

## CHAPTER 4

### INDUSTRY ISSUES ARISING FROM THE ADI SALE

#### Regionalism

4.1 One of the features of ADI is that its factories are widely dispersed, with many located in regional areas. These factories have been important employers in those regions. The prospect of ADI's privatisation, with its inevitable uncertainties about the continuation of ADI's regional facilities, has been a matter of concern for regional authorities.

4.2 The Committee received a number of submissions which focussed on the importance of continuing to operate ADI factories in regional areas, especially in Bendigo and Lithgow. Among these were submissions from the City of Greater Bendigo and the Council of the City of Lithgow. His Worship the Mayor of Bendigo, Councillor Daryl McClure, also gave evidence at a public hearing:

The council's concern in relation to the sale of ADI is particularly in regard to the Bendigo plant, which is the heavy engineering plant – formerly the Bendigo ordnance factory – and which employs a large number of people in Bendigo and has done for a very long period of time.

The council is concerned because it believes that the operation of that facility should continue beyond the time of the sale and, if possible, be improved, upgraded and offer even further employment opportunities within the city – either directly as part of its operations or indirectly through outsourcing various of its requirements within the city.<sup>1</sup>

4.3 Councillor McClure drew attention to the recent history of the plant and its effects on Bendigo:

We all have an acute interest in the welfare of this particular plant but I suppose as a community we have been saddened since the mid-1980s as the workload at the plant has declined and the work force has declined. It has dropped towards 50 per cent of where it was. That is a substantial income loss to our economy.<sup>2</sup>

4.4 Councillor McClure went on to say that although Bendigo's population growth rate is 1.7 per cent per annum, the highest in regional Victoria, it would have been higher if the workforce of the ADI Bendigo plant had not declined. The higher population growth would have allowed better facilities for the people of the area.

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1 *Committee Hansard*, 25 October 1999, p. 19.

2 *Committee Hansard*, 25 October 1999, p. 25.

4.5 The General Manager of the Council of the City of Lithgow, in his written submission, said that:

Obviously the Lithgow community looks to the new owners to commit to the development of the manufacturing capacity of the Lithgow facility, and the Council has offered to assist the new owners in a site-rationalisation process.<sup>3</sup>

4.6 The Committee noted that one of the objectives set out in OASITO's sale strategy was:

(viii) to achieve a sale outcome which contributed to a competitive, sustainable and efficient Australian defence industry, as well as to regional industry development.<sup>4</sup>

4.7 Mr Eaton (OASITO) told the Committee that retention of existing ADI regional facilities 'was not a specific requirement but it was part of the evaluation process. In other words, the bidders' plans for the regional activities of ADI were assessed as part of the evaluation process.' He went on to say:

We had a sale objective which was to achieve a sale outcome that would contribute to a competitive, sustainable and efficient Australian defence industry as well as to regional industry development. So the government wanted to measure the bids against those criteria, but it did not specify in advance that the existing regional structure had to be maintained – and it was prepared to look at restructuring if that was what the bidders proposed.<sup>5</sup>

Under the sale contract, Transfield Thomson-CSF is required to seek the permission of the Australian Government to dispose of ADI assets within 18 months of the date of sale<sup>6</sup>. After that time, Transfield Thomson-CSF may dispose of assets in line with its commercial judgement.

4.8 Transfield Thomson-CSF submitted that it:

plans to retain and develop ADI's regional operations at Bendigo, Benalla, Mulwala, Lithgow, Albury and Newcastle. Both Transfield and Thomson-CSF have demonstrated a strong commitment to regional industry development. With regard to ADI, Transfield has already provided precision engineering work to ADI Bendigo, e.g. telecommunications shelters. Through an extension of this relationship, Transfield can investigate providing additional civil workload to ADI operations in

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3 Council of the City of Lithgow, submission.

4 OASITO, submission, p. 18.

5 *Committee Hansard*, 29 November 1999, p. 174.

6 Mr Tony Shepherd, Chief Executive – Project Development of Transfield Pty Ltd, inadvertently referred to this period as three years rather than 18 month when he gave evidence to the Committee on 25 October 1999 (p. 38). He corrected this error in a letter dated 18 November 1999.

regional facilities such as Bendigo and Lithgow, transfer of Transfield's Process Equipment business to Lithgow. Thomson-CSF is an international company and is well aware of their impact on local economies and communities and is actively contributing to job creation programs in areas affected by industry restructuring.

