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Advancing the interests of our members and the profession

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SUBMISSION TO THE INTERNATIONAL AIR SERVICES COMMISSION IN REGARD TO THE QANTAS APPLICATION FOR RENEWED AND REVISED CAPACITY ALLOCATIONS

INTRODUCTION

On 11 October 2011, Qantas wrote to the Executive Director of the International Air Services Commission (IASC) seeking the renewal of 17 Determinations of capacity allocated to Qantas Airways Limited and its wholly-owned subsidiaries which will expire in 2012. Qantas has also requested variations to some of those extant Determinations, mainly to extend the usage of the allocated capacity to its wholly-owned subsidiaries and to allow combinations of internal code-sharing between Qantas and those subsidiaries.

The Australian & International Pilots Association (AIPA) is not in a position to comment on the quanta of the capacity allocated to Qantas and its wholly-owned subsidiaries. AIPA also observes that paragraph 2(ea) of section 15 of the *International Air Services Commission Act 1992* (*IASCA 92*), although discretionary, has been given the effect by the IASC of treating allocations of capacity, where wholly-owned subsidiaries exist, as consolidated allocations.

AIPA wishes to make submissions regarding the potential for adverse outcomes stemming from the way in which both paragraphs 2(e) and 2(ea) are applied, particularly in the context of the objects of the *IASCA 92*, the *Qantas Sale Act 1992* (*QSA 92*) and Schedule 2 of the *Competition and Consumer Act 2010* (the Australian Consumer Law).

WHO ARE WE?

The Australian & International Pilots Association (AIPA) is the largest Association of professional airline pilots in Australia. We represent nearly all Qantas pilots and a significant percentage of pilots flying for the Qantas subsidiaries (including Jetstar Airways Pty Ltd). We are a key member of the International Federation of Airline Pilot Associations (IFALPA) which represents over 100,000 pilots in 100 countries.

AIPA is committed to:

- sustaining, developing and expanding careers in professional aviation in Australia;
- consultative and cooperative engagement with like-minded management teams to further the benefits of aviation for all stakeholders;
- ensuring that safety and technical standards are upheld and that aviation businesses can flourish in a sensible and focused regulatory regime; and
- participating openly, honestly and forthrightly in all activities to achieve these aims.

SECURE OUR FLYING

As we said in the introduction to our submission to the forthcoming Senate Inquiry into the *Qantas Sale Amendment (Still Call Australia Home) Bill 2011*:

> "It is critical ... that there is a widespread public and political recognition that AIPA is highly motivated to see Qantas succeed in a business sense so that we, directly, and more broadly the rest of Australia, benefit from that success. However, AIPA, in combination with what we believe to be the majority of the Australian public, is committed to see the success of this great Australian business take place with the minimum leakage of contributions to the Australian public purse, employment, skills development, national infrastructure and the national reach in time of emergency.
>
> AIPA is particularly aware that Qantas and its employees live in a dynamic and changing world of aviation as well as a changing world of business. We offer our considered advice ... against the backdrop of the national interests of prosperity, influence and security for all Australians."

THE QANTAS REQUESTS

Qantas has requested the renewal of 17 Determinations. Of those, AIPA is concerned about 6 requests which involve variations that relate to broadening the scope of the Determinations to included subsidiaries and/or corporate group code sharing. Those requests (emphasis added) are:

Qantas Request [2006] IASC 107 - Germany Route

Qantas is fully utilising the capacity under this determination. We therefore request renewal of this determination, as varied by Decision 214/2007, which allocates four frequencies per week on the Germany route and permits joint services with British Airways and Iberia Airlines, for five years from 1 July 2012.

As part of the renewal, Qantas seeks a variation to add conditions enabling capacity to be used by any wholly-owned subsidiary of Qantas and be used by Qantas to provide services jointly with any wholly-owned subsidiary of Qantas.

Qantas Request [2006] IASC 108 - Hong Kong Route
Qantas Request [2006] IASC 114 - Hong Kong Route

Determinations 108/2006 and 114/2006 (each as varied by Decision 205/2007 to permit joint services with Air France) allocate fifteen and five frequencies per week on the Hong Kong route respectively. As Qantas is fully utilising the capacity under these determinations, we seek renewal of these determinations for five years from 1 July 2012.

