

Is Air Pacific, heading for disaster???

The sudden announcement of the planned departure of Air Pacific's controversial American head David Pflieger has raised more than a few eyebrows in Fiji and internationally. Was Pflieger pushed or did he jump because of an imminent commercial disaster?

While any commercial operation would always try to avoid controversy, Fiji's national airline has attracted headlines for all the wrong reasons since Pflieger took over in May 2010. The most controversial was Pflieger/Air Pacific's hiring of a top US Law firm to draft the draconian *Essential National Industries (Employment) Decree* and successful lobbying of the Bainimarama Regime to introduce the said Decree. The lawyer who drafted it was charging a rate of \$1,800 an hour.

This is rather unusual where a private company (even though it is 51 percent owned by the Government) actually commissioned and paid for a private legal firm to draft a legal decree aimed at curbing workers' rights.

Under his watch, Air Pacific also took the drastic step of ditching its orders of five B767-3 Dreamliners. It opted instead for three Airbus A330-200. It later became clear that Air Pacific and the Bainimarama regime had committed \$181 million of Fiji's Workers pension funds as a loan to fund a down payment for the financing of the three aircrafts.

This purchase also raised a few questions. Why Airbus when Air Pacific had always flown Boeing and all its engineering staff and service facilities are set up for that. The A330-200 has a shorter length and wing span, higher total thrust, a lower MTOW¹, a lower cruise speed and a lower passenger capacity when compared to the B787-9.² Airbus also plans to stop producing the A330-200 in 2015. Finally why purchase when the trend is for airlines to lease? Were there secret kickbacks involved in the deal?

The Regime also introduced another controversial decree - the *Civil Aviation (Ownership and Control of Airlines)* to ensure Pflieger and Aviation Minister Aiyaz Sayed-Khaiyum circumvent the articles of association of Air Pacific, which this article will examine later.

¹ Maximum Take Off Weight

² <http://www.aviatorjoe.net/go/compare/A330-200/787-9/>

The coup of December 2006 has presented a strong challenge for Fiji's Tourism Industry. In order to sail through the resulting market downturn, players in the industry (hotel/airlines/travel agents) had to work together to sustain the industry.

Their task was not made easier with the delay in taking delivery of their five ordered Boeing 787-3 Dreamliner Jet, the oil price hikes of the last five years and the arrival at the scene of two new competitors – Jet Star and V Australia.

With all the above variables, something had to give and in Air Pacific's case, medium and senior-level managements were gradually being forced out by the new CEO David Pflieger, when he took over in May 2010. All staff were forced to take massive pay cuts and the standard (and therefore quality) of inflight service suffered badly as Air Pacific began cutting costs to compete with the two new competitors mentioned. Inflight crew manning a B747, were for example, cut from 12 to 8 per long-haul flights.

Pflieger inherited a two-tiered management structure comprising the Executive Corp and the Management Corp when he took over.

The Executive Corp comprised four executives: John Campbell (CEO), Executive GM Commercial, Executive GM Manager Operations and Executive GM Corporate services. All were expatriates except for GM Corporate Services, Josephine Yee Joy. Today, there are only three and all are expatriates: MD/CEO Pflieger, Chief Financial Officer/Executive GM Finance and Chief Commercial Officer.

On the lower rung of the Executive Corp are the GMs. Isaac Komailevuka (GM Peoples) Manoa Kamikamica (GM Pacific Sun), Dallas Foon (GM Strategic Planning), Jim Samson (GM Inflight Services), Michael Nacola (GM Sales and Marketing), Thomas Robinson (GM Engineering), Ranjan Naidu (GM IT), Captain Hilton (Chief Pilot and GM Flight Services), and Salote Rokobuli (GM Finance) Out of the nine, only one is left – Thomas Robinson. The rest have either resigned or were asked to hand in their Resignation by Pflieger.

Salote Rokobuli and Michael Nacola's positions were abolished but a new GM Revenue Management was established and a General Manager Flight

Operations/Chief Pilot. Interestingly, I could not see any tertiary qualifications in the GM Revenue's profile.³

Savings from the abolition and resignation but not replaced previous executives were then diverted to the Executive GM levels now rebranded Chief Financial Officer, Executive GM Finance and the MD/CEO. In other words, the responsibilities and workload of eight GMs and two Executive GMs' roles were taken over by three executive GMs and four GMs.

Apart from the failure to retain good workers that Air Pacific had invested heavily in training for years, Pflieger's management style is well complemented by the Military Sponsored Regime and its *control freak* Line Minister Aiyaz Sayed-Khaiyum.

Khaiyum moved by decree to blunt the effect of Article 15 of the Airline's Articles of Association, which was introduced in 1987 when Qantas took the additional shares in Air Pacific to take their stake up to the 46 per cent range.