... the Joint Venture intends that the Engineering and Vehicle businesses at Bendigo should continue as going concerns and that work opportunities be found for those opportunities to grow employment for the direct and wider community. Increased investment at Bendigo to accommodate the Bushranger, GE and other contract development opportunities will ensure that ADI Bendigo continues its strong support of the local economy.

The Joint Venture's redevelopment proposal for Mulwala, when implemented, will immediately boost employment during the construction phase and ensure current jobs are secure in the future.

Lithgow will remain operational and ADI Albury's prospects will benefit from access to Thomson-CSF's world leadership in simulation and established presence in prospective international markets.<sup>7</sup>

#### 4.9 Mr Shepherd told the Committee that:

We are going to work hard to endure the viability, as we do with all of the assets of ADI. As with all companies, we are cast adrift on a windy sea, and who knows what is going to happen in three, four or 10 years time? Who knows what is going to happen to Transfield? I cannot make a prediction 10 years out, but our intention as we sit here now is to grow the business and to make it viable and strong, and that is what we will do. We are not in the business of carving up businesses that we have paid a lot of money to acquire. We are driven to make them work.<sup>8</sup>

4.10 As detailed above, the successful tenderer, Transfield Thomson-CSF, has made written commitments to develop ADI's regional facilities. The Committee looks forward to the realisation of those commitments and to the benefits that should flow from them to the regional communities in which they are located. The maintenance and enhancement of employment opportunities and services in regional Australia are matters of concern for the whole Australian community. It is pleasing that a business is seeking to help develop existing facilities in regional areas. The Committee is aware that the future of these facilities is dependent on their commercial viability and that at least Transfield Thomson-CSF is seeking to secure that viability.

### **Foreign Investment in ADI**

4.11 On 17 August 1999, when announcing the preferred buyer of ADI, the Minister for Finance and Administration and the Minister for Defence stated that:

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7 Transfield Thomson-CSF, submission, p. 19.

8 *Committee Hansard*, 25 October 1999, p. 38.

The Joint Venture brings together two corporations with complementary skills and experience with the dual benefits of significant Australian involvement and access to world class defence technology.<sup>9</sup>

4.12 They emphasised that Thomson-CSF's bridge to international markets was anchored in three decades of involvement in local subsidiaries and joint venture partnerships in the Australian defence industry.<sup>10</sup>

4.13 Despite the Government's support for foreign investment in ADI, concerns over whether foreign ownership of ADI Limited would compromise Australia's national and strategic interests were raised during the sale process.<sup>11</sup> Defence sources immediately dismissed these concerns, with reports suggesting that privatisation had now gone too far for any alternative course to be taken.<sup>12</sup>

4.14 The Committee received several submissions expressing concern that the Government should contemplate selling Australia's defence industry and, in particular, into foreign ownership.<sup>13</sup> These submitters questioned whether a foreign-owned firm could guarantee Australia's national interests would take precedence over the commercial interests of its parent company, or over the foreign policy objectives of its parent country. More pointedly, they asked whether sale to foreign owners would affect Australia's ability to defend itself or to engage in military or peace-making operations where and when the Australian Government judged it necessary.

4.15 In addition, the question was raised whether Thomson-CSF would use its position to lock Australia into purchasing products from overseas which may not be the best for Australian defence purposes. Mr Robert Downey observed that: 'It would seem unlikely that Thomson-CSF will regenerate manufacturing industry in Australia but [will] rely on the concept of purchasing from the cheapest source'.<sup>14</sup> Mr Leonard Fallon also questioned the wisdom of facilitating domination of Australia's defence industry by such an aggressive and efficient partnership which, as a private entity, is not obliged to place its operations and financial performance on the public record.<sup>15</sup>

4.16 The Committee sought clarification of the status of French Government ownership and, in particular, to establish what influence the ownership would have on

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9 Joint Media Release, 'Sale of ADI Limited—Selection of Preferred Purchaser', 17 August 1999, 42/99, p.1.

10 Joint Media Release, 'Sale of ADI Limited—Selection of Preferred Purchaser', 17 August 1999, 42/99, pp. 1–2.

11 See for example: *Canberra Times*, 18 August 1999; *Australian Financial Review*, 5 August 1999, pp. 1, 10; *Age*, 26 June 1999, p. 4 and *Australian Financial Review*, 25 June 1999, p. 21.

