

Senator Nick Xenophon - Dissenting Report

1.1 The aim of the inquiry was to consider what steps the Parliament could take to ensure Qantas remains a strong national carrier that supports aviation jobs in Australia. Unfortunately, at this stage I believe there are too many ‘known unknowns’ to be able to come to a firm conclusion, particularly given the current management and erratic direction of Qantas. However, I also believe there are some points that can be accepted as a foundation when considering this issue:

- i. Qantas is in a financial crisis largely of its own making, in large part due to its failed foray into Asia with its Jetstar operations;
- ii. Current Australian accounting rules do not prevent cost-shifting from one part or entity of a group to another;
- iii. Rather than amending the *Qantas Sale Act*, which as proposed could lead to a massive offshoring of jobs, changes to the *Air Navigation Act* should be considered to address the ambiguities that are best demonstrated in the current Virgin Australia structure and its international operations; and
- iv. 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, it is important to make it clear that the short time available for this inquiry barely allowed the committee to scratch the surface of the issues surrounding Qantas and the Australian aviation sector. Without further examination, it is impossible to make appropriate policy decisions in this area, and as such the recommendations in the committee report should not be supported at this stage.

1.3 Of particular concern is the significant distrust felt by Qantas staff towards the current management and Board. Mr Stephen Purvinas of the Australian Licenced Aircraft Maintenance Engineers Association provided evidence from a survey taken by his union of Qantas and Virgin Australia employees, stating:

*The first one is, of Qantas engineers, how many of them think the company will improve in the next 12 months. It was three per cent. The Virgin engineers were at 84 per cent. Of Qantas pilots, only three per cent think the company will improve over the next 12 months. It was 91 per cent of Virgin pilots.*¹

Mr Purvinas went on to state that, according to the survey, only one per cent of both Qantas engineers and Qantas pilots said they trusted the Qantas management².

¹ Mr Stephen Purvinas, Australian Licenced Aircraft Maintenance Engineers Association, *Committee Hansard*, 14 March 2014, pp 32–33.

² *Ibid*

1.4 This is a significant burden for a company to overcome. It also supports the view that CEO Alan Joyce and Chairman Leigh Clifford are not the people to manage Qantas through this stage. I note that others, including the Government, have said these are matters 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.

1.5 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. 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 a success, and Qantas International a financial failure. 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.³ 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 the March 14 hearing, 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.*⁴

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.

³ O'Sullivan, Matt and Ferguson, Adele 'Mayday', *Sydney Morning Herald*, 1 March 2014

⁴ 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

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.⁵ I am concerned that these inconsistent messages may demonstrate serious confusion and a lack of strategic direction within Qantas.

1.9 Further, Mr Joyce's evidence to the committee seems to indicate a lack of understanding of Qantas' downward spiral. In particular, in response to a line of questioning about subsequent financial result announcements in 2011, Mr Joyce said, surprisingly, he did not recall making statements that indicated a financial loss for Qantas International:

Senator XENOPHON: Mr Joyce, on 17 February 2011, in announcing half-yearly results, you said that Qantas improved yield by nine per cent, that it demonstrated a strong revenue recovery across both international and domestic businesses. Yet, on 22 June 2011, you said that Qantas international was forecast to generate a loss, before interest and tax, of approximately \$200 million. Could you please explain what happened to the trading environment in 3½ months? What happened to Qantas international?

Mr Joyce: Sorry, Senator, could you give the dates again?

Senator XENOPHON: Sure. You made a statement on 17 February 2011 that Qantas improved yield by nine per cent. You also stated that it demonstrated a strong revenue recovery across both international and domestic businesses. Then, on 22 June 2011, you singled out the international component of Qantas for special attention, saying that Qantas international, in financial year 2011, was forecast to generate a loss, before interest and tax, of approximately \$200 million. I am just trying to establish what occurred in that period from 17 February to 22 June 2011.

Mr Joyce: I think we will have to take that on notice because I do not remember the statements.

Senator XENOPHON: They were very well reported at the time.

Mr Joyce: They probably were. But, as you know, it was three years ago and I would say may we take that statement on notice and come back.⁶

⁵ Whinnett, Ellen 'Qantas switch on carbon tax blame', *Herald Sun*, 6 March 2014

⁶ Mr Alan Joyce, Chief Executive Officer and Managing Director, Qantas, *Proof Committee Hansard*, 14 March 2014, p. 47

1.10 Mr Gareth Evans, Chief Financial Officer of Qantas, later sought to clarify these comments by stating that this period was the first in which Qantas International was reported as a separate business segment⁷. However, Mr Evans did not adequately justify or explain why the losses occurred in such a short period.

1.11 Qantas' assertion that Qantas International is in 'terminal decline' and unable to compete has also been rejected by the Australian Competition and Consumer Commission in its assessment of the alliance deal with Emirates. The ACCC's determination states:

*In particular, the ACCC does not accept or rely on the applicants' claim that Qantas International is in 'terminal decline' and unable to compete effectively or operate profitably absent the alliance.*⁸

1.12 The ACCC continues:

*The ACCC does not accept or rely on Qantas' claim that Qantas International is in 'terminal decline' and unable to compete effectively or operate profitably. The ACCC considers that the scope of Qantas' international operations in the likely future without the proposed conduct would not be materially different to the likely future with the proposed conduct.*⁹

1.13 In my view, the ACCC's finding was a major rebuff to Qantas management. If anything is in 'terminal decline', it is the credibility of Mr Joyce, Mr Clifford and the Board.

