2014

Submission To: The Senate Economics Legislation Committee regarding the Qantas Sale Act 1992.

Submission By:

Colonial Airways - Aerospace Consultancy

Submitted 10 March 2014

Qantas Sale Amendment Bill 2014

On 6 March 2014, the Senate referred the provisions of the Qantas Sale Amendment Bill 2014 to the Senate Economics Legislation Committee for inquiry and report.

The bill proposes to repeal Part 3 of the *Qantas Sale Act 1992,* which stipulates the requirements regarding Qantas' articles of association. The bill would also amend the *Air Navigation Act 1920*, to allow Qantas to be included in the definition of an Australian international airline.

In its examination of the provisions of the bill, the Committee has been asked to:

- Evaluate the effect of the proposed amendments on the aviation sector and the broader Australian economy;
- Scrutinise the detail and impact of the legislation, including any potential impact on other legislation; and
- Consider the opportunities the amendments will provide for Qantas to increase its competitiveness through the harmonisation of Australia's aviation regulatory framework.

The Committee is due to report to the Senate by **24 March 2014**.

The Committee would like to receive written submissions by **14 March 2014.**

Please note that this inquiry is separate from the Senate Rural and Regional Affairs and Transport References Committee's current inquiry into the future of Qantas.

Committee Secretariat contact:

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Phone: +61 2 6277 3540
Fax: +61 2 6277 5719

Authors: Captain L. McNeil & Captain P. McNeil

Colonial Airways. Aerospace Consultancy Division.

Aerospace Facility Hangar 119C Hervey Bay Airport
Urangan.

HERVEY BAY

QLD 4655

Head Office:

Colonial Airways Aerospace Training & Consultants.

No. 37 Gerona Circuit

VARSITY LAKES

QLD 4227

Ref MASIMP03

Attention: **Committee Secretary**

For distribution to**: Senate Economics Legislation Committee**

PO Box 6100

Parliament House

CANBERRA

ACT, 2600

E: economics.sen@aph.gov.au

Dear Senator;

There are in essence, three major fiscally controversial, politically provocative and managerially questionable issues for consideration regarding Qantas Airways Limited and its associated group infrastructure.

Those issues are;

1. The Qantas Sales Act (QSA) and
2. The historical selection and reasonable determination of Aircraft Equipment and
3. Airline development and entrepreneurial ventures by the Qantas Group.

Let us discuss the Qantas Sales Act first.

Notably the Australian and International Pilots Association (AIPA), the representative Professional Association that represents Australian Airline Pilots, offered its support to the Qantas campaign to change the Qantas Sale Act as far back as November 2013.

Statements may be reviewed at; http://www.aipa.org.au/media-room/aipa-supports-changing-qantas-sale-act-provided-new-investment-stays-australia

For those who work in the industry and understand the ramifications and complexities of the Qantas Sales Act and the Air Navigation Act this is seen as a logical and common sense step, not only for Qantas however also for the Australian Aviation Industry as a whole.

The act can be reviewed at; http://www.comlaw.gov.au/Details/C2010C00854

Note: Additional information is attached to this submission.

Essentially the Qantas Sale Act (QSA) stipulates that:

- Any single foreign investor is limited to a 25% stake in Qantas and
- Foreign airlines can hold no more than 35% of Qantas shares in total and
- Total foreign ownership of Qantas is capped at 49%

A statement released by the AIPA, the Qantas Pilots Association, acknowledged a precipitous and dynamic change in the Australian airline industry from circa 1992 onwards. This preordained that the Association was now inclined to support changes to the Qantas Sale Act. The Act, as the reader would glean by now, limits foreign ownership levels in Qantas to 49 per cent, and any single airline investor to 25 per cent which may significantly stifle investment by interested companies and enterprises.

At the time of writing the ACTU (Australian Council of Trade Unions) and elements of the Federal Government opposition (The Labor Party, The Greens and some Independents) parties were not supportive of such change without compromise or concession in regards to securing employment for Australian Aviation employees.

It is most certain that Mr John Borgehitti, the current Virgin Australia CEO comprehends and appreciates the Act extremely well and has utilised such understanding for placing Virgin Holdings Limited in an enormously positive competitive position in the Australian Aviation Industry.

In fact across the stakeholders and government, from the AIPA President Mr Nathan Safe, Mr Alan Joyce the CEO of Qantas, the Federal Treasurer Mr Joe Hockey and the Prime Minister Mr Tony Abbott, all have stated in various forms, that the problem at the moment, is an un-level playing field within the Australian Aviation market.

