

8 June 2007

By Electronic Transmission

Committee Secretary
Senate Standing Committee on Economics
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

Dear Mr. Hallahan,

Re: Inquiry into Private Equity Investment and its Effects on Capital Markets and the Australian Economy

Thank you for the opportunity for the Australian and International Pilots Association (**AIPA**) to provide a late submission to the *Inquiry into Private Equity Investment and its Effects on Capital Markets and the Australian Economy*.

AIPA's experience of the growing phenomena of private equity investment has been, in line with much broad community sentiment, one of growing unease. Primarily, this concern has centred upon the balance between private interest and the wider public or social good and particularly three underlying and interrelated aspects - transparency, effective control and, in the case of commercial aviation, the impact of commercial factors on safety standards.

AIPA believes that such issues pose significant challenges for existing legislative and regulatory oversight mechanisms, especially when coupled with increasingly complex financial innovation. As a consequence, and reinforced by recent experience with the proposed takeover of Qantas Airways Limited, AIPA calls upon the Federal Government to urgently review the ability of the existing legislative and regulatory safety nets to effectively protect the wider national interest.

AIPA highlights, however, that when developing new policy to address private equity concerns, all social stakeholders must play a part in determining the appropriate balance between competing public and private interests. Australia's Airline Pilots firmly believe that public money should not solely underwrite share prices or facilitate private investment profit, but rather be used to ensure that broader social, economic and public objectives are met.

It is in this context that AIPA provides the attached submission on the pilots' perspective of private equity investment for the Committee's consideration. This submission focuses upon issues relating to items (b), (d) and (e) of the Inquiry's Terms of Reference (**TOR**).

Please contact me if I can provide the Committee with any additional information, clarification or assistance.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ian Woods', written in a cursive style.

Captain Ian Woods
President

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AIPA SUBMISSION TO SENATE ECONOMICS COMMITTEE
Inquiry into Private Equity Investment and its Effects on Capital
Markets and the Australian Economy

Introduction

1. The Australian and International Pilots Association (**AIPA**) is the professional Association representing pilots and flight engineers employed by Qantas Airways Ltd and its wholly owned subsidiaries (“the Qantas Group”) in airline operations within Australia and around the world. AIPA represents over 2,300 professional airline transport category flight crew and is the largest professional pilot body in Australia.

2. AIPA encourages the Committee to consider flight crew [pilots and flight engineers] to be part of an essential quality control process that ensures safety remains at the centre of aviation decision making. This system of checks and balances promotes the national interest by facilitating the diffusion of the world’s highest operational standards, developed over more than 85 years of continuous airline transport category operations, throughout the Australian aviation industry - including within the rapidly developing Low Cost Carrier (**LCC**) sector.

3. The Preamble to the Convention on International Civil Aviation (the Chicago Convention) states that the Convention was agreed in order that “*international civil aviation may be developed in a safe and orderly manner and that international air transport services may be established on the basis of equality of opportunity and operated soundly and economically*” (ICAO, 2001). AIPA contends that, as was clearly demonstrated during the recent failed takeover of Qantas Airways Limited, private equity investment eschews this guiding egalitarian principle.

4. Rather, as appears to Australia’s Airline Pilots to be far more evidently the case, this unifying goal, which has underpinned global social and economic development for more than fifty years, is being discarded by private equity investment in favour of single dimensional profit maximisation and vested minority interest. The resultant shift from the traditional economic emphasis of a strategic national industry - away from a

collaborative focus upon the wider social good and toward placing the interests of a select minority disproportionately ahead of those of the vast bulk of citizens - is of particular concern to Australia's Airline Pilots.

5. This change imperative is clearly articulated within the private equity investment strategy of introducing massive levels of organisational debt as the primary mechanism of investment return. Such extreme levels of debt, newly loaded onto the takeover target's balance sheet, create latent instability.
6. AIPA believes that the creation of instability as the basis of a profit generation strategy is harmful to the national interest, especially within strategic infrastructure providers. In the case of the aviation transport sector, this vulnerability is increased further by factors such as the cyclical nature of the industry, its underlying exposure to external shock (arising from the derived nature of services and associated demand elasticity issues), and the very high degree to which many of the primary cost inputs are outside the control of management.
7. As a professional association and social advocate representing stakeholders in the recent attempted takeover of Qantas Airways Limited by a private equity consortium, AIPA's experience has been that disparity between current legislative protections and this fast evolving and innovative investment phenomenon has made it extremely difficult for stakeholders and the public to be confident that the veracity of stated intentions, assurances and guarantees can and have been properly assessed.
8. Lastly, due largely to the private equity specific features of inherent lack of transparency and massive debt loading, AIPA was not confident that current legislative safety nets - the Qantas Sale Act, the Foreign Acquisitions and Takeovers Act and Foreign Investment Review Board - were able to effectively safeguard the national interest with respect to ensuring that control would be effectively retained by Australians.

Transparency Issues

9. International private equity investment is quickly evolving toward the targeting of increasingly larger companies, many of which (as already indicated) provide core infrastructure services that characterise them as strategic national assets. AIPA submits that, given the growing scale of private equity investment, even the largest infrastructure providers are now potential takeover targets. AIPA highlights to the Committee that such organisations have many stakeholders in addition to shareholders or potential private equity owners.

10. Private equity is, by its very nature, private. Indeed, one of the key aspects underpinning private equity takeovers is the [intended] ability to remove a company from public listing and thereby, largely, from public scrutiny. The target may then be restructured [in private] away from any underlying social service obligation and focused toward a new prime mission of profit maximisation and investment return. AIPA submits, however, that in the case of key infrastructure providers, lack of transparent restructuring is highly unlikely to be in the national interest.

