

Dissenting Report by Nick Xenophon, Independent Senator for South Australia

1.1 The views in this Dissenting Report can be summarised as follows:

- a. Qantas is in a crisis largely of its own making, due to its failed foray into Asia with its Jetstar Asian operations;
- b. Current Australian accounting rules do not prevent cost-shifting from one part or entity of a group to another;
- c. It appears that CEO Mr Alan Joyce, the Chairman Mr Leigh Clifford and the Board have lurched from one failed strategy to another;
- d. Rather than amending the *Qantas Sale Act 1992*, which as proposed could lead to a massive offshoring of jobs, changes to the *Air Navigation Act 1920* should be considered to address the ambiguities that are best demonstrated in the current Virgin Australia structure and its international operations; and
- e. The Open Skies policy needs to be critically examined, as there appears to be no other nation that has such an open slather approach to aviation.

1.2 At the outset, I believe it is vital to place this bill in its proper context. Qantas has been struggling as a business since at least 2009¹, and there has yet to be any substantial improvement. My strong view is that before the government takes any action to alter the current legislative environment or to offer any other assistance we need to have a full understanding of the reasons behind Qantas' difficulties. Any measures put in place without this understanding may end up being merely a costly band-aid solution, or even no solution at all.

1.3 I have said publicly that I have serious concerns about the management of Qantas, and in particular about decisions made by Mr Joyce and members of the Board, and in particular the Chairman Mr Leigh Clifford, in relation to the future of the company. I note that others, including the government, have said this is a matter for shareholders; however, if the government is considering taking action to assist Qantas, then clearly this becomes a matter for the government and for the people of Australia, on whose behalf the government is acting.

1.4 The issues relating to Qantas' management strategy are many and complex. Australian accounting standards and the structure of the Qantas Group mean it is often difficult to get a full understanding of its financial operations. I hope this will be addressed in greater detail through the current Senate Rural and Regional Affairs and Transport Committee's inquiry into Qantas' future as a strong national carrier supporting jobs in Australia.

1 Qantas Annual report 2009, p. 11.

1.5 In particular, my concerns centre around the apparent focus on the Jetstar brand at the expense of Qantas. This includes the rapid growth of the Jetstar fleet (now estimated to be nearly 60 per cent the size of Qantas' fleet) and suggestions of cost-shifting between the arms of the business to make Jetstar appear more profitable, and Qantas International less so. I note that under current Australian accounting and corporate governance rules, this level of cost-shifting within group accounts is permissible.

1.6 Tied in with this is the establishment of the Jetstar brands in Asia, and in particular Jetstar Hong Kong, which has not yet received regulatory approval to operate. This has resulted in the airline's nine Airbus planes being stranded in France and unable to fly, at an estimated cost of \$3 million a month.² There are also questions regarding leasing arrangements between Jetstar in Asia and the Qantas Group, and whether they are structured so as to deliver a profit to the Asian carriers. In a hearing for the Senate Rural and Regional Affairs and Transport Committee, Mr Joyce justified criticism of Jetstar Hong Kong by comparing it to that levelled at Jetstar Australia when it was being established:

But the same comments were made in relation to Jetstar, the same comments that it was not going to work. It did lose money in the first year when we set it up, but in 10 years Jetstar Australia has contributed over \$1 billion in profits to the group. It has been an amazing success story because of the entrepreneurial nature of the group. In the Asian ventures that we have, I have absolutely no doubt that the Japanese venture in particular is going to be similarly successful for the Qantas group.³

1.7 It is impossible to deny, however, that Jetstar Australia was established in a very different financial climate, both globally and within the Qantas Group. I would hope that Mr Joyce has acknowledged this and has not based his strategy on the assumption that what worked in 2003 will work now.

1.8 I also feel it is important to note Mr Joyce's inconsistencies in recent months. His appeals for government support have included an amendment to the Air Navigation Act to bring Virgin Australia under the same foreign investment requirements as Qantas, a repeal of the Qantas Sale Act, and a debt guarantee. His comments regarding the impact of the carbon tax on Qantas have also varied, firstly saying that it was not to blame for the company's problems and then reversing his position just two days later.⁴ I am concerned that these inconsistent messages may demonstrate a serious confusion and a lack of strategic direction within Qantas.