12 FED: 'No Worries about French Interest in ADI', *Australian General News*, 5 August 1999.

13 See for example submissions from: Mr Robert Downey; Ms Pauline Mitchell, Secretary, Campaign for International Cooperation and Disarmament; Mr Bob Cameron MP, State Member for Bendigo West; Dr Mary Maxwell and Ms Karen Kyle, Secretary, Bendigo Trades Hall Council.

14 Mr Robert Downey, submission, p. 1.

15 Mr Leonard Russell Fallon, AFAIM, CPI, FIPEA, submission, p. 7.

dealings of ADI Limited internationally. Mr Anthony Shepherd (Transfield) told the Committee:

The bottom line is that Thomson is a private company. It is run for the benefit of its shareholders, and it is still only a fifty-fifty partner in ADI, so we would not expect any political problems to impact on the continuing operation of ADI. We do not see it as an issue going forward. It is a privately owned company; that's it. What we do is what we do. It is not a functionary of the French Government or an outlet of the French Government in any way, shape or form.<sup>16</sup>

4.17 Mr Shepherd also observed that the French Government was in the process of reducing its current ownership from 40 per cent to 34 per cent.<sup>17</sup>

4.18 Commenting on previous tensions with France, Mr Gilbert Dangleterre, CEO of Thomson-CSF, said:

Just to add one point, the previous crisis never impacted on the business of Thomson-Marconi Sonar delivering sonar systems for the ANZAC and for the Minehunter. So I believe that we have proven that we have the capability to maintain full production for the Australian market through our activity in Australia. To respond to the political element, France has signed the agreement on non-testing of nuclear weapons, so I do not want to enter into this.<sup>18</sup>

4.19 Dispelling concerns that Transfield Thomson–CSF intended to use ADI as a shopfront for its own products, and that Australia's potential to tap into cutting edge United States' technologies would be damaged by ADI's French connections, Mr Shepherd explained:

It is our intention to source the most appropriate technology for Australia's needs from whatever source. To this end we have confirmed with the major US and other corporations already working with ADI that the current relationships with ADI will continue. In addition, we intend to develop a closer relationship between ADI and significant US companies, such as Raytheon, Computer Sciences Corporation and SAIC. It is interesting to note that our partners, Thomson-CSF, are already working with Raytheon to supply NATO the LOC 1 command and control system for air defence.<sup>19</sup>

4.20 A related concern investigated by the Committee was whether the sale of ADI to the French-Australian joint venture would affect United States' access to the Captain Cook Dry Dock at Garden Island, Sydney.<sup>20</sup> Questioned about ownership of

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16 *Committee Hansard*, 25 October 1999, p. 31.

17 *Committee Hansard*, 25 October 1999, p. 31.

18 *Committee Hansard*, 25 October 1999, p. 31.

19 *Committee Hansard*, 25 October 1999, p. 28.

20 See Leonard Fallon, submission, pp. 6–7.

the dock after the sale, OASITO and Defence representatives stated that Defence regarded the dock as a strategic asset and would lease, but not sell, it to ADI's new owners.<sup>21</sup>

4.21 The Committee considered whether Transfield Thomson-CSF had a long-term commitment to maintain a balance between French and Australian ownership. In his opening statement to the Committee, Mr Shepherd emphasised that Thomson-CSF was building on already established connections in the local industry and the region:

Thomson-CSF has maintained a strong presence in Australia and the Asia-Pacific region for some 30 years. For example, Mr Malcor has been managing director of Thomson–Marconi Sonar in Australia, which has been very successful in supplying Australia's defence needs as well as growing a civil export capability.<sup>22</sup>

4.22 In response to questioning by the Committee, Mr Shepherd said that any suggestion that Transfield would withdraw from the joint venture was 'a mischievous allegation'. He emphasised:

It is a genuine fifty-fifty arrangement. Transfield has put an enormous effort into the bid and is investing a significant amount of money into ADI and we are transferring some of our top executives into ADI. We are making a very big commitment. Relatively, given the size of the two companies, this is a far bigger commitment from Transfield than it is from Thomson. Our intention is to stay there as a full fifty–fifty partner forever. We have no intention of stepping back, walking away or anything. It would be a huge failure on our part to do so.<sup>23</sup>

4.23 However, in terms of official requirements or guarantees made under the sale process, the preferred purchaser was not under obligation to retain ownership, or present ownership arrangements, in the long term. Mr Eaton (OASITO) said that:

The purchaser cannot dispose of or divest of any businesses for a period of 18 months post sale...without the Commonwealth consent. Beyond that the TTJV [Transfield Thomson Joint Venture] has given us, in its business plan, a general picture that it intends to maintain for the long term the current regional activities of ADI, subject, obviously, to commercial pressures that might arise in the future.<sup>24</sup>

4.24 Mr Shepherd confirmed that, outside of the specified period, the buyers were in fact 'unfettered' in their business decisions about ADI.<sup>25</sup> On this note, Mr Malcor

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21 *Committee Hansard*, 29 November 1999, p. 165.

