

General Counsel
Brett Johnson



12 March 2012

Ms Sue McIntosh
Executive Director
International Air Services Commission
GPO Box 630
Canberra ACT 2601
email: IASC@infrastructure.gov.au

Dear Ms McIntosh

Virgin Australia Airlines Request to Transfer Capacity on the Indonesia Route

We refer to Virgin Australia Airlines Pty Ltd's (VAA) letter dated 23 February 2012 requesting a variation to each of VAA's determinations on the Indonesian route to transfer the capacity allocated to VAA to Virgin Australia International Airlines Pty Ltd (VAIA).

As VAA explains in its letter, its request is required as a result of the proposed new structure for the Virgin business. Under that proposed structure, Virgin Australia International Holdings Pty Ltd (VAIH) will be incorporated as a new unlisted entity to hold all of Virgin Australia Holdings Ltd's (VAH) international airlines (including VAIA). VAIH will "be owned by existing VAH shareholders, have a majority of independent directors and will be comprehensively serviced, managed and funded by VAH".

The Virgin proposal is designed to permit the foreign shareholding in VAH to exceed the 49% limitation imposed on Australian international airlines. In fact, once the proposed structure is implemented, there is nothing preventing VAH from becoming wholly owned by foreign shareholders. Subject to FIRB approval, there is also nothing preventing VAH from being acquired by one foreign shareholder.

It is arguable that the proposed VAIH structure may comply with the requirements of the Air Navigation Act. Nevertheless, Qantas is very concerned that the proposed structure is likely to result in foreign persons having effective control of the day-to-day operations of VAIH, in breach of Australia's obligations under many Air Service Agreements (ASAs). Effective control at the day-to-day management level is of key importance in analysing compliance with obligations under the ASAs.

By its own admission, Virgin has acknowledged that VAIH "will be comprehensively serviced, **managed** and funded by VAH" (emphasis added). In circumstances where VAIH is comprehensively serviced, managed and funded by VAH, it is neither possible nor logical to argue that VAIH is **not** effectively controlled by VAH. While VAIH may have a separate Board comprising a majority of Australian citizens, "effective control" must be tested on a substantive basis. On its own submission, Virgin has acknowledged that VAH will have effective control of the day-to-day management of VAIH.

Even if there is an argument (which is not possible to verify based on public information) that the Board of VAIH retain some control of the company, there is no reason why VAIH cannot be "effectively controlled" by two people and VAH has acknowledged its ability to comprehensively service, **manage** and fund VAIH.

Further, the penultimate paragraph of VAA's letter states: "To facilitate compliance with the Air Navigation Act 1920 and **preserve our ability to access rights** under the Australia-Indonesia air service arrangements as an Australian designated carrier..." (emphasis added). This letter is written by VAA, an entity which will remain wholly owned by VAH, yet it is attempting to "preserve our [i.e. VAA's] rights" to operate using Australian traffic rights, which is not possible once VAH is majority owned by foreign persons.

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Once VAH's foreign shareholding exceeds 49%, it is no longer an Australian Person. At that time foreign persons have "effective control" of VAIH.

Worse, should VAH be substantially (or wholly) acquired by one foreign shareholder, that shareholder has control of the composition of the VAH Board and, therefore, itself has effective control of both VAH and VAIH.

The implementation of the proposed restructure will create a real risk of VAIH and its subsidiaries not being entitled to be designated as Australian carriers and to continue with their current operating authorisations.

Prior to making your decision, Qantas recommends that the Commission undertakes a comprehensive, public review to confirm that VAIH will, at all times in the future, be in a position to comply with the requirements to be designated as an Australian carrier under the relevant ASAs. This is particularly where the Commission will be aware of its obligations to make decisions by reference to the benefit to the public, and the role that considerations of "effective control" play in that context.

Yours faithfully

A handwritten signature in black ink, appearing to read "Brett Johnson", with a stylized flourish extending to the right.

Brett Johnson
General Counsel