

CHAPTER 3

THE AUSTRALIAN SUBMARINE CORPORATION AND THE SALE OF ADI

Exclusion of the Australian Submarine Corporation (ASC)

3.1 The decision not to offer the ASC for sale with ADI Limited was raised in the inquiry. As noted above, OASITO had determined early in the sale process that it would not be advantageous to sell ASC with ADI. Accordingly, when the proposed sale of ADI was announced on 12 December 1997, the Government stated that it would defer, until the second half of 1998, consideration of the Commonwealth's shareholding in the ASC.¹ The decision was based on a number of factors.

3.2 The ASC had been established to develop and construct, as a prime contractor, six Collins class submarines for the Australian Navy. Kockums Pacific (a subsidiary of the Swedish Celsius group) held 49 per cent interest in the company while the Commonwealth, through the Australian Industry Development Corporation (AIDC), owned 48.45 per cent. The remaining 2.55 per cent was held by RCI (a subsidiary of James Hardie Industries Limited).² The shareholder arrangements were an important consideration in the Commonwealth's belief that inclusion of the ASC in the ADI sale would both lengthen the sale process and detract from ADI's saleability.

3.3 OASITO submitted that market research on the preferred model for sale of ADI and the ASC conducted during the scoping phase had revealed that: 'There was no commercial rationale or market interest in acquiring a merged ADI/Australian Submarine Corporation'.³ Mr Harris said that ADI had assessed the feasibility of acquiring the Government's equity in the ASC, and had judged that most of the profit in the company had already been taken up by investors, leaving 'a huge amount of risk'.⁴

3.4 Even before the ADI sale process began, the Collins class submarine was experiencing serious problems. The submarine project was eventually subject to an inquiry, the report of which (June 1999) confirmed serious design flaws requiring costly rectification.⁵ Debate about the submarine project had shadowed the sale

1 Joint Media Release, 'The Future Sale of ADI Limited and the Australian Submarine Co-operation Pty Limited', 9 December 1997, 83/97.

2 'The Future for ADI Limited and Australian Submarine Corporation Pty Limited', Joint Media Release, December 1997 83/97, *Defence Acquisition Organisation* Internet site (16 September 1999).

3 OASITO, submission, p. 12.

4 *Committee Hansard*, 19 November 1999, pp. 120.

5 See Report to the Minister for Defence on the Collins Class Submarine and Related Matters: Summary and Recommendations, attachment Media Statement, the Hon. John Moore, MP, Minister for Defence, 'Reform of the Defence Acquisition', 1 July 1999.

process, contributing to the Commonwealth's decision not to complicate the sale of ADI by including ASC.⁶

3.5 The Committee sought information about any approaches made to OASITO to include the ASC in the tender. Mr Hutchinson told the Committee that no unsolicited bids had been made for the ASC. This was in contradiction to newspaper reports suggesting that major tenderers Tenix Pty Limited and Transfield Thomson-CSF had both done so. Mr Hutchinson told the Committee that interested consortia did consider possible options for the ASC in their bids but none suggested that they would improve their bids for a joint sale, and nothing so formal as an 'unsolicited bid' had been received.⁷

3.6 The Committee noted Mr Hutchinson's reply that no bids had been received for the ASC. It then sought to establish whether there had been any unsolicited expressions of interest in the ASC. Mr Hutchinson said that an unsolicited expression of interest had been received during the expressions of interest phase, but the Government judged that the party was not sufficiently informed about the risks entailed in their bid at that point. The bid from that party was, therefore, not taken forward.⁸ Mr Ian King, Director of Baring Brothers Burrows, clarified this, saying: 'during the expression of interest phase you cannot stop unsolicited requests to buy all sorts of assets. We had quite strange requests to buy ADI from all sources and that includes ASC...our role was to assess whether there was any serious interest in it, and I think the answer was no'.⁹