22 *Committee Hansard*, 25 October 1999, p. 27.

23 *Committee Hansard*, 25 October 1999, p. 45.

24 *Committee Hansard*, 29 November 1999, p. 174.

25 *Committee Hansard*, 25 October 1999, p. 38.

sought to reassure the Committee that Transfield Thomson-CSF would not sacrifice 'core capability' defence production to commercial interests. He acknowledged the need to maintain capability in areas of production less profitable in peace time and banked on making profit from product diversification:

You need a core that you can expand quickly if you have to multiply your output by three or four. Having paid for this facility, there is a lot of what we call marginal business to be done around it, where you can be fairly competitive in the marketplace. That is what we are looking for.<sup>26</sup>

4.25 Mr Harris told the Committee that the defence industry, like all other business, was subject to the 'global trend towards opening markets'. He judged that this meant that Australian ownership was not an important issue. Instead, commercial viability in the global market place was important. This, he thought, was why Transfield Thomson-CSF had been selected. They had offered Government the 'best proposition': 'international market access - capital and technology'.<sup>27</sup>

4.26 From their side, Mr Dangleterre explained the comparative attraction of ADI to foreign industry participants:

The attraction for Thomson-CSF of the Australian defence market is its stability, clarity and predictability. It is true now that, like all the other markets, Australia is embarking on new, imaginative ways to develop the relationship between industry and defence for the long term, through the incentive scheme we call PFI and through long-term partnerships which are certainly necessary and which are on the verge of being implemented in Australia. So there is a parallel to be made between what we are encountering in Europe and in Australia. Australia is ranked as a significant, valuable market for any foreign country, I would say.<sup>28</sup>

4.27 Transfield Thomson-CSF thus saw that Australia's defence industry had a viable future trading products back to the world.<sup>29</sup> Mr Harris explained the global dynamic conditioning this engagement, and what sort of obligations it places on defence industry participants:

what is interesting about this industry - and it is a global thing - is that companies are often competing against each other for some project and collaborating on others. So it is an industry that is strangely characterised by a high level of competition but also a high level of collaboration. We found ourselves - and other companies did - working with company X on one project and competing against one another on another project. That requires

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26 *Committee Hansard*, 25 October 1999, p. 40.

27 *Committee Hansard*, 19 November 1999, p. 121-22.

28 *Committee Hansard*, 25 October 1999, p. 41.

29 *Committee Hansard*, 25 October 1999, p. 41.

a high degree of sophistication in managing those commercial relationships...<sup>30</sup>

4.28 In its submission Transfield Thomson-CSF cites evidence of its expertise in managing its own commercial interests coupled with the strategic interests of its clients. In a section entitled ‘Protecting Australia’s Defence Relationships and National Security’, the submission states:

The Joint Venture will continue the current ADI strategy of teaming with the appropriate partners and suppliers, which have the products and expertise that best meet the needs of ADI’s clients. Consistent with this approach the Joint Venture will maintain procedures to deal with the transfer of technology from overseas companies, including those developing and owning US technologies.<sup>31</sup>

4.29 The submission goes on to state that: ‘Interoperability with the defence systems of Australia’s allies is a task addressed almost daily by Thomson-CSF when working on contracts in the US, Canada, the UK and other NATO countries’. It lists Thomson-CSF’s extensive commercial relationships with European and US firms, including GEC-Marconi and Raytheon, before elaborating its record on meeting Australia’s national security requirements.<sup>32</sup> In particular, the submission states:

ADI will meet all of the requirements of the Defence Industrial Security Program (DISP) as set out in the SECMAN 2 and the Agreement between Australia and France, in particular those requirements relating to the protection of Australian and foreign sourced classified material and official information.<sup>33</sup>

4.30 At hearings, it became clear that Joint Venture obligations to safeguard Australian interests through ADI Limited fit into Thomson–CSF’s necessary compliance with the international security requirements governing global armament trading. ADI Limited, as an international trader, must seek an ‘end user certificate’ for any export done, so as to safeguard national and international security, and non proliferation requirements. Mr Malcor explained that the process was ‘very thorough and deep’ and required extreme vigilance on the part of participants.<sup>34</sup>

4.31 Mr Dangleterre (Thomson-CSF) drew attention to Thomson-CSF’s record to show that it can and will meet Australia’s national and security requirements:

I think the track record of Thomson-CSF in Europe has proven that we respect the national rules of each and every country we are established in.

