



Polynesian
AIRLINE OF SAMOA

FACSIMILE TRANSMISSION

TO : Chairman NZ Commerce Commission

FROM : JOHN F FITZGERALD

CITY/COUNTRY: Wellington/New Zealand

DATE : 17 July 2003

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Subject:

Letter/submission of five (5) pages follows

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17 July 2003

The Chairman
New Zealand Commerce Commission
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New Zealand

BY FACSIMILE
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Dear Sir,

Cross Submissions by Polynesian Airlines re: Applicants Response to the Draft Determinations by the Commerce Commission in the matters of:

APPLICATIONS BY AIR NEW ZEALAND AND QANTAS TO IMPLEMENT A STRATEGIC ALLIANCE AND FOR QANTAS TO ACQUIRE SHARES IN AIR NEW ZEALAND (The Applications)

This is the third submission made by Polynesian Airlines on these matters and reference is made to the first and second submissions dated 7 February and 5 June 2003 respectively.

At this late stage in the process Polynesian will not attempt to present a voluminous commentary on the pro and con arguments included in the many thousands of pages of material presented to the Commission so far.

However, having itself reviewed the original Applications and all the subsequent material presented by interested parties and the Applicants as well as the Commission's Draft Determinations and the Applicant's responses to them, Polynesian will seek only to register certain critical points in a succinct manner for the Commission's convenience, as follows;

1. The Applicant airlines are representatives of an industry in great need of fundamental restructuring to reduce costs. Polynesian Airlines is an integral part of that industry whose future is closely bound up with that of the Applicants and on that ground Polynesian has a right to be involved.
2. The Applications do not represent the most appropriate solutions to reconcile the contradictions inherent in the need for industry wide restructure and maintaining effective air service competition in the Wider Public Interest.
3. There is a better solution to the restructuring problem and Polynesian proposed it in its second submission dated 5 June 2003.

Refer Table 4 at Page 25.

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In that proposal Polynesian has shown that it is possible to balance the enhanced sustainability of flag airlines against the public demand for competition.

4. The Applicants have compromised their urgent need for restructure by advancing relatively unconvincing arguments that have failed to sway public or industry opinion and have likewise failed to identify the full scope of the Wider Public Interest involved in the air services industry.
5. The Commission has not, so far, assessed the Wider Public Interest in the Applications as defined and canvassed in Polynesian's submissions of 5 June 2003.

Refer Section 2 and Table 1 on Page 10.

The Draft Determinations are, therefore, incomplete and so the Commission has been misled and has, consequentially, arrived at erroneous conclusions.

6. With the exception of Polynesian, all of the contributions from interested parties ignore the fact that flag airlines are subject to artificial (bilateral) constraints on their operations that are imposed by governments and are in direct conflict with the thrust of competition law in New Zealand and Australia. This is no fault of the flag airlines and so a pragmatic approach to the Applications is called for.
7. Those other interested parties also ignore the fact that Air New Zealand has already met the test of a failed company insofar as it has had to be financially rescued from collapse by the New Zealand government on behalf of taxpayers. That could well happen again, as Air New Zealand itself avers in its definition of the counterfactual.
8. Several of the interested parties have argued that in the interim since the Applications were lodged Air New Zealand has substantially recovered and so there is no substance to the airline's counterfactual argument. Evidence that has been cited includes:
 - 8.1 The airline is back in profit due to successful restructuring.
 - 8.2 The airline is now enjoying lower gearing
 - 8.3 The domestic market initiative Air New Zealand Express is a successful strategic move that is very profitable.

None of the above three arguments is valid.

Air New Zealand will show a profit this financial year because it has hugely benefited from a massive exchange rate increment of the NZD against the USD (in which latter currency the bulk of the airline's costs are denominated).

The point is not that Air New Zealand has made an NZD 200 million profit but that it should have made at least 6% pre tax on total turnover before the extra-ordinary exchange gain. Absent that exchange gain the airline would still likely be operating at a loss of up to 8c in every dollar earned.

For obvious reasons it is not to be expected that the airline would focus attention on that factor in its public statements or make public any estimates of it but the fact remains that any business that relies solely on a fortuitous currency movement is clearly unsound.

The lower financial gearing of the balance sheet (69% now v/s 93% previously has been quoted) is not due to enhanced profits but is the outcome of the abandonment of the Ansett investment liabilities combined with the New Zealand government's purchase of new shares issued by the airline and the deployment of the bulk of those new funds to retirement of debt.

The Air New Zealand Express initiative does not represent either a material reduction of costs or generator of airline profits. Simple arithmetic would show that discounting fares by the amounts claimed would require much larger traffic increases than the mid 20s percent that has resulted so far. The result has been more traffic but not necessarily more profit.

