



# Cabinet Business Committee

CBC Min (02) 11/8

Copy Number:

## Minute of Decision

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### Air New Zealand Qantas Strategic Alliance

On 18 December 2002 the Cabinet Business Committee, having been authorised by Cabinet with Power to Act [CAB Min (02) 34/23]:

#### Background

- 1 **noted** that on 16 December 2002 Cabinet authorised the Cabinet Business Committee on 18 December 2002 to have Power to Act in considering the submission on the proposed Air New Zealand – Qantas Strategic Alliance (the “Alliance”) [CAB Min (02) 34/23];
- 2 **noted** that on 25 November 2002 Qantas submitted an application to the Air New Zealand Kiwi Shareholder (Hon Paul Swain) seeking approval for Qantas acquiring 22.5% of the equity securities in Air New Zealand, including unconditional approval for Qantas acquiring up to 4.99% of the equity securities in Air New Zealand;
- 3 **noted** that on 26 November 2002 Air New Zealand sought approval from the Kiwi Shareholder for changes to the Air New Zealand Constitution arising from the proposed Alliance;
- 4 **noted** that Air New Zealand has also sought an indication from the Minister of Finance, as principal shareholder, as to whether he supports the Alliance;

#### Nature of Decision

- 5 **noted** that an agreement to provide conditional Kiwi Shareholder consents for Qantas acquiring 22.5% of the equity securities in Air New Zealand, and associated changes to the Air New Zealand constitution, would be subject to:
  - 5.1 all necessary authorisations for the Alliance being granted by the New Zealand Commerce Commission (Commerce Commission) and Australian Competition and Consumer Commission (ACCC);
  - 5.2 there being no material changes to the Alliance proposal, or significant new information revealed, during the competition authorisation and any other regulatory processes;
  - 5.3 approval of the Alliance transaction by Air New Zealand shareholders, with respect to any portion of equity securities requiring shareholders’ approval;

- 6 **noted** that should conditional Kiwi Shareholder consents be granted, and the Commerce Commission and ACCC subsequently grant all required authorisations, then Cabinet will decide whether there have been any material changes to the proposal or significant new information revealed;
- 7 **noted** that any material change to the Alliance proposal, or significant new information, would only be considered material or significant if it would alter the original national interest judgements made by the Cabinet or substantially shifted the value of the proposal to the Crown as shareholder;
- 8 **noted** that any agreement to provide unconditional Kiwi Shareholder consent for Qantas acquiring up to 4.99% of the equity securities in Air New Zealand would not be revisited by the government even if there were material changes to the Alliance proposal, or significant new information revealed, during the competition authorisation and other regulatory processes;

### Factual and Counterfactual Scenarios

- 9 **noted** that before Cabinet can make a decision on whether the Alliance should be allowed to proceed through the competition authorisation processes, Ministers need to make a judgement about Air New Zealand’s prospects within the Alliance, and how this compares with its position without the Alliance (the counterfactual);
- 10 **noted** that Air New Zealand and Qantas have agreed that the competitive environment with and without the Alliance would be characterised as follows:

With the Alliance (“Alliance base case”)	Without the Alliance (“stand-alone base case”)
<ul style="list-style-type: none"> <li>▪ Alliance provides new Trans-Tasman destinations</li> <li>▪ Air New Zealand and Alliance total capacity rises between 2003 and 2006</li> <li>▪ Value-based airline (VBA) has 3 aircraft on the trans-Tasman by 2004, but no entry in New Zealand domestic</li> </ul>	<ul style="list-style-type: none"> <li>▪ Qantas increases New Zealand domestic capacity from five to eight aircraft to improve its market share and profitability</li> <li>▪ Qantas increases trans-Tasman capacity and on other selected routes between 2003 and 2006</li> <li>▪ VBA has 3 aircraft trans-Tasman by 2004 but no entry on New Zealand domestic</li> </ul>

- 11 **noted** that Treasury’s ownership advisors, First New Zealand Capital (FNZC), confirm that the base cases in paragraph 10 above provide a reasonable assessment of the competitive environment with and without the Alliance;