The 1987 change was aimed at ensuring that Qantas had a say in crucial Board and Management decisions and that the major shareholder not ride roughshod over the (financial) interests of such a large minority shareholder for some misguided or non-commercial reasons.

Subsection (c) (6) and (7) specifically requires the consent of Qantas Directors with regards to the issuance of shares or "options in respect of shares" as well as the grant of any mortgage, charge or other security interest of any asset of the company.

Under Article 15, there must be a 2/3 approval from board members to approve the appointment of a CEO and ensure no unqualified political favourite or permanent secretary is thrust into the role.

Article 15 also aimed at ensuring that decisions to open new routes demanded a clear business case.

A political directive to the board could not be dictated as to where and when Air Pacific could fly as the Airline had been down that path before with the disastrous "Project America" in 1983⁴.

³ www.airpacific.com under About Us_Our People

⁴ <http://business.highbeam.com/26/article-1G1-9086378/stoking-up-home-fires-project-america-drove-air-pacific>

According to a former board member familiar with the Articles of Association of the Airline, he never saw Qantas exercise its power during his time there and there was never a vote to approve major decisions. He added that no vote was ever taken during Gerald Barrack's 17 years as Chairman.

He further added that board papers were prepared in detail and for major issues, papers were submitted progressively so board members could understand complex issues such as aircraft evaluation and purchase.

The former board member said Fijian directors looked to their Qantas counterparts for comment and advice as Qantas directors' have the industry professionalism to explain technical issues.

Another former director concurred that Qantas directors were a bonus and totally professional and when sitting around the board table they always acted in the best interest of Air Pacific.

If there was a discussion that impacted Air Pacific/Qantas relations, they would offer to leave the room to allow the Fijian directors to discuss the matter privately.

He added that this was not to say that there were never any disagreements. Rather, any disagreements, whenever they arose, were always handled professionally.

This is interesting as Khaiyum is pushing for the National Carrier to start operating to Singapore and/or Bangkok probably in lieu or perhaps in addition to Hong Kong, which would better serve the Indian Market – A desire thought not shared by the former middle management team.

The new regulations should not make a material difference so long as the Bainimarama Regime behaves sensibly and does not push its agenda to operate in Singapore or Bangkok or appoint non-professionals into key roles.

Qantas will feel unloved and may even be keen to sell its shares. Maybe the regime is keen on a fire sale as recent national disasters will ensure there is no money to pay a reasonable price.

According to the *Ownership and Control of Airlines Decree*, an airline cannot operate under Fiji's laws unless "it is a citizen of Fiji". It takes away the "supermajority approvals" and the "veto rights" of a foreign minority

shareholder in a Fiji registered international airline. Apart from controlling 51 per cent of voting interest for a company to be a Fiji Citizen, the Decree went on to say that “at least two-thirds of the board members and any committee” in the company should be a citizen and such a company should be under “effective and actual control of citizens of Fiji”.

The Decree deems an air carrier is no longer a citizen of Fiji if foreigners have effective and actual control on matters such as shareholders or board voting rights, equity or debt agreement, budget, funding, financing, loans, capital needs or expenditure.

The introduction of the Civil Aviation (Ownership and Control of Airlines) had frustrated Qantas as indicated by a letter CEO Alan Joyce wrote to Khaiyum. When contacted by a *Fijian business* magazine on the subject, Qantas corporate office in Sydney responded with a statement that Qantas does not have veto power over Air Pacific’s operational decision nor does it have effective control over the airline. The response stresses that Qantas is a minority shareholder.

Though the response was merely repeating what had been said in local and overseas media, it is quite plain that its view that while certain standard joint venture decisions were to be made by consensus, it should continue to be “board” not “shareholders” decisions. Qantas feels that Air Pacific directors must at all times, act in the best interests of Air Pacific and not their appointing shareholders.

Also, if Qantas exits, so too will a lot of free benefits (safety system reviews, access to global airfares and interlining, technical advice, airports systems and a host of others). These benefits will either disappear altogether or will only become available at commercial pricing and Air Pacific and Fiji will feel more pain in its tourism sector.

Whatever the arrangement is right now, and as an outsider looking in, one cannot tell but given that Qantas had withdrawn its board appointees and the rest of the board members are Bainimarama Regime lackeys, the Board’s decision over the Airbus financing plan had undoubtedly advanced the Fijian Regime’s interest over that of the airline. It is up to readers to draw their own conclusion from what is described below.

As previously mentioned, Air Pacific negotiated a down payment loan from the sole Fijian pension fund, the Fiji National Provident Fund (FNPF) in 2011. To

secure the FNPF loan, the Fijian Government mortgaged its 51 per cent share in Air Pacific, 13,307,075 shares.

The mortgaged deed was formalised on the 21st September 2011 and was signed and initialled by Jaoji Koroi as acting Managing Director and CEO of FNPF, and Aiyaz Saiyad-Khaiyum, acting Prime Minister and acting Minister of Finance. Both signatures were witnessed by the-then Solicitor General Christopher Pryde.

