

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

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

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

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

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

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

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

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

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70 EM, [p. 5].

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

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

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



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

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

## **Other issues**

### ***Intervention options***

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

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

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

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

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

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

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

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

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

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

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

### **Committee view and recommendation**

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

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

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

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

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

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

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

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

**Recommendation 1**

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

**Senator the Hon Eric Abetz**

**Chair**