9. The arguments by interested parties in 8 above are presented to support their claims that the airline is not in crisis and, therefore, does not need the Alliance. That proposition is patently not correct. Polynesian supports Air New Zealand's own contentions about its operating realities and lack of financial strength (as stated in the previously confidential Appendix 6 of Air New Zealand's responses to the Draft Determinations).

10. On the critical issue of tourism, Polynesian again believes the Applicants have not succeeded in providing a convincing methodology for increasing tourism into New Zealand. The fundamentals have been lost in the midst of voluminous argument about machinery for processing bookings whereas the real issue is about creating product first and generating demand based on it. This has not been addressed.

There can be no doubt, however, that the potential does exist for generating the extra tourist numbers inbound to New Zealand and for the earnings benefits cited by the Applicants but they have missed the point made in the preceding paragraph and, in so doing have failed to ignite support.

11. The essential problem with the structure of Air Services in the South Pacific (and in many other parts of the world as well) is that bilateral intervention in the industry by governments dating back to the middle of the last century is in conflict with competition laws that evolved much later and in a quite different context.

The airlines are constrained artificially and prevented from accessing the benefits inherent in takeover, merger and acquisition activity while, at the same time, they are expected to engage in cutthroat competition – and in fact are obliged to do so by the law.

In the absence of any compensatory factor to offset the bilateral constraints on their freedom of action, it is inevitable that they will, from time to time, suffer technical business failure and have to be rescued by taxpayers. The many interested parties who have lodged objections to the Applications have, with only Polynesian's exception, failed to focus on that inevitability of failure and the contingent liabilities on the taxpayer that arise from it.

***Refer Polynesian's second submission of 5 June
at Appendix 2 on Pages 48 and 49.***

No other interested party, apart from Polynesian, has attempted to assess the true cost to a nation of supporting a national flag airline in the artificially created bilateral environment.

As matters now stand, the fact is that users who pay less than the true cost of air service production are eventually contributing to the failure of the flag airlines and are, thus, being subsidised by the population at large; that is to say, taxpayers.

- 12 Polynesian has argued that the Wider New Zealand Public Interest in air services encompasses a geographic region greater than just Australia (as was reflected in the Applications) but should include those Pacific Islands with whom New Zealand has special relationships, particularly Samoa and Niue. They are part of the regional air services system by virtue of their role in servicing the VFR travel needs of the very large populations of Pacific Island origin that are now resident in New Zealand and Australia.
13. Polynesian supports the position taken by the New Zealand government (and many other governments around the world that survival of a national flag airline is essential infrastructure for the maintenance and growth of tourism.

It is not, however, necessary to create a regional monopoly to achieve that, hence the alternative that has been proposed by Polynesian.

Conclusion

Polynesian concludes that nothing has subsequently been contributed, by the Applicants or any of the other interested parties, that would lead to amendment or addition to the first and second submissions and recommendations it has already made to the Commission.

We respectfully recommend that the Commission should recognise that it is in the Wider Public Interest that national flag airlines should not be prevented from accessing the opportunities that undoubtedly exist for lowering their production costs and, thus, facilitating sustainable competition and reducing the inherent financial exposure for taxpayers

As an extension of that premise, we believe the Commission must also differentiate between the production cost side of the air services equation (as addressed by Polynesian) and the revenue side that has been exclusively focused upon by all the other interested parties.

That obsession with the "low fares and rates" revenue side by the majority of submitters has misled the Commission and led it to adopt conclusions in its Draft Determinations that do not recognise the realities faced by the Applicants nor, indeed, the Wider Public Interest as opposed to the narrower, user interest represented in their submissions by most of the interested parties.

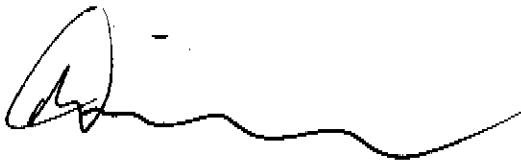
Polynesian believes, therefore, that a suitably qualified approval along the lines it has proposed would fit the realities of the situation much better and it further believes that it has, itself, a Wider Public Interest case for inclusion in that approval.

*Refer: Polynesian's second submissions at Section 12
Recommended Conditions for Approval Pages 40 – 43 inclusive.*

The airlines have to be sustainable as well as competitive. It is in nobody's interest that they should continue to fail from time to time and have to be bailed out at huge taxpayer expense.

Polynesian reiterates its wish to be heard at the Commission's conference and an appointment would, therefore, be appreciated.

Yours faithfully,



John F Fitzgerald
MANAGING DIRECTOR &
CHIEF EXECUTIVE OFFICER