Whereas Virgin is free to access foreign investment channels that Qantas cannot due to the restrictions of the QSA. The AIPA clearly contend in their documentation the only viable policy approach is for the QSA to be reviewed and suitably altered.

Whilst the AIPA position is in tandem with Qantas Corporate Management there is a significant anomaly in what the AIPA outline.
The AIPA states that changes to the QSA are justified to ensure the Australian Flag carrier is not disadvantaged against foreign competitors. This is well understood and in agreement and consideration of all the relevant stakeholders. However the AIPA additionally promotes and specifically stipulates that it is

absolutely vital, that any advantages gained through amendment of the QSA, must flow straight to Qantas's Australian operations.

Therefore, AIPA readily support changes to the QSA, however and most interestingly only if the foreign investment that may flow from those changes is used to invest in Australian Aviation operations and by inference then Australian jobs.

It is not known at this time if that position by Mr Safe is agreeable or untenable to Qantas Corporate Management or the CEO Mr Alan Joyce himself. It has yet to hit an accord with the Federal Labor party and the Greens or see dynamic support from the ACTU.

However, the policy does delve into the alleged veracity that much of the negative fiscal position at Qantas has been pejoratively attributed to Airline development and entrepreneurial ventures by the Qantas Group into South East Asia, namely Jetstar operations into Japan, the Republic of Singapore, Vietnam and Hong Kong and the considerable fiscal purchases of equipment and logistics to support those embryonic enterprises.

As reported in Aviation Business magazine, by Mr Doug Nancarrow (6th Oct 2011); The Qantas Group had ordered 110 Airbus neo aircraft, plus a series of purchase rights. Of the 110 aircraft, 99 will go to Jetstar International and the other 11 will go to the new premium Qantas airline which will be based in either Singapore or Kuala Lumpur.
Of the 99 Jetstar aircraft, a considerable number will be devoted to enhance the new operations in Japan, while others will be allocated to support growth in the existing business and to roll over older aircraft.

This may be read at: http://www.aviationbusiness.com.au/news/qantas-explains-a320-neo-buy
Ancillary develops may be read at: http://www.smh.com.au/travel/travel-news/qantas-2-billion-deal-on-engines-for-new-a320neo-jets-20120423-1xg1t.html

Therein and given the exact science of fiscal hindsight the AIPA, based on such historic outcomes to date, are now soliciting that under any changes to the QSA, new streams of foreign investment should *not* be used or *transferred* onto the sort of unproven forays and costly business expeditions into Asia that the Qantas Group pursued through Jetstar and other subsidiaries in recent times.

An insight to this analogy may be read at; http://www.smh.com.au/business/jetstars-japan-offshoot-forced-to-park-planes-20140107-30ffv.html

This proposition by the AIPA, and therefore perhaps a major consideration by the Senate Economics Legislation Committee, is whether Qantas Airways, the AIPA and the Australian Aviation Industry are best served by such a recommendation to place a caveat or direction on such foreign investment as part of pending changes to the QSA. That is to say, that any incoming investment funds would be channelled into

International and Mainline Qantas Domestic operations, bypassing the Jetstar operation, until Qantas International and Mainline Domestic operations had once again gained fiscal autonomy and viability.

We at Colonial Airways submit that the logic is sound in theory and this submission relates to observation of what has taken place affecting the airline to date.

Let us review the facts;
Until recently the domestic aviation business has been affected by a significant switch in demand from the Australian domestic leisure market, to the outbound leisure (overseas international travel) market, largely as a result of an elevated Australian dollar.
It was at the time, that Mr. Alan Joyce the Qantas CEO had drawn his well-known sixty five percent of domestic market share line and focused on that strategy and both Virgin and Qantas dumped capacity into the market as a result.

Astonishingly and in knowledge of the Australasian Aviation marketplace and as any aviation economist would forecast, airline revenues fell and airline costs rose significantly at Qantas. Whether this was a well thought out strategic ploy by John Borghetti is yet to be determined, however it appears given the capital raising at Virgin was entrain, then perhaps Borghetti wanted the capacity war, at least in the short-term and Qantas Airways have suffered fiscally at that strategic move.
It should be noted also that over the past four years, the annual growth in outbound travel averaged nearly 10 per cent, notably almost twice the long-run average of 6 per cent.
Yet over the same time period, domestic overnight leisure travel fell by approximately 4.5 per cent.
Qantas losses also rose and compounded dramatically here due to the inconceivable and poorly timed withdrawal and handoff of lucrative international routes and national markets.