1.9 While I believe many of Qantas' difficulties are due to its management, I also acknowledge the challenges posed by Australia's aviation sector as a whole. These

2 Matt O'Sullivan and Adele Ferguson, 'Mayday', *Sydney Morning Herald*, 1 March 2014.

3 Mr Alan Joyce, Chief Executive Officer and Managing Director, Qantas, Senate Rural and Regional Affairs and Transport Committee *Proof Committee Hansard*, 14 March 2014, p. 49.

4 Ellen Whinnett 'Qantas switch on carbon tax blame', *Herald Sun*, 6 March 2014.

include our geographical location, tax and regulatory arrangements, comparative costs on operators, and the 'Open Skies' policy. There has been little current research done into the effects of these issues on Australian airlines, and as such almost no data or information can be relied on to make informed policy decisions in this area. In particular, the Open Skies policy was brought into effect in the late 1990s and has not been reviewed or considered since. Its impact on Australian airlines, which anecdotally is quite significant, has never been properly evaluated.

Recommendation 1

1.10 That the government, as a matter of urgency, consult with industry and relevant bodies to formulate terms of reference for a comprehensive review of Australia's aviation sector, including the Open Skies policy, and its impact on operators and consumers, to be undertaken by the Productivity Commission.

1.11 I also believe some clarification about the provisions in the bill is required. As the committee report states, Qantas is currently subject to the foreign ownership restrictions outlined in the *Qantas Sale Act 1992*, and is exempt from meeting the requirements in the *Air Navigation Act 1920*. This Bill would remove those foreign ownership provisions, among others, from the Qantas Sale Act, and consequential amendments in the bill would repeal Qantas' exemption from the provisions in the Air Navigation Act. The Government's stated intention of this is to 'level the playing field' by allowing Qantas to be subject to the same rules as other Australian operators and to allow Qantas to access greater levels of foreign investment.

1.12 It is important to note, however, that Qantas as a whole would still be bound by the 49 per cent foreign ownership cap for Australian airlines under the Air Navigation Act, although the investment caps on individual foreign investment in the airline would be removed. Qantas would only be able to circumvent the 49 per cent rule and access further investment if it were to restructure and separate its international arm from its domestic arm, similar to the restructure of Virgin Australia. Qantas has not committed either way to such a restructure. I note that the committee report states:

In order to properly level the playing field, and enable Qantas to compete without unreasonable and outdated regulatory restrictions, it is necessary to repeal Part 3 of the Qantas Sale Act in its entirety, including the 49 per cent limit on foreign ownership.⁵

1.13 It is important to note that the bill itself does not repeal the 49 per cent limit; only a restructure of Qantas would enable them to access greater amounts of foreign investment through their domestic arm (not the international).

1.14 I note that one view, put forward by Qantas itself, is that Australia's national interest will still be protected if Qantas can circumvent the 49 per cent limit because any application for foreign investment must be approved by the Foreign Investment

5 Majority committee report, p. 6.

Review Board.⁶ However, it is important to note that Qantas has in the past been critical of FIRB's oversight of foreign investment proposals for Virgin Australia.⁷ Whether these concerns have been addressed, or are simply no longer relevant if Qantas can have equal access to foreign investment, remains unclear.

1.15 The bill does, however, repeal provisions requiring Qantas to maintain the majority of its operations in Australia. It could be argued that this is the real endgame for the management and Board, and the discussion around foreign ownership is largely a furphy, as the repeal of this provision would allow them to shift as much of their operations offshore as is practical.

1.16 It is important to note that the Air Navigation Act, to which Qantas would be subject if the bill were passed, does not contain provisions relating to principal place of business or majority operations. An associated Departmental Guidance Note states that an airline must have its head office and operational base in Australia to access an International Airline Licence (and therefore Australia's bilateral air services agreements). However, no definitions of 'head office' or 'operational base' are included. Further, as the provisions are not in the legislation or even regulations, there is some doubt as to whether they can be appropriately enforced.