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30 *Committee Hansard*, 19 November 1999, p. 124.

31 Transfield Thomson–CSF, submission p. 25.

32 Transfield Thomson–CSF, submission pp. 25–6.

33 Transfield Thomson–CSF, submission pp. 27.

34 *Committee Hansard*, 25 October 1999, p.36.



We have more than 5,000 employees in the UK. We are a defence supplier in the UK, and we apply all of the rules which are incumbent on any UK company to whom we export. In a similar way we do it in Germany, in Spain and in the United States, where we have 1,000 employees. So we follow the national rules to the letter, in full.<sup>35</sup>

4.32 Although concerns have been voiced about a French company with part French Government ownership investing in 50 per cent of ADI, the company has a long and successful history of working in the Australian defence industry. As a major international contractor, Thomson-CSF is in a position to provide ADI with finance, technology and access to markets overseas. By having only a 50 per cent interest in ADI, it does not have a controlling interest. The Committee has no reason to doubt that the new owners of ADI will proceed in accordance with the plans submitted to OASITO on which their bid was evaluated and won the tender.

### **Safeguarding intellectual property**

4.33 Mr Chris Rodwell of the Australian Industry Group's Defence Council told the Committee that the protection of national security interests, particularly in Western countries, would be subject to increasing stress as a result of mergers amongst major European and US defence companies.<sup>36</sup> He also identified problems Australia's Department of Defence has in determining the best capability plans for future development, given that competing private companies advising them are reluctant to volunteer answers in advisory fora for fear of exposing their intellectual property, with subsequent loss of competitive advantage.<sup>37</sup>

4.34 The underlying issue here, in both these cases, is the availability of intellectual property and the relative security of its exchange in an increasingly global and private sector dominated defence industry. Whether ADI's intellectual property can remain secure under these circumstances was examined by the Committee.

4.35 During the sale process, an emerging concern was that French ownership of ADI would compromise important defence ties with the United States. The issue crystallised after ADI won the frigate upgrade contract. The United States was reported to have reservations about potential intellectual property flow to France via the upgrade project if Transfield Thomson-CSF were selected as preferred buyers of ADI.<sup>38</sup> Mr Fallon submitted that:

anecdotal evidence that the US is screening and filtering data and information available to Australia based upon US concern that this data and

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35 *Committee Hansard*, 25 October 1999, p. 36.

36 *Committee Hansard*, 26 October 1999, p. 85.

37 *Committee Hansard*, 26 October 1999, p. 85.

38 *Australian Financial Review*, 25 June 1999, p. 21.

information may become available to the French during defence project and contract work as a result of the sale of ADI limited.<sup>39</sup>

4.36 OASITO representatives judged the management of intellectual property matters as one of the ‘three top complexity factors’ in the sale.<sup>40</sup> Mr Hutchinson said:

I think it is fair to say that the role of intellectual property in the ADI business and the importance of intellectual property to the ADI business are far greater than in any other Commonwealth business that we have dealt with, particularly third-party intellectual property that is licensed to ADI or licensed for use by ADI. It is integral to their business in a way that intellectual property is not really integral to the operations of many other Commonwealth businesses.<sup>41</sup>

4.37 OASITO submitted that intellectual property ownership and related rights was regarded as an important component of the value of ADI. In the scoping study, OASITO identified the need to form an intellectual property register to protect the Commonwealth’s interests and to enhance the commercial attractiveness of ADI to prospective buyers. OASITO listed the following measures which were taken in relation to intellectual property:

- (i) the identification and collation as far as possible of all documented and non-documented IP owned or used by ADI and the establishment of an IP register;
- (ii) the identification and clarification of IP issues arising under the original Deed of Transfer of IP from the Commonwealth to ADI in 1989 (including IP owned by third parties);
- (iii) the identification of IP which the Commonwealth required either revert to it or otherwise be confirmed as the subject of Commonwealth ownership;
- (iv) a review of the adequacy of various IP licences and, where necessary, the development of strategies for the negotiation of amendments to some licences; and
- (v) the development of strategies to address the likely concerns of Prospective Purchasers with various IP issues facing ADI.<sup>42</sup>

4.38 Mr Hutchinson explained that the need to transfer and document intellectual property, and to allocate intellectual property between ADI and the Commonwealth, was a commitment made at the time of the foundation of ADI but had never been

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39 Mr Leonard Russell Fallon, AFAIM, CPI, FIPEA, submission, p. 7.