This is made crystal clear by Mr. Oliver Lamb from Pacific Aviation Consulting. Lamb stated in a national article in December 2013 “that the struggling airline needed to reconnect with its Australian customers outside Sydney (read internationally) if it was to return to profitability”
He said further “Qantas had made an error by slashing international services from Brisbane, Melbourne, Perth and Adelaide in the past two years, allowing foreign airlines to capture its market share”.
"Qantas has spent a lot of money on ventures in Asia, and Jetstar, at the expense of its international network," Mr Lamb said.

This is the crux of the very reason Qantas has moved backwards. The International arm of Qantas could not capture the outbound market when the Australian dollar rose against all currencies. Unbelievably the Qantas board and Alan Joyce followed the international reduction philosophy in order to attempt to reduce costs dropping the international traditional and rite of passage routes such as Melbourne, Sydney and Brisbane to Singapore and onto Europe (London, Frankfurt and Paris) as well as the Melbourne and Sydney to Bangkok and London and Melbourne and Sydney to Hong Kong and London routes.

Additionally the Perth operations and the Cairns Operations to South-East Asia as well as the Adelaide and Darwin operations.

As a result of Qantas having withdrawn from the international market and therein given the financial and historical operational facts as presented here, the AIPA are correct in their proposal, as they politely try to re-establish an Australasian Aviation infrastructure that Qantas has always relied on and prospered by.

Looking at the whole picture it should be noted that within the domestic market, Jetstar domestic capacity is also hurting Qantas mainline yields and has also contributed to the weaker Qantas earnings position. Broadly speaking, this is because the Jetstar business has been transformed from a low cost carrier to a hybrid carrier – somewhere between a low cost and full service carrier.

This has hurt Qantas Mainline Domestic operations significantly, as Jetstar slowly and awkwardly moves to a new carrier image to compete with Virgin, who itself recently changed from a low-cost-carrier to a new-world carrier image as it seeks further inroads into the Qantas market share.

The brunt of costs by Qantas operations are borne by reduction in services of mainline jets, where B-737s are replaced by Dash 8 Turbo props and older refurbished B-717 on routes such as Sydney to Canberra and Brisbane to Canberra and more recently (announced 15th January 2014) Sydney and Melbourne to Hobart and Jetstar overtakes mainline in traditional full-service (see Figure 1) operations.
All of these downgrades are in an attempt to reduce ongoing loses at Qantas.
Jetstar now flies and competes on primary capital city routes on an integrated Qantas flight schedules. This capacity by Jetstar and Cobham Aviation (the managing low-cost enterprise of the B-717) is eating into domestic mainline revenues.

Figure 1.

Figure 1: Disproportionate offerings. The Afternoon Qantas Group schedule from Gold Coast where once Qantas Mainline Domestic was the dominate Airline now subjugated by the Low Coast carrier Jetstar to all Capital Cities.

Mr. Tony Webber who is an associate professor at the University of Sydney Business School and more notably the former Chief Economist at Qantas, evidences this transformation, where he clarifies the change as in its early days he states in a recent article; "Jetstar flew off-peak services from the east coast of Australia to the Gold Coast, the Sunshine Coast and Cairns. Most passengers wore T-shirts, shorts and thongs.

Nowadays, the carrier flies to the big three ports (Sydney, Melbourne and Brisbane) often during the morning and afternoon peaks in direct competition with Qantas mainline"

The losses out of Qantas mainline could not be regained from the leisure market as the Australian low-cost market is fast approaching saturation point. It has become increasingly difficult to stimulate domestic leisure travel by lowering airfares. The reason for this is the airfare is just 18 per cent of total travel spend in the case of domestic overnight travel. So when Jetstar (Qantas) or Tiger (Virgin) reduce fares by, say, 10 per cent, the effective reduction in total travel costs is just 1.8 per cent. This may stimulate demand by 1.8 per cent or even twice this at 3.6 per cent, but relative to the 10 per cent reduction in airfares, the demand response is weak and could even result in a reduction in revenue.

While the Virgin market share battle has contributed significantly to Qantas's weakness, Qantas Corporate Management and the Qantas Board must take sole responsibility and liability for the recent fiscal outcomes. The reduction in capacity of Qantas International carriage and the release of extensive routes

and reduction of international aircraft hulls, failed to supply Qantas Domestic Mainline with the inbound carriage so desperately needed in its capacity war against Virgin.
Significantly Qantas had not upgraded its international fleet to fuel-efficient B-777 and had released Boeing from the firm orders of the fuel efficient and technically advanced B-787-900 and was attempting to compete with 1963 technology and fuel guzzling B-747's and high cost four-engine A380 aircraft over routes that are suited to wide-bodied twin jets.