1.14 Ultimately, there are serious concerns regarding a number of decisions made by the management and the Board. On 17 February this year, I wrote to the Treasurer, Prime Minister and Deputy Prime Minister outlining these matters, and to date I have not received a response. The letter is attached for the committee's information.

1.15 Evidence provided to the Senate Economics Legislation Committee inquiry into the *Qantas Sale Amendment Bill* by the Australian and International Pilots Association (AIPA) also outlined the possible failures in the bill, which aims to remove Part 3 of the *Qantas Sale Act*. Part 3 relates to foreign ownership provisions and also requires that the majority of Qantas' operations remain in Australia. By removing Part 3 and instead bringing Qantas under the remit of the *Air Navigation Act 1920*, from which it is currently exempt, the Government's position is that the playing

⁷ Mr Gareth Evans, Chief Financial Officer, Qantas, *Senate Economics Legislation Committee Hansard*, 18 March 2014, p. 11

⁸ ACCC Final Determination on Qantas Airways Limited & Emirates - Authorisations - A91332 & A91333, 27 March 2013, p. i

⁹ ACCC Final Determination on Qantas Airways Limited & Emirates - Authorisations - A91332 & A91333, 27 March 2013, p. 38

field will be levelled and Qantas will be able to access greater levels of foreign investment.

1.16 However, as AIPA pointed out, provisions relating to Australian operations for Australian international airlines under the *Air Navigation Act* are contained in a Departmental Guidance Note rather than appropriate regulations or legislation. This means that, 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.

1.17 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.

1.18 An article by Michael Janda and published on ABC's *The Drum* earlier this month echoes the concerns laid out in AIPA's submission¹⁰. 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.

1.19 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. I see it as a questionable practice that highlights the flaws in the *Air Navigation Act* that fail to protect the national interest. 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 opportunity to do so, or rather the loophole, exists.

1.20 This has worrying implications for Qantas if the Government's 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

¹⁰ Janda, Michael, 'An Act of foreign ownership tickery', 6 March 2014, online: <http://www.abc.net.au/news/2014-03-05/janda-an-act-of-foreign-ownership-trickery/5299048>

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*.

1.21 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 a wholesale shift of as much of their operations offshore as they can get away with.

1.22 It is also important to note that Qantas has not formally announced its intention to replicate the Virgin Australia structure if the Government's bill were to pass, although it is fair to say that the general assumption is that will be the case. However, Mr Joyce's own disconcertingly vague answer to the Senate Economics Committee inquiry into the bill adds further confusion:

Mr Joyce: I think we are going into hypotheticals. At the moment, I do not know what will happen into the future with relation to Qantas. I am saying that there is a domestic and an international arm today. This is all about giving Qantas the same flexibility that Virgin has both in ownership and in the structure. That is what we are talking about here, that it is a level playing field and the repeal of part 3 of the act provides a way of giving that level playing field.¹¹

1.23 With respect, I believe the CEO of a company requesting a specific legislative change from the Government should be able to say very clearly what will happen in the future with the company if that legislative change were to go ahead. Mr Joyce's comments are not constructive and only add to the uncertainty, confusion and doubt surrounding his governance of Qantas.

1.24 All of these signs point towards an organisation with no clear and consistent policy in terms of its future direction, or at least not one that they are willing to discuss in the public sphere. I am concerned that legislative changes made by the Government or other measures, including a debt guarantee, may not have the intended impact if there is not the ability or the will within Qantas to take advantage of them, or an understanding on the part of the Government how they are to be used. Indeed, the legislative changes proposed by the Government may have a significant negative impact, particularly on Australian jobs, by allowing further offshoring of Qantas operations.

1.25 Qantas has also not stated a strong position on what specific changes it needs to recover, other than insisting it is operating on an 'un-level playing field' compared to Virgin Australia. It would perhaps be more useful and inspire greater confidence on the part of employees and consumers if Qantas were to have a clear strategic plan and a 'wish list' of actions for the Government. This would demonstrate an engagement on

¹¹ Mr Alan Joyce, Chief Executive Officer, Qantas, *Senate Economics Legislation Committee Hansard*, 18 March 2014, p. 5

the part of Qantas and assist the Parliament in ensuring any action taken has the desired outcome.

1.26 In conclusion, the ‘Qantas problem’ cannot be fixed with a band-aid solution such as the *Qantas Sale Amendment Bill 2014* proposed by the Government or the debt guarantee proposed by the Opposition. The appropriate response should have two parts: firstly, to determine exactly what the current financial situation is within Qantas and how Parliamentary action can support Qantas’ recovery; and the broader aviation sector in Australia and the challenges faced by Australian airlines on a geographical and regulatory basis.

Recommendation 1

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.

Recommendation 2

That the Government take no further action on legislative or other reform and provide no assistance or guarantee to Qantas until an independent audit of the company has been completed, which should also seek to establish the level of any cost-shifting between Jetstar and Qantas.

Recommendation 3

Subject to Recommendation 1, that the *Air Navigation Act 1920* be amended to address the apparent loophole that allows the foreign investment cap to be obviated, as demonstrated in the restructure of Virgin Australia.

Senator Nick Xenophon

Independent Senator for South Australia