11. AIPA finds it particularly concerning that if assurances demanded by the community and the government in order to offset wider social concerns, cannot be effectively tested or assessed they may subsequently be proven ineffective or untrue post takeover. Obviously, if assurances cannot be effectively determined before a national asset is removed from public listing then the national interest may well be irretrievably damaged.

12. AIPA submits that the lack of public confidence in the ability of current legislation to provide an effective safety net was a key factor underpinning the broad community opposition to the failed purchase of Qantas Airways Limited and, indeed, to other private equity buy-outs reviewed by this Association. The Association notes, for example, the similar concerns expressed during the Onex-led proposed takeover of Air Canada [which did not subsequently proceed] and the Texas Pacific Group buy-out of US electric utility Portland General Electric (**PGE**).

13. In these cases there was widespread doubt about the true intentions of the private equity bidders, and concerns that those intentions were contrary to the public

assurances and guarantees provided. In the case of PGE, the Texas Pacific Group gave assurances regarding employee layoffs, the length of the investment, and other key intentions that were later found to be demonstrably false.¹² As the attorney acting to have the Texas Pacific Group's PGE Internal Analysis documents made public stated: *'The truthfulness, the hidden or undisclosed intentions, and future plans for the [electricity] utility are all part of the public interest... the public has a right to know.'*^{3'}

14. AIPA believes that the low level of transparency inherent in private equity investment reduces the capacity of current legislative mechanisms to effectively ensure this right. AIPA therefore submits that the Committee considers the development of additional legislative mechanisms that address the issue of transparency in order to facilitate assessment of both the intentions of investment consortiums purchasing key strategic infrastructure assets and any assurances or guarantees given.

Effective Control

15. In response to the recently attempted takeover of Qantas Airways Limited, the community turned to existent legislative and regulatory mechanisms in order to ensure that the national interest was protected. Unfortunately, however, AIPA believes that these safety nets were found to be sadly inadequate in ensuring that a proper balance between private and wider public interest was maintained.
16. AIPA's view is that effective control based on the existence of significant debt obligation is as critical a consideration for legislative oversight as traditional majority ownership control. AIPA's experience of private equity investment is that the financially innovative feature of debt maximisation as the investment strategy leads the Association to conclude that legislation must address the effective control dimension to the same rigor as foreign ownership if it is to protect the national interest.

¹ <http://www.wweek.com/editorial/3109/5899/>

² <http://cbc.ca/cgi-bin/templates/view.cgi?news/1999/11/02/aircaw991102>

³ <http://www.wweek.com/editorial/3109/5899/>

17. In the failed Qantas Airways takeover proposal AIPA does not believe that the government was able to assess or determine the impact of massive debt provision on the effective control of the airline to the degree required. This left AIPA, along with an apparent majority of the public, uncomfortable with the assurances provided and the proposed takeover proceeding.

Impact of Commercial Factors on Safety Standards

18. Cost minimisation priorities in safety sensitive environments have important implications for operational safety standards. In 2005 the International Civil Aviation Organisation (ICAO) recognised this potential conflict between commercial factors and safety outcomes in the Study on the Safety and Security implications of Economic Liberalisation⁴. The fifth ICAO Worldwide Air Transport Conference (ATConf5) noted that *'globalization, liberalization and privatization... have brought about fundamental changes in the air transport industry, some of which also have implications for safety and security regulation.'*

19. In response to the challenge of such implications, private equity investors argue vigorously that safety and security would never be compromised by commercial considerations. The reality is, however, that safety involves significant operational costs, including passenger screening costs, the thoroughness and efficiency of maintenance checks, the age of aircraft, the training level of employees and the working hours and fatigue levels of safety sensitive workers. All of these factors come under fierce pressure in the climate of absolute cost minimisation.

20. AIPA's view is that legislative and regulatory safety nets must be capable of effectively ensuring that Australia's high standards are not driven down to global minimum standards by the cost minimisation strategies of private equity investment.

⁴<http://www.icao.int/ICDB/HTML/English/Representative%20Bodies/Air%20Transport%20Committee/Working%20Papers%20by%20Session/175/AT.175.WP.1993.EN/AT.175.WP.1993.EN.HTM>

Recommendations

With respect to private equity investment, the Australian and International Pilots Association recommends that:

1. The Committee review the ability of existing legislative and regulatory mechanisms to effectively determine the following components of private equity investment takeover proposals:
 - i. the accuracy of the publicly stated intentions of the investors, including, but not limited to:
 - a. the intended length of investment;
 - b. employee redundancy and retrenchment;
 - c. business plans;
 - d. omission of significant information.
 - ii. the veracity of any guarantees, assurances and/or undertakings given;
 - iii. the degree to which effective control, as opposed to majority ownership, is retained by Australian interests.
2. The Committee assess the ability of current legislative and regulatory mechanisms to effectively counter the low level of transparency inherent within private equity investment proposals and ownership.
3. Any foreign investment approvals, licenses or other permissions granted by the Commonwealth be contingent on the accuracy of publicly stated intentions, guarantees, assurances and/or other undertakings provided.
4. Private equity takeover proposals for organisations providing strategic national infrastructure services be subjected to a higher level of assessment and review than non-strategic assets before the organisation is removed from public listing.
5. Such assessment and review include the takeover proposal's impact on safety standards, employment conditions and debt based (sector specific) stability.

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