Thus we arrive now at point two of our submission; the historical selection and reasonable determination of Aircraft Equipment.

Suffice to say that Air New Zealand, an end-of-line operation, subject to the same fuel costs and a near mirror image in structure just declared a significant profit, the glaring deference is the operational equipment in that the New Zealander managers chose wisely with a timely selection of aircraft equipment that makes operation on leaner routes more efficient and far more profitable.

This may be reviewed at; http://tvnz.co.nz/business-news/air-new-zealand-profit-more-than-doubles-5547408
And; http://www.smh.com.au/business/aviation/air-new-zealand-profit-leaves-qantas-in-the-shade-20140227-33j29.html
Thus we see the insight to the broader spectrum across Oliver Lamb from PAC, Nathan Safe from the AIPA and Professor Webber from Sydney University Business School where Qantas needs to expand back into traditional markets and retain and develop the lineage between Qantas International and Qantas Mainline Domestic operations.

Notably however in order to move back to where Qantas should be it needs to buy fuel efficient aircraft now, in order to compete on leaner routes and to make increased profits from its current primary routes as shown by Air New Zealand, it needs fuel efficient technologically advanced equipment.

Our position and solicitation therein, is that Safe, Lamb and Webber are correct and Colonial Airways support the position of growing the Domestic Mainline and International operations together, through a caveat on foreign investment on release and restructure of the QSA. Furthermore Qantas Management will need to purchase slots and rights to technologically advanced aircraft in the B-777-X, B-787-900 and the Airbus A-350 range in order to reposition the operation correctly. With further consideration of upgrade to the fuel-efficient B-747-800.

Further information may be read at; http://blogs.crikey.com.au/planetalking/2009/08/17/v-australia-reminds-qantas-how-wrong-it-was-about-the-777/
And; http://blogs.crikey.com.au/planetalking/2012/05/18/cathay-pacific-hastens-its-retreat-from-747s/?wpmp_switcher=mobile

And; http://www.theaustralian.com.au/opinion/columnists/next-task-at-qantas-to-bring-forward-5001st-job-cut/story-fnfenwor-1226839952185#

It is also noted and subject of a previous Briefing Paper to the LNP Federal Government by this author that Qantas Corporate Management and therein the Qantas Board have erred in judicious and timely selection of the correct operational aircraft for International Fleet Operations.

The Senate Economics Legislation Committee may note that the expertise actually exists within the current ranks of Qantas Technical Aircrew and Qantas Engineering to make correct and timely aircraft selections. Whereas under ex CEO Geoff Dixon and to date Mr Alan Joyce such reviews and external consultations have failed Qantas Airways miserably in correct aircraft selection and configuration.

The Briefing Paper to the LNP Federal Government made the primary submission to recommend a seeding onto the Qantas Board of Pilots and Engineers as directors, based on a steering committee for the selection of and purchase transition of technical advanced fuel efficient aircraft for future operations.

The final point of this submission although touched upon in the detailed composition previous is: Airline development and entrepreneurial ventures by the Qantas Group.

Let’s examine some actualities.

Under the collective Qantas leadership of Mr Alan Joyce and Chairman Mr Leigh Clifford, Qantas has reeled from one unsuccessful strategy to the next within Asia with its Jetstar and Asian Airline expeditions. From mid-2011, Joyce was focused on setting up a premium Asian airline initially referred to as Red Q.

This new Premium Airline was to be based in Singapore, then Kuala Lumpur, before being abandoned in 2009.

Qantas paid allegedly circa $60 million for the Singapore-based Jetstar Asia's assets - the book value was at a little over $3 million - as well as $200 million in alleged accumulated losses. The Singapore Jetstar Flight Operation was necessary as an adjunct to the Red Q airline proposition, yet Red Q was abandoned and Jetstar continues flight operations. Mr Geoff Dixon, Alan Joyce's former tutor, stated in September 2004, when Jetstar Asia was launched in Singapore, that Jetstar Singapore was "going to be a very, very substantial airline". Yet it seems the only diminutive monetary return from Jetstar Asia is from its subleases of aircraft from Jetstar in Australia. Jetstar Singapore appears only to be flying because Qantas still foots the bill, despite being a minority shareholder in that operation.