As part of the renewal, Qantas seeks a variation to add a condition enabling capacity to be used by Qantas to provide services jointly with any wholly-owned subsidiary of Qantas.

Qantas Request [2006] IASC 110 - Thailand Route

This determination allocates seven B747 weekly services in each direction on the Thailand route, all of which is currently being utilised. Accordingly, Qantas seeks renewal of this determination for five years from 1 July 2012. We would request to retain the conditions of the determination to support the code share arrangements with British Airways, Finnair, Air Malta, Iberia Airlines and Kenya Airways.

As part of the renewal, Qantas seeks a variation to add conditions enabling capacity to be used by any wholly-owned subsidiary of Qantas and be used by Qantas to provide services jointly with any wholly-owned subsidiary of Qantas.

Qantas Request [2006] IASC 117 - Japan Route

This determination allocates 45.6 8767-200 equivalent units of capacity per week in each direction on the Japan route. all of which is currently being utilised. Accordingly. Qantas seeks renewal of this determination. as varied to enable joint services with Japan Airlines, for five from 1 July 2012. As part of the renewal. Qantas seeks a variation to add conditions to enable joint services with Qantas or any wholly-owned subsidiary of Qantas.

Qantas Request [2006] IASC 123 - Philippines Route

This determination allocates 458 seats per week In each direction on the Philippines route. We seek renewal of this determination for five years from 1 July 2012. As part of the renewal, Qantas seeks a variation to add conditions enabling capacity to be used by any wholly-owned subsidiary of Qantas.

Another request involves a Determination that already includes those terms about which AIPA has concerns:

Qantas Request [2006] IASC 124 - Japan Route

Qantas seeks renewal of this determination allocating 0.6 8767-200 units of capacity per week in each direction on the Japan route, as varied, for five years from 22 April 2012.

Determination [2006] IASC 124 was made in anticipation of the commencement of Jetstar and contains the terms that AIPA understands Qantas seeks to import to the new Determinations requested. The following extracts provide the background and the conditions:

[2006] IASC 124 - Japan

"2.2 Under the Minister's Policy Statement (No. 5) of 19 May 2004, there is a rebuttable presumption in favour of the carrier seeking the renewal. The Commission notes that:

- Qantas has fully utilised the relevant capacity for most of the period since its allocation. The capacity is currently unused as a result of recent adjustments to Qantas' Japan operations, following the ending of services by Australian Airlines. However, there are firm plans for the capacity to be fully utilised again early in 2007 with the commencement of services to Japan by Jetstar;

...

3.3 The determination is subject to the following conditions:

- Qantas is required to fully utilise the capacity;
- only Qantas or another Australian carrier which is a wholly-owned subsidiary of Qantas is permitted to utilise the capacity;
- neither Qantas nor another Australian carrier which is a wholly owned subsidiary of Qantas is permitted to utilise the capacity to provide services jointly with another Australian carrier or any other person without the approval of the Commission;
- the capacity may be used by any wholly-owned subsidiary of Qantas to provide joint services with Qantas;
- to the extent that the capacity is used to provide joint services on the route, Qantas and any wholly-owned subsidiary of Qantas must take all reasonable steps to ensure that passengers are informed of the carrier actually operating the flight at the time of the booking;..."

For the benefit of any members of the public unfamiliar with the complexity of capacity management, Determination [2006] IASC 124 was amended by [2007] IASC 204, [2008]

IASC 216, [2008] IASC 221 and [2010] IASC 210. Decision [2007] IASC 204 enabled code-sharing by JAL. Decision [2008] IASC 216 amended the code-share city pairs and the date. Decision [2008] IASC 221 was a capacity reduction and Decision [2010] IASC 210 amended the code-share routes and extended the date to 31 December 2012.