The mortgage deed filed with the Registrar of Companies showed that the shares comprised :

- 4,237,328 fully paid ordinary shares of \$1 per value representing 16.24 per cent of the entire issued capital of Air Pacific;
- 2,390,750 of fully paid B ordinary shares of \$1 per value representing 9.16 per cent of the entire issued capital of Air Pacific; and
- 6,678,997 partly paid ordinary shares of \$1 per value paid up to \$0.01 per share representing 25.6 per cent of the entire issued capital of Air Pacific

If shares were at par value, then this represents \$13,307,075 worth of shares and 25.6 per cent of these issued shares had only been paid up to 1 per cent of its par value or \$66,789.97.

These shares represent a minor proportion of the securities offered by Air Pacific and the Fijian Government. They also mortgaged the five aircraft Air Pacific owns (2 B737-800, 1 B737-700 and 2 ATR42-500 operated by subsidiary Sun Air).

The deed document had Pflieger as Managing Director and CEO and Caine as CFO for Air Pacific and witnessed by Jay Shree Raniga, the Airline's Attorney. FNPF was represented by its General Manager and CEO Aisake Taito and Jaoji Koroi Chief Investment Officer signed as authorising officer.

As stipulated in the signed deed, each aircraft are to carry a plaque that reads 'This aircraft (or engine) is owned by Air Pacific Limited and is mortgaged to Fiji National Provident Fund'.

Papers filed with the Registrar of Companies put the value of the five aircraft at \$141 million. Funds uplifted from FNPF totalled \$181,233,151.48. Interest on

borrowing but figures that was quoted to a local business magazine hovers around 8 to 9%.

Speaking on condition of anonymity, former Air Pacific Staff that were keen to talk about these financial arrangements agreed that mortgage fixing assets for a loan was not unusual for an airline business. It has been done couple of times in the history of Air Pacific and Pflieger was not doing anything out of the ordinary.

What is not ordinary was the government's decision to offer as security its entire equity in the airline.

Documents released by Sayed-Khaiyum showed Qantas valued Air Pacific's total value at around \$151 million as per its London-based valuer.

Official press releases taken from its website indicated that the airline recorded its highest revenue of \$645.9 million in FY2012/2011⁵. This was a \$90.5 million increase in revenue from FY2011/2010 and a \$130-million increase from FY/2010/2009, the year before airline restructuring and turnaround effort began.

Given no annual reports had been released, it is impossible to do some proper accounting analysis on Air Pacific's financial performance; however a \$91.5 million or 13.5 percent turnaround in revenue should warrant forensic accounting investigation as it is rather unusual in this business.

It is not even know whether external auditing has been done to confirm these figures.

Apart from that, and taking away the penalty of \$24.8 million paid by Boeing for late delivery of the Dreamliner, Air Pacific should highlight that they also operated at a loss in 2011.

Interestingly, closer observation of the FY2012/2011 figures revealed a \$33.4 million hole in the FY2011/2010 figures Air Pacific released. In other words, 12 months later, the 2011 revenue figures had changed without any official announcement from the Airline's board. Year end revenue on the 2011 release was \$553.3 million but in the 2012 release, the 2011 figures used for comparison purpose had changed to \$586.7 million.

⁵ Financial year ends on the 31st March of each year

The operating loss had also increased by \$700k and net operating profit increased by \$600k. The confusion here is that while operating loss increase, final net profit (after income tax) also increased.

Given what's described above, David Pflieger was supposed to take these contradicting financial reports and sell it to European Credit Agencies (ECA) for a positive business rating.

In an interview with *Islands Business Magazine* in June 2012, Pflieger explained that ECAs only look at proposals six months before plane delivery. He added that come September 2012, he and his CFO, Nick Caine would be doing the rounds with ECAs to tie up the \$1.2 Billion financing of the three A330-200s using the \$181 million obtained from FNPf as down payment. In his own words, no European banker would look at funding the balance of the cost without an ECA.

Given that the first airbus is scheduled for delivery in March 2013 and given the inaccuracy/inconsistency highlighted in Air Pacific's official performance press releases of 2012, has Pflieger failed to secure an ECA or a number of ECAs?

Did he and his CFO failed to pick up the inconsistent figures or were they too busy cooking the books to notice?

Has Pflieger failed to secure the \$1.2 billion funding from European Bankers and advised that his contract will not be renewed?

On a closing note, David Pflieger has now secured further employment as President and CEO of Silver Airways, a US domestic carrier with a fleet of turbine propeller powered Saab 340BPlus and Beechcraft 1900D airplanes. Coming from managing Boeings and proposed Airbus jumbos to the equivalent of Pacific Sun, has the international job market now properly gauge his true worth and has Air Pacific's board finally saw the light, realised that he was punching above his weight and politely showed him the door?