40 *Committee Hansard*, 26 October 1999, p. 101.

41 *Committee Hansard*, 26 October 1999, p. 98.

42 OASITO, submission, p. 13.

finalised.<sup>43</sup> Mr Lewis (OASITO) confirmed that ADI's intellectual property register was more extensive compared with those prepared for other sales handled by OASITO. He stated:

We see it as a very important requirement to get these things absolutely of a high quality in order to protect the Commonwealth's interests post-sale, because any warranties we offer are in relation to those registers. ADI probably had a more extensive IP register than would be usual for a Commonwealth asset sale, but there have been IP registers in other asset sales.<sup>44</sup>

4.39 Transfield Thomson-CSF sought to show that ADI's intellectual property was secure under its stewardship. Thomson-CSF had existing strong ties with the United States in this area and a good record of handling these matters efficiently and with integrity in the international arena.<sup>45</sup> Mr Shepherd emphasised that consideration of Australia's security interests here was a priority in Transfield Thomson-CSF's bid for ADI, and that measures were devised to ensure ongoing confidence:

We will put in place tried and proven processes which have been approved by the Department of Defence. These processes will ensure the integrity of any Australian classified material. We understand also that our closest ally, the United States, has approved these processes. The board of ADI will have a preponderance of Australian citizens, including myself, who will be suitably cleared from a security viewpoint.<sup>46</sup>

4.40 On 5 August 1999, the *Australian Financial Review* reported that United States Government sources had denied that the sale of ADI to Thomson-CSF might raise technology transfer problems for Washington.<sup>47</sup> On the announcement of the sale, the Government was reported to be comfortable that Transfield Thomson-CSF had strong joint venture arrangements with the United States, dismissing fears that conflict over intellectual property matters might arise.<sup>48</sup>

4.41 The Committee received no evidence that the sale of ADI to Transfield Thomson-CSF was likely to cause concern in the United States to the detriment of the close co-operation existing between Australia and the United States in relation to transfer of technology or related matters. Thomson-CSF is a respected international prime contractor with existing contracts with American firms. The Committee is satisfied that Thomson-CSF's investment in ADI is not likely to disadvantage Australia.

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43 *Committee Hansard*, 29 November 1999, p. 172.

44 *Committee Hansard*, 26 October 1999 p. 98.

45 Transfield Thomson-CSF, submission pp. 27–8.

46 *Committee Hansard*, 25 October 1999, p. 27.

47 Geoffrey Barker, 'French Bid in ADI Sale Exposes Raw Nerves', *Australian Financial Review*, 5 August 1999, p. 10.

48 Lincoln Wright, 'PM Approves ADI Sale', *Canberra Times*, 18 August 1999.

### Access to global markets

4.42 One of the main motivations of Government in securing the sale of ADI was to build Australia's defence export industry and to gain greater access to overseas markets. Questioned on 19 November 1999 about ADI's competitiveness prior to sale, former Managing Director Ken Harris stated that ADI had been very competitive in the domestic market, however:

The world marketplace is a different thing altogether. To be competitive in the world marketplace for a company the size of ADI you need stronger global links. I do not really believe a company coming out of Australia with the sort of technology we have here could ever be highly competitive in a global market, dominated as it is by customers who want to buy very complicated systems. Systems are the key to it. The key to ADI's future or any Australian company's future as an international competitor is to tie up with a company that can provide it with the technology it needs to compete internationally.<sup>49</sup>

4.43 The interlinking between access to the global market place, enhanced IP and technical development and more capital investment were integral to the free market model of engagement driving the sale of ADI Limited. Mr Harris judged that Transfield Thomson-CSF had seemed to offer the strongest vehicle for success.<sup>50</sup> At hearings, Mr Malcor (Thomson-CSF) told the Committee that a strong network is needed to access international markets, given the difficulty of doing this from Australia.<sup>51</sup> He explained the joint venture's vision for ADI:

From our point of view, ADI is a company with real growth potential. I have been given the task to grow ADI. Growth is particularly dependent upon three factors: access to technologies; access to international markets; and access to capital. This is what Transfield and Thomson-CSF are providing. While operating as an independent company, ADI will be able to draw on the worldwide resources of the two shareholders. Our vision is to strengthen and revitalise ADI as Australia's premier defence company and to further expand in international and commercial markets.<sup>52</sup>

4.44 Other industry witnesses in their evidence to the Committee confirmed that Australia's defence industry needs foreign participation to give it the necessary stimulation and contacts to remain viable and to grow.<sup>53</sup> Mr Sharp (GEC-Marconi) remarked that the size of the Australian market, and the cyclic nature of contract

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49 *Committee Hansard*, 19 November 1999, p. 108.

50 Australian Defence Magazine, October 1999, pp 68-70.

51 *Committee Hansard*, 25 October 1999, p. 33.

52 *Committee Hansard*, 25 October 1999, p. 28.

53 Dr John White, *Committee Hansard*, 19 November 1999, p.134; Mr John Favalaro, *Committee Hansard*, 25 October 1999, p. 54; Mr Chris Rodwell, *Committee Hansard*, 26 October 1999, p. 72.

letting, meant that there must be outside project work coming in.<sup>54</sup> He judged that having the right partner was most important. He thought that Thomson-CSF would provide access to markets in Europe, the United States and the Asian region.<sup>55</sup>

4.45 Nevertheless, there was also scepticism about Transfield Thomson-CSF. Some submitters thought the Joint Venture aimed to dominate the Australian industry without any real commitment to generating local engagement. Mr Favalaro, (Tenix Pty Ltd) said that the joint venture was an ‘Australian facade for an overseas contractor who seeks to appear as a local’.<sup>56</sup> He explained that there is a need to gain ‘critical mass’ in the Australian industry so as to elevate Australian players into a level of significance within the international scene.

4.46 Mr Favalaro said that Tenix Pty Ltd combined with ADI Limited would have elevated the company to a level 30 or 40 on the world scale. This would have created a substantially Australian-owned industry of sufficient mass to attract international technology partners, and to develop skilled teams for platform construction and for systems integration and support.<sup>57</sup> However, as Mr Harris observed, ‘critical mass’ is what the joint venture already had. As a plus, it also offered established international connections:

It comes back to the point I made before that a country of Australia’s size - and it is critical mass thing - is always going to find it difficult to have its technology sold in a big way against suppliers of the big global systems. What I hope will come out of this sale is that Thomson will do some serious technology transfer into ADI and make ADI a centre of excellence for some of their high technology products and, if so, that will result in an awful lot of R&D being done in Australia in developing products for a global market.<sup>58</sup>

### **Access to technology and research and development**

4.47 Technology transfer underpins the vision for ADI’s future as a successful competitor in the global defence industry, and is understood to be the key to building a vital competitive local industry. Mr Harris explained the importance of technology transfer in the defence industry. He said that Defence budgets now concentrate on systems building and integration rather than on conventional military products - ammunition, weapons and engineered products. ADI had been restructured accordingly but gaining access to high technology remained ‘the biggest hurdle’ for ADI.<sup>59</sup>

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54 *Committee Hansard*, 25 October 1999, pp. 4, 7.

55 *Committee Hansard*, 25 October 1999, p. 8.

56 *Committee Hansard*, 25 October 1999, p. 55.

57 Annual listing of world defence contractors as published in the *US Defence News*. See *Committee Hansard*, 25 October 1999, p. 55.

58 *Committee Hansard*, 19 November 1999, p. 123.

59 *Committee Hansard*, 19 November 1999, p. 110.

4.48 Transfield Thomson-CSF supported this judgement. Mr Shepherd said:

The problem with ADI at the moment is that it is endeavouring to move into higher technology, but without access on a permanent basis to sources of this technology and know-how - that is not in question of product, just in question of how to deal with this technology - it is not going to go anywhere. So it was vital to form that international link with somebody or a company that had that expertise. Without that, ADI would have just drifted further and further into lower technology work and would not have had the capacity to participate as a prime contractor in the bigger programs.<sup>60</sup>

4.49 Mr Shepherd further observed that the speed of development globally meant strong international links were essential.<sup>61</sup> Thomson-CSF's credentials as one of the world's most advanced electronic systems suppliers and one of top five defence contractors in world guaranteed that:

The sale to our joint venture will result in the retention and revitalisation of ADI as a competitive, growing, high technology company in both defence and civil business. In this regard, ADI will enter a detailed technical cooperation agreement with Thomson-CSF whereby Thomson guarantees the transfer of valuable technology and know-how. We are committed also to the retention of ADI's regional facilities and have detailed plans to achieve this.<sup>62</sup>

4.50 Transfield Thomson-CSF has pledged, as a priority, to invest \$40 million in ADI Limited, and in research and development within ADI, over the next five years<sup>63</sup> This money will fund an expanded technology base, and bringing 'a base of people' to ADI's facilities. Mr Malcor confirmed that Transfield Thomson-CSF has the necessary capital to inject sufficient research and development money 'to anticipate the extent of the market and to develop new products'.<sup>64</sup>

4.51 Mr Shepherd emphasised that the above financial commitments are set down in Transfield Thomson-CSF's business plan for ADI, which is a part of the sale contract.<sup>65</sup>

4.52 Vice Admiral Walls (Retired), a Director of Thomson-Marconi Sonar, also gave testament to the research and development orientation of Thomson. He said that about 60 per cent of 'Thomson-Marconi Sonar business today in Australia is export

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60 *Committee Hansard*, 25 October 1999, p. 32.

61 *Committee Hansard*, 25 October 1999, p. 32.

62 *Committee Hansard*, 25 October 1999, pp. 27-28.

63 *Committee Hansard*, 25 October 1999, p. 34.

64 *Committee Hansard*, 25 October 1999, p. 33.

65 *Committee Hansard*, 25 October 1999, p. 34.

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oriented and is directly related to R&D work that has been done in Australia with the Defence Science and Technology Organisation'.<sup>66</sup>

4.53 Mr Harris emphasised the importance of research and development for the future growth and development of ADI:

Buying off the shelf is happening, it always has happened and always will happen, and that is important. But a lot of the products that Australia requires do need to be adapted for Australia's particular strategic and even environmental circumstances. A lot of R&D is directed towards that issue.

The R&D that would be of most interest to me, though, would be the contribution of R&D to the development of new business opportunities overseas. It comes back to the point I made before that a country of Australia's size - and it is critical mass thing - is always going to find it difficult to have its technology sold in a big way against suppliers of the big global systems. What I hope will come out of this sale is that Thomson will do some serious technology transfer into ADI and make ADI a centre of excellence for some of their high technology products and, if so, that will result in an awful lot of R&D being done in Australia in developing products for a global market.<sup>67</sup>

4.54 The Committee raised broader issues relating to increasing research and development in the defence industry during the inquiry. Mr Rodwell (Defence Council) told the Committee:

There is a number of ways you can look at increasing your level of R&D. One is through the tax concession. Following the reduction in the company tax rate to 34 per cent and then to 30 per cent, that 125 per cent is effectively being diluted a little. There is actually a further reduction there. So you can look at increasing the R&D tax concession as a means of increasing research and development. You can look at the CRCs, the cooperative research centres, and defence research and development in that area. A number of CRCs are currently with Defence, and industry interests are being progressed there. So there is the ability there to increase the levels of R&D, and there is the ability, through DSTO, to once again increase the level of R&D.

It is not just a government issue but also an industry issue. The decisions of the defence industry are informed by the organisation. They have to look at the capability it needs over the next 10 years. It is not viable to put in an enormous amount of R&D in an area where there is no interest for Defence, so there is an onus on Defence in the broadest terms to inform the industry

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66 *Committee Hansard*, 25 October 1999, p. 34.

67 *Committee Hansard*, 19 November 1999, p. 123.

about its capability decision making. They are the main ways that Defence can look at changing its R&D.<sup>68</sup>

4.55 Mr Shepherd (Transfield) said that taxation concessions for investment in research and development in the defence industry are very important and would affect investment decisions. He also suggested that Defence should encourage the development of specific technologies through direct funding of technology demonstrator programs, which in effect become joint ventures between the private and public sectors, for mutual benefit.<sup>69</sup>

4.56 Mr Favaloro (Tenix) told the Committee that research and development in the Australian defence industry is usually very focussed and is done at the behest of government or as a collaboration between industry and government. He said that taxation concessions for research and development in the defence industry are really government investment in a specific program from which it will ultimately benefit. In that way, they are different from general business research and development taxation concessions, which are provided to help in the development of Australian business.

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68 *Committee Hansard*, 26 October 1999, pp. 84-85.

69 *Committee Hansard*, 25 October 1999, p. 34.