AIPA'S CONCERNS

AIPA is concerned about how the IASC views the evolution of parent-subsidiary corporate capacity and code sharing arrangements today, given that there appear to be repetitive references to the analysis of the relationship between Qantas and Australian Airlines as justification for the probity of those arrangements in general. That issue first arose in the aftermath of the Ansett failure:

[2002] IASC 203 - Hong Kong, Japan, Singapore &Taiwan

"1.1 On 19 December 2001, Qantas applied to the Commission to vary determinations allocating capacity to Qantas on the Japan, Hong Kong, Singapore and Taiwan routes. On the Hong Kong, Japan and Singapore route Qantas is seeking to enable some or all of the capacity to be operated by a wholly owned subsidiary, at this time, Qantas envisages that some services would be operated by Australian Airlines Ltd, (AAL) (ACN 099 625 304)[1].

1.2 On the Taiwan route Qantas is seeking to have Qantas, Qantas Limited (ACN 003 613 465)[2] or AAL use the capacity and to permit Qantas and Qantas Limited to code share with Eva Air."

...

"3.5 The variation being sought is to allow a wholly owned subsidiary to use the capacity. Paragraph 7.3 of the Minister's Policy Statement states:

> "An Australian carrier seeking an allocation of capacity, or which may be permitted to use capacity allocated to an incumbent Australian carrier, will not be taken to be a new entrant if it is a subsidiary or a holding company of an incumbent Australian carrier operating on the route or if there is some other substantial connection between the two carriers in relation to ownership and control."

3.6 The Department of Transport and Regional Services (DOTARS) has advised that AAL is reasonably capable of obtaining the necessary approvals to operate on the Hong Kong, Japan, Singapore and Taiwan routes.

3.7 In the case of determinations allocating capacity on the Hong Kong, Japan and Singapore routes, Qantas is seeking a condition to allow the capacity to be used by a wholly owned subsidiary. Any existing code share arrangements are to remain between Qantas and foreign airlines only.

3.8 In relation to passenger capacity on the Taiwan route, capacity is allocated to Qantas Limited which is a subsidiary of Qantas Airways Limited, in this case Qantas is seeking to have Qantas Limited, Qantas Airways Limited or another Australian carrier which is a wholly owned subsidiary of Qantas use the capacity."

AIPA has expressed concern to the Senate Inquiry that treating the Qantas-Jetstar relationship as consistent with the Qantas -Australian Airlines relationship is flawed. We quoted an extract from Decision [2006] IASC 209 (which resulted in Determination [2006] IASC 103) for the start-up of Jetstar's Japan operations:

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1 Still an active ACN as Australian Airlines Limited

2 Was Australia-Asia Airlines Limited, then became Qantas Limited and now is Express Freighters Australia Limited

"4.5 The Commission has considered the issue of code sharing between Qantas and wholly-owned subsidiary companies on several occasions in relation to operations by Australian Airlines, another Qantas subsidiary, including on the Indonesia route - see Decision [2003] IASC 207. Similar decisions were made in respect of applications for code sharing on the Malaysia and New Zealand routes ([2003] IASC 205, and [2005] IASC 2006 respectively).

4.6 The Commission's position in those cases was that Qantas and Australian Airlines operated in different markets which best matched their product and cost structures and they would be unlikely to compete on price even where both carriers operated on the same route. The Commission concluded that there can generally be expected to be no lessening of public benefit from authorising the parent airline code sharing with the subsidiary airline. The Commission considers that the same conclusion is applicable in relation to code sharing between Qantas and Jetstar and will authorise code sharing between Qantas and its wholly-owned subsidiaries."

We than observed that Australian Airlines was just a 'minnow' compared to the Qantas 'whale' and the route structure was designed on a no-compete basis. Jetstar on the other hand is on a trajectory to outgrow its parent and, as the domestic market shows, is often directly competitive with Qantas.

AIPA is concerned that the parent-subsidiary corporate capacity and code sharing arrangements permitted by paragraphs 2(e) and 2(ea) of s15 of the *IASCA 92* have the unintended consequence of allowing Qantas to deliberately shrink its own operations in favour of its subsidiaries, in support of a strategy to circumvent the constraints of the *QSA 92*. While we recognise that capacity is broadly viewed as an Australian asset first and foremost, those arrangements act to protect capacity allocation while permitting so-called "phoenix" subsidiaries to emerge from the ashes of the parent airline. AIPA does not believe that such outcomes truly meet the object of the *IASCA 92*.