3.7 Tenix confirmed that it did not make an unsolicited bid for the ASC.¹⁰

3.8 Transfield Thomson-CSF told the Committee that it had included an unpriced offer for the ASC in their proposal to buy ADI, but this was subject to certain conditions. These related to the need to sort out the current contractual issues surrounding the Collins project and to clarify the pre-emptive rights that the Swedish shareholder Kockums has over the Commonwealth's shareholding. The final proviso was that Transfield Thomson-CSF would only be interested in the ASC if it could obtain fifty per cent ownership.¹¹ Mr Shepherd regarded the Commonwealth's minority ownership in ASC as a problem. He said that ASC's inclusion in the ADI sale would have lengthened the process and made it more complicated.¹²

6 See for example, President Mr Lars Joseffson of Celsius, owner of ASC shareholder Kockums defence of the Collins submarine on 20 November 1998.

7 *Committee Hansard*, 26 October 1999, p. 96–97.

8 *Committee Hansard*, 26 October 1999, pp. 91–92.

9 *Committee Hansard*, 26 October 1999, pp. 103–04.

10 *Committee Hansard*, 25 October 1999, p. 66

11 *Committee Hansard*, 25 October 1999, p. 47.

12 *Committee Hansard*, 25 October 1999, p. 47.

SECA's interest in the ASC

3.9 The Committee was told that Systems Engineering Consortium of Australia (SECA) expressed an interest in acquiring the ASC along with ADI, although it did not ultimately make a bid for ADI. The Chairman of SECA, Dr John White, had previously put together Australian Marine Engineering Consortium, which purchased the Williamstown naval dockyards in 1987. The dockyards were subsequently bought by Transfield, which restructured them into a profitable enterprise.¹³

3.10 SECA's vision for ADI, based on the Williamstown model, was for it to become 'a premier technology company', supported by a strong Australian SME network.¹⁴ SECA had recruited Celsius, the Swedish parent company to Kockums and co-owner of the ASC, into the consortium with the intention of integrating shipbuilding interests into ADI, so creating a consolidated and predominantly Australian-owned defence industry.¹⁵

3.11 Dr White elaborated on his vision for a combined ADI and ASC, saying that the Australian defence industry needed consolidation so as to compete in the international arena. SECA had secured the support of Pratt's Visy industry group (30 per cent equity stake), the Australian National Bank (20 per cent equity) and incorporated Celsius on the clear understanding that they would ultimately consolidate their 49 per cent share in the ASC with ADI in majority Australian ownership.¹⁶

3.12 Mr Hutchinson acknowledged that the partnership with Celsius singled out SECA among other contenders in its desire to acquire the ASC:

Whereas the other bidding parties had expressed general interest in being involved or consulted or accommodated in whatever the Commonwealth in the future decided to do in respect of the ASC shareholding, of those who were on the list after the expressions of interest stage SECA was the most aggressive in pursuing and indicating a linkage to its interests in ASC.¹⁷

3.13 In early November 1997, Dr White had expressed his hopes that ADI and the ASC would be offered for sale together saying:

The Federal Government's sale of ADI and its shares in the ASC is a unique opportunity to create a strategically important 'smart' Australian company that can work across defence and civilian markets.¹⁸

13 *Committee Hansard*, 19 November 1999, p. 134.

14 Philip Hopkins, 'Transfield Project Seen as Model', *Age*, 17 August 1998, p. B4.

15 *Committee Hansard*, 19 November 1999, p. 136.

16 This totalled 80 per cent. The remaining 20 per cent would be filled by the 'most appropriate Australian company' with the Clough Group of Perth keenly interested. See *Committee Hansard*, 19 November 1999, p. 136.

17 *Committee Hansard*, 29 November 1999, p. 158.

18 Reported in Michael Gordon, 'When the Boat Doesn't Come In', *Age*, 26 June 1999, p. 4.

3.14 Dr White told the Committee that, in 1997, prior to ADI coming on the market, SECA had offered an unsolicited bid for ADI, at a book value of \$320 million, on the condition that it could purchase the Government's shares for the ASC at book value in return.¹⁹ Dr White stated that, after the Government announced its intention to sell ASC and ADI separately, SECA made a commercial decision to approach Celsius.²⁰

3.15 The viability of the SECA bid therefore hinged on the continued commitment on the part of the Celsius group. The basis of the agreement was that, having secured ADI, the consortium would work to consolidate the ASC into it.²¹ However, evidence revealed that the arrangement between the two was predicated on agreements being made with the Commonwealth that Dr White had hoped to secure prior to bidding.