Jetstar Pacific is majority owned by a Vietnamese government entity and its audited accounts are not made public. The reported $24 million in losses from 2009 to 2011 may be understated and media reports indicated losses at high as $63 million.

An overview media report is here; http://english.vietnamnet.vn/fms/business/70553/jetstar-pacific-lost-nearly-vnd2-5-trillion.html

Jetstar Hong Kong is a very long way from being operational. With capital commitments of $66 million, it is yet to receive initial start-up or regulatory approval from the Hong Kong Government. The plan to have 18 aircraft flying by 2015 is naïve at the very least defiantly improbable given progress to date.

The aircraft however are on their way ordered earlier and being delivered (and parked) and some flight crews are rumoured to have been employed yet are unable to fly, there being no actual airline to fly for!

Media Opinion here http://blogs.crikey.com.au/planetalking/2014/02/28/joyce-policies-under-stress-as-qantas-buckles/

Japan: recently the group injected another $60 million into Jetstar's Japan operations additional to the original start-up costs.

A report can be read here; http://www.smh.com.au/business/qantas-stumps-up-60m-to-help-jetstar-japan-fly-higher-20131031-2wly0.html

Seven years ago, Dixon purportedly said he didn't think Jetstar would ever be more than 20 per cent the size of Qantas. Jetstar now has a fleet greater than 60 per cent the size of Qantas. Independent Senator Nick Xenophon is sceptical of how the money tree has been pruned where the Senator asserts that Qantas International looks much sicker than it is because of cost-shifting from Jetstar, alas allegedly something perfectly legal under Australian accounting rules.

Adding weight to the assertions by Senator Xenophon was the significant action by the Australian Competition and Consumer Commission rejecting Alan Joyce's assertion Qantas International was in "terminal decline".

An article may be read here; http://www.theaustralian.com.au/national-affairs/xenophon-queries-jetstar-drain/story-fn59niix-1226830927290

The supposition is that Jetstar is the business entity depleting the host enterprise Qantas and not insignificantly. In any methodology or strategy to revitalise Qantas Mainline International and Mainline easing of investment to Jetstar should be a recommendation. Recognition that the philosophy of supporting Qantas International and Qantas Mainline Australian operations must once again become the focus point for Qantas Corporate Management and the Qantas Board.

An article by Ben Sandilands, an Australian Aviation correspondent sets out some statistics in late 2009 that have come to fruition and may be read here;
http://blogs.crikey.com.au/planetalking/2009/09/29/conspicuous-consumption-of-qantas-by-jetstar/?wpmp_switcher=mobile

We submit that the focus must return to the area of Mainline Australian and Mainline International operations and as has been detailed here with the mid-term to long term focus on route expansion, route competition and specific aircraft equipment.

For any proposed change to the QSA we respectfully submit that the following conditions should be met:

1) **A caveat that any change to the QSA specifically induces investment into Qantas International and Qantas Domestic Mainline operations and**

2) **The historical selection and reasonable determination of Aircraft Equipment is achieved by seeding the Qantas Board with a steering committee from the Technical Aircrew and Line Engineering operations as part of aircraft choice and procurement and**

3) **Investment into Jetstar cease until Mainline International and Australian Domestic flight operations are once again profitable.**

During the 1989 Pilots dispute an article appeared in a local newspaper on the Gold Coast relating to the ancillary effects of a diminished and weakened Australian Aviation Transport system. It had an image of a local Butcher with a bemused look at his corner shop. The catching headline has been long ago forgotten however the article was of note in that this local Butcher related that his business had suffered a massive financial decline in sales which was attributed to tourists unable or not inclined to visit the Gold Coast during that turbulent period in Australian Aviation history. No tourists meant no hotel bookings, no hotel bookings meant less advanced purchasing for associated hotel restaurants, room service and eating houses which meant down the line and in turn that the local Butcher had lost a significant market and such loss of trade had a potential to place him into fiscal decline. Herein we have a glimpse, a micro-economic view of the catastrophic effect that aviation and airline failure may have on the travelling public, tourism and the many ancillary business within the whole of Australia that depend on a healthy and competitive air transport system.

A healthy Qantas International Operation is good for Australian Business, good for Australian Tourism just as a healthy and competitive Qantas Domestic Mainline operation is also good for Australian Business, good for Australian Tourism and supports local communities such as the Gold Coast.
We submit that our recommendations above are very much in line with the interests of a healthy and competitive air transport system that will serve the travelling public and the Australian Economy very well and we place those recommendations to the Senate Economics Legislation Committee for their learned and meaningful consideration.