AIPA is further concerned the 'fair warning' condition is inadequate to properly give effect to the object of the Australian Consumer Law. That condition typically states:

- "to the extent that the capacity is used to provide joint services on the route, Qantas and any wholly-owned subsidiary of Qantas must take all reasonable steps to ensure that passengers are informed of the carrier actually operating the flight at the time of the booking;..." [emphasis added]

AIPA is concerned that identifying the carrier alone is insufficient to fully inform the passengers that the service standards, recruiting standards, training standards and operating procedures not the same for the marketing and operating carriers. We are concerned that the standard condition may not be sufficient to avoid a potential breach of ss 18, 29 and/or 34 of the Australian Consumer Law.

INTERNATIONAL AIR SERVICES COMMISSION ACT 1992

Section 3 sets out the object of the *IASCA 92* as follows:

"3 Object of Act

The object of this Act is to enhance the welfare of Australians by promoting economic efficiency through competition in the provision of international air services, resulting in:

(a) increased responsiveness by airlines to the needs of consumers, including an increased range of choices and benefits; and

(b) growth in Australian tourism and trade; and

(c) the maintenance of Australian carriers capable of competing effectively with airlines of foreign countries."

Section 15, in pertinent part, states:

"15 Content of determinations

(1) A determination may include such terms and conditions as the Commission thinks fit.

(2) Without limiting subsection (1), the determination:

(a) must specify the period, under subsection (3), during which the determination is to be in force; and

(b) may include a statement to the effect that the determination is an interim determination; and

(c) must include a condition that the capacity be fully used, except so far as:

(i) the determination provides otherwise in relation to a specified period commencing when the determination comes into force; or

(ii) the regulations otherwise permit; and

(d) must include a condition that, except to the extent permitted by the condition referred to in paragraphs (e) and (ea), the available capacity in question is only to be used by the one or more Australian carriers to whom the capacity is allocated; and

(e) must include a condition stating the extent (if any) to which any such carrier may use that capacity by providing joint international air services with another Australian carrier or any other person; and

(ea) may include a condition that, to the extent that any of the capacity is allocated to a particular Australian carrier, it may be used in whole or in part by any one or more of the following:

(i) the carrier;

(ii) a wholly-owned subsidiary of the carrier;

(iii) if the carrier is a wholly-owned subsidiary of another Australian carrier—that other carrier; and

(f) must include a condition stating the extent to which changes in the ownership or control of any such carrier are permitted while the determination is in force. "

AIPA submits that a cursory application of paragraphs 15(2)(e) and (ea) that ignores the emerging evidence of a Qantas strategy to 'phoenix' Jetstar will fail to satisfy subsections 3(a) and (c). For instance, the reduction in capacity or withdrawal of Qantas from some routes in favour of Jetstar reduces the range of choice and reduces the benefit to Australia, particularly where those passengers who prefer full service airlines seek out foreign carriers to gain that level of service. Transferring capacity to Jetstar, beyond the normal economic response to market conditions, also hastens the lack of competitiveness of Qantas in the full-service market.

AIPA suggests that the IASC should advise the Minister that the Ministerial Policy Statement may need to be reviewed in light of these unintended consequences. As desirable as corporate flexibility may be in some scenarios, it should never be permitted at the expense of the object of the Act.

AIPA further suggests that code share arrangements between associated entities may not be as beneficial as previous IASC Determinations and Decisions have indicated. This current round of renewals should be considered as sufficient reason to excite the latter requirement of subsection 3.6 of the Ministerial Policy Advice for full consultation with the Australian Competition and Consumer Commission.