3.16 The Committee sought to clarify these agreements. Mr Hutchinson explained that there were two aspects to SECA's request, made on 30 March 1999. The first was a standard request to vary the membership of the consortium from that declared at the expression of interest phase on 30 July 1998.²² The Committee was told that the first request was never finalised because the related second request, which involved the guaranteeing of certain consents and waivers, was not granted.²³

3.17 SECA proposed that the Commonwealth would guarantee that SECA could become fifty-fifty shareholders in the ASC with the Celsius vehicle, KPAC-Kockums Pacific Australia, building on its 49 per cent holding and SECA claiming the AIDC's shares.²⁴ The ultimate aim of the request was that the Commonwealth would support this amalgamation as a new company called the Australian Naval Corporation Pty Ltd. Meanwhile, SECA would be collectively owned by a number of parties, including 30 per cent by Celsius.²⁵

3.18 As OASITO explained, acceptance of this rested on the second aspect which would have required the Commonwealth to agree not to exercise its pre-emptive rights under the Collins class submarine contract and also that the AIDC would agree not to exercise its pre-emptive rights in connection with equity in ASC. On this basis, and despite the fact the agreement would only be activated if SECA were selected as the preferred purchaser, Blake Dawson Waldron advised the Commonwealth not to give consent. Mr Hutchinson told the Committee:

19 *Committee Hansard*, 19 November 1999, p. 140.

20 *Committee Hansard*, 19 November 1999, p. 136.

21 *Committee Hansard*, 19 November 1999, p. 136.

22 *Committee Hansard*, 29 November 1999, pp. 148–49.

23 *Committee Hansard*, 29 November 1999, p. 150.

24 Presumably, the 2 per cent held by another firm would also be obtained by the consortium. *Committee Hansard*, 19 November 1999, p. 138.

25 Mr Michael Hutchinson, OASITO, *Committee Hansard*, 29 November 1999, p. 146.

SECA's application was rejected mainly on legal grounds. It would have been inappropriate to agree in advance of bid receipt and assessment to unsolicited proposals and conditions put to the Commonwealth in the context of the sale. The Commonwealth legal advisers warned that accommodating such an approach at that stage could have threatened the legal basis and integrity of the sale process.²⁶

3.19 He further explained that this was because any decision drawn on the matter would have called into consideration elements of the evaluation criteria set for the sale. These related to industry development and future industry structure. It was considered inappropriate to make judgement on these outside, and especially, in advance of the sale process. In essence, it would mean that the Commonwealth 'would be making bid related decisions for one party on matters that the other parties had not been given the opportunity to have considered'.²⁷ Mr William Conley, Managing Partner of Blake Dawson Waldron, confirmed Mr Hutchinson's summation noting, in particular, that:

there were industry issues which went to the heart of the application by way of the proposal of the SECA consortium which were the very issues, by way of evaluation criteria, all bidders were being asked to address in their bids, which were due on 30 June, and here we were in April, being asked to consider those very issues on behalf of one party.²⁸

3.20 Dr White had expressed concern that OASITO had engineered the rejection of SECA's proposal, independent of prior approvals gained from Defence.²⁹ Mr Hutchinson emphasised that the decision made against the proposal and correspondence about it was issued as a collective Commonwealth response, and not just that of OASITO, despite the latter's obvious responsibility as manager of the sale process.³⁰ OASITO also emphasised that SECA had been told that the decision had been made 'without prejudice' to SECA's proposal being subject to 'proper and constructive assessment' at the appropriate time, that is, at the time of bid assessment.³¹

3.21 Mr Hutchinson told the Committee that it was OASITO's perception at the time of the request for the ex ante arrangements that they were being sought in order to keep the SECA consortium together. On the basis of Dr White's evidence, OASITO drew the conclusion that: 'Celsius had been able to use the absence of the ex ante approvals to exercise an option to leave the consortium prior to bidding'.³² It is

26 *Committee Hansard*, 29 November 1999, p. 146.