1.17 The committee is correct when it states there is not an inevitable link between loss of Australian jobs and foreign investment, but I believe it would be very unusual for there not to be a link between allowing businesses to move operations offshore and the loss of Australian jobs.

1.18 Evidence provided to the committee by the Australian and International Pilots Association (AIPA) also outlined the possible failures in the Air Navigation Act as a result of reliance on this Departmental Guidance Note rather than appropriate regulations or legislation. As AIPA pointed out, while the foreign ownership restrictions are enshrined in the Act (at least relating to international airlines), there is nothing equivalent in the legislation to require the majority of an Australian international airline's operations to remain in Australia.

1.19 The most obvious example of the gaps in the legislation is the Virgin Australia restructure that occurred in 2012, where Virgin Australia created a separate, non-listed private company to act almost as a 'placeholder' for its international business. Virgin Australia International Holdings (VAIH) has been designated an Australian international airline by the Department for the purpose of the Air Navigation Act as it meets the 49 per cent foreign ownership cap and the other requirements set out in the Guidance Note.

6 Mr Alan Joyce, Chief Executive Officer and Managing Director, Qantas, *Proof Committee Hansard*, 18 March 2014, p. 2.

7 Steve Creedy, 'Virgin's capital success irks Qantas', *The Australian*, 13 December 2013.

1.20 An article by Michael Janda and published on *The Drum* earlier this month echoes the concerns laid out in AIPA's submission.⁸ As Janda points out, VAIH may meet the requirements of the Act, but while it does have its own Board of Directors, it does not have its own management, its own aircraft or any of the crew, maintenance, HR or customer support resources that an international airline could reasonably be expected to have. Instead, it is wholly reliant on the resources owned and operated by Virgin Australia Holdings, the domestic arm of the business which, under the *Air Navigation Act*, can be wholly foreign-owned.

1.21 Some may say this is merely good business practice: that is, seeking out any available opportunity for a 'better deal', but it has created a serious precedent in the industry. To date, Virgin Australia has maintained its principal place of business and the majority of its employees in Australia, but there is opportunity under the Act for it to offshore a significant portion of its domestic business, which is in turn supporting the international arm, without breaching the Act. While the extent to which this is practical for a domestic airline is debateable, there is no denying the capacity, or loophole, is there.

1.22 This has worrying implications for Qantas if this bill should pass. If Qantas were free to replicate Virgin Australia's structure under the Act, we could potentially see a one hundred per cent foreign-owned Qantas Domestic with full operating control over a Qantas International that is little more than a sham company allowing foreign interests access to Australia's bilateral air services agreements. It is also worth noting that Jetstar as it stands could potentially access this loophole, as it has never been confirmed whether it is fully covered by the Qantas Sale Act.

Recommendation 2

1.23 That, consistent with the findings of the Productivity Commission inquiry in Recommendation 1, the Government amend the *Air Navigation Act 1920* to close existing loopholes and ensure the Act is consistent with its objectives.

1.24 Ultimately, the purpose behind this bill should be to ensure that Qantas returns to profitability while providing the greatest benefit to Australia. There is no guarantee, or even vague assurance, that the measures in this bill will achieve that result; in fact, they are likely to lead to greater offshoring of jobs without addressing the core issues facing Qantas. Unless problems with the current management are addressed and the systemic failures within the aviation sector are corrected, then this bill will simply be a very expensive failure. Whatever solution is proposed, it must involve more than the repeal of some parts of the Qantas Sale Act if we do not want to face more, even worse, problems down the track. There is no short term fix to this issue, and the government must abandon this legislation until it has a full grasp of the underlying problems and how they should be addressed.

8 Michael Janda, 'An Act of foreign ownership trickery', 6 March 2014: <http://www.abc.net.au/news/2014-03-05/janda-an-act-of-foreign-ownership-trickery/5299048>

Recommendation 3

1.25 That the bill not be passed.

**Senator Nick Xenophon
Independent Senator for South Australia**