QANTAS SALE ACT 1992

The forthcoming Senate Inquiry into the *Qantas Sale Amendment (Still Call Australia Home) Bill 2011* will explore the issues that concern AIPA the most in regard to the congruence of the intentions of the QSA 92 and those of Qantas management. One of the concerns that we have raised in our submission to that Inquiry is:

> "AIPA recognises that Qantas code-shares with many airlines, consistent with international airline practice. However, this practice is predominantly arranged with unrelated entities and would normally attract little comment. But should it be the same case when dealing with subsidiaries and associated entities?
>
> In the context of our discussion on the effectiveness of the *QSA 92*, it appears to us that international code-sharing arrangements between Qantas and its subsidiaries and associated entities provide a convenient platform for Qantas to shrink back from being an 'operating carrier' to becoming predominantly a 'marketing carrier'.
>
> While AIPA is unclear on what legal limitations may or may not exist, Qantas might even be able to relinquish its International AOC altogether, but still issue tickets in its own name for international flights on its subsidiaries, in much the same way as Qantaslink (which does not hold an AOC) does domestically. Improbable as that scenario may seem, it appears to us that the *QSA 92* could still be satisfied legally, even though the international business would mainly consist of just a call centre and associated IT facilities.
>
> AIPA believes that the burning question now, as it was in 2007 and in 1992, is whether strictly legal compliance with the *QSA 92* will satisfy the political and public expectation of protecting the survival of Qantas as Australia's pre-eminent national carrier? "

AIPA recognises that the IASC must make its determinations and decisions only in accordance with the IASCA 92, including the Ministerial Policy Statement. However, the IASC are the experts in the area of capacity allocations and code sharing arrangements and should therefore be able to identify where the potential strategies available to Qantas management begin to undermine the Australian framework for capacity allocation.

THE AUSTRALIAN CONSUMER LAW

AIPA is concerned that the negative impact on consumers as a result of code sharing between full-service and low cost carriers in general, and Qantas-Jetstar in particular, are not adequately identified to either outbound or inbound passengers. There is plenty of anecdotal evidence of Qantas passengers being most unhappy at discovering that the flight they booked as a Qantas flight is to be operated by Jetstar. Some passengers may enjoy some fleeting positive benefits in the reverse circumstances, but the situation is apparently disproportionately rare.

AIPA suggests that there are 3 provisions of the Australian Consumer law that may be relevant in terms of full disclosure:

> **"18 Misleading or deceptive conduct**
>
> (1) A person must not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive."

"29 False or misleading representations about goods or services

(1) A person must not, in trade or commerce, in connection with the supply or possible supply of goods or services or in connection with the promotion by any means of the supply or use of goods or services:

...

(b) make a false or misleading representation that services are of a particular standard, quality, value or grade; or

..."

"34 Misleading conduct as to the nature etc. of services

A person must not, in trade or commerce, engage in conduct that is liable to mislead the public as to the nature, the characteristics, the suitability for their purpose or the quantity of any services."

AIPA believes that the standard condition was written when service standards were essentially similar or, at the very least, not as differentiated as full service and low cost carriers are today. We provided considerable evidence on that differentiation to the Senate Standing Committee on Rural Affairs and Transport *Inquiry into Pilot training and Airline Safety including Consideration of the Transport Safety Investigation Amendment (Incident Reports) Bill 2010* that was completed earlier this year.

Without offering any advice or suggestion of the preferability of one scheme over another, AIPA asserts that there are significant differences in the approach and standards used by operators in the recruitment and training of personnel, operating procedures and service standards, particularly between full service and low cost carriers. It is unreasonable to expect the average member of the public to understand those differences, either in absolute or relative terms, or to realise without being specifically alerted that the product and service standard that they paid for may not be available under a code share arrangement. Furthermore, having discovered the mismatched expectation, they may well be unable to exercise any further choice to redress the issue.

SUMMARY

AIPA is concerned that the true competitiveness of the parent-subsidiary corporate capacity and code sharing arrangements permitted by paragraphs 2(e) and 2(ea) of s15 of the *IASCA 92* has not been fully explored in current market conditions.

AIPA is concerned that the parent-subsidiary corporate capacity and code sharing arrangements are providing a vehicle for Qantas management to avoid the intent of the *QSA 92* and to shrink Qantas in favour of Jetstar for reasons other than market conditions.

AIPA is concerned that the level of disclosure required by the IASC about code-sharing between full-service and low cost carriers is inadequate and may lead operators to breach some or all of sections 18, 29 and 34 of the Australian Consumer Law.

-- END --