27 *Committee Hansard*, 29 November 1999, p. 151.

28 *Committee Hansard*, 29 November 1999, p. 162.

29 *Committee Hansard*, 19 November 1999, p. 137.

30 *Committee Hansard*, 29 November 1999, p. 146.

31 *Committee Hansard*, 29 November 1999, p. 147.

32 *Committee Hansard*, 29 November 1999, p. 147.

reasonable to assume that the failure to gain advance security for future development plans was a catalyst to Celsius' withdrawal from SECA.

3.22 The *Australian Financial Review* of 14 May 1999 reported that, earlier in that month, Celsius had shocked the Swedish stock market by recording losses of \$1.6 million. These resulted from severe cutbacks in defence spending by governments globally, also leading to mergers in the industry. Celsius was said to be keen to consolidate its place in the Europe by the teaming up with other European firms. At the same time, however, Celsius President Lars Joseffson, commenting on the break-up with SECA, said that this was because of 'very different commercial judgements on a very central issue'.³³

3.23 The Committee was satisfied with the explanations received from OASITO and its advisers on SECA's request of 30 March 1999. It was, nevertheless, disappointing that SECA withdrew from the sale process, thereby reducing the number of bidders for ADI and weakening the process. It would have been a more commercially robust process if more of the original short-listed consortia had remained in the sale process and lodged bids for ADI.

Alleged interest by Electric Boat in the ASC

3.24 The Committee sought to establish whether Electric Boat, an American submarine company, had made any approaches to OASITO about the ASC and whether it was being advised by Baring Brother Burrows (or any related company).

3.25 The Committee asked OASITO:

if ING made any representations to OASITO in the early part of the sale, when there were expressions of interest, or later, on behalf of the Electric Boat company, the [American] submarine company.³⁴

3.26 Mr Hutchinson replied:

We know that they did not make any representations to OASITO at all. I cannot recall having heard from ING other than through their Baring Burrows subsidiary here in Australia.³⁵

3.27 The Committee asked 'did any company act on behalf of Electric Boat in making representations or unsolicited bids in respect of the Submarine Corporation?' Mr Hutchinson replied that he had 'no recollection of an unsolicited bid at all'. When prompted about 'any expressions of interest', he replied 'The unsolicited expression of

33 'ADI Battleground for Families at War', *Australian Financial Review*, 14 May 1999, pp. 48, 80.

34 *Committee Hansard*, 29 November 1999, p. 169.

35 *Committee Hansard*, 29 November 1999, p. 169.

interest that arose during the pre expressions of interest stage was not to my knowledge traceable to Electric Boat, to Barings or to ING'.³⁶

3.28 Mr King confirmed that Baring Brothers Burrows is 50 per cent owned by ING, and that the two are effectively the same business entity.³⁷ Asked whether the ING had represented Electric Boat at all, Mr King stated that he 'had no knowledge of that'. Mr Hutchinson also confirmed that the ING had not made any representations to OASITO on behalf of Electric Boat.³⁸

3.29 In subsequent written answers to questions taken on notice at the hearing on 29 November 1999, OASITO advised that 'Electric Boat has never been a client of Baring Brothers Burrows' and 'Preliminary inquiries have been undertaken of the global client data base of ING Barings, which indicate that Electric Boat is also not a client of the group'.³⁹

3.30 On the basis of the explanations received from OASITO and its advisers, the Committee is satisfied that Electric Boat had not approached OASITO directly or indirectly about any interest it might have in the Australian Submarine Corporation. On the same basis, the Committee is satisfied that Electric Boat was not a client of Baring Brothers Burrows or any related entity. Baring Brothers Burrows could not, therefore, have had a conflict of interest by advising both Electric Boat and OASITO.

36 *Committee Hansard*, 29 November 1999, pp. 169–70.

37 *Committee Hansard*, 29 November 1999, p. 169.

38 *Committee Hansard*, 29 November 1999, p. 169.

39 OASITO, letter to Committee dated 4 January 2000.