### Effective Control of Air New Zealand

- 12 **noted** that the most significant issue raised by the Alliance from an ownership and national interest perspective (and outside of the matters that may be addressed in the competition authorisation processes), is whether effective control of Air New Zealand remains in the hands of New Zealand nationals;

- 13 13.1 **noted** that at an operational level Qantas will have significant influence, but not control, over Air New Zealand through the Strategic Alliance Advisory Group and seconded employees; and
- 13.2 **noted** that Qantas will have two directors on the Air New Zealand Board and that Air New Zealand will have a director on the Qantas Board;
- 14 **noted** that the Alliance agreement, and associated documents, include provisions which are likely to discipline the operational behaviour of the two parties, including strong commercial incentives to maximise the profitability of the Joint Airline Operation, provisions designed to facilitate negotiated outcomes, and provisions which would facilitate the efficient termination of the Alliance;
- 15 **noted** that:
- 15.1 Air New Zealand is likely to face strong financial incentives to increasingly integrate its operations with Qantas, but that such integration carries the risk of attenuating Air New Zealand's autonomy by increasing its separation costs, potentially to the point where the option to terminate is no longer a credible discipline on Qantas;
- 15.2 the Air New Zealand Board is keenly aware of the need to preserve its autonomy within the Alliance, and that there is an opportunity to reinforce this by sending a letter of expectations (attached) from the Minister of Finance to the Air New Zealand Board if the proposal is approved;

### Competition Considerations

- 16 **noted** that one of the most significant national interest issues raised by the Alliance is the possible adverse effects on competition, and that both the Commerce Commission and ACCC would closely scrutinise the public benefits and detriments associated with the proposal;
- 17 **noted** that Commerce Commission and ACCC decisions on the authorisation applications would not be expected until July-August 2003, and may not be finally confirmed until much later if appeal rights are exercised;

### Ownership Assessment

- 18 **noted** that the Alliance will bring a range of financial benefits for Air New Zealand, including enhanced revenue, costs savings and efficiencies, a stronger competitive positioning, and an improvement to the company's balance sheet;
- 19 **noted** that the likely benefits of the Alliance to the Crown include an improvement to the Crown's operating balance, and a reduced need to provide Air New Zealand with additional equity;
- 20 **noted** that alternative options to the Alliance, such as enhanced co-operation with Star alliance members or entering strategic alliances with other airlines, have either little prospect of arising or have little to offer Air New Zealand in comparison with the current proposal;

- 21 **noted** that given the absence of any interest from other airline partners, the option of deferring the selection of a strategic partner runs the risk that Air New Zealand will be in a weaker negotiating position if, and when, Qantas reactivates negotiations;
- 22 **noted** that from an ownership perspective the key risks associated with the Alliance include:
- 22.1 the Crown facing greater difficulty exiting its shareholding in the future;
  - 22.2 the durability of the Alliance, given industry volatility and the reliance of the proposal on sustained co-operation between Qantas and Air New Zealand;
  - 22.3 Qantas' influence and access to information;
  - 22.4 the financial impact of undertakings that may be required from competition authorities;
  - 22.5 the likely competitor response;
  - 22.6 the possibility of minority buy-out rights being exercised (considered unlikely);
- 23 **noted** that, on balance, the Alliance proposal would generate significant benefits to the Crown from an ownership perspective;

#### **National Interest Assessment**

- 24 **noted** that on 20 November 2002, Cabinet Policy Committee having been authorised by Cabinet with Power to Act, agreed that the following considerations should be used to assist the Government's national interest evaluation [POL Min (02) 20/7 refers]:
- 24.1 maintenance of effective control of Air New Zealand by New Zealand nationals;
  - 24.2 continuation of Air New Zealand's ability to exercise New Zealand's existing and future air rights;
  - 24.3 preservation of the unique New Zealand identity of Air New Zealand;
  - 24.4 provision of effective channels for international tourism and travel;
  - 24.5 provision of a durable domestic air services network;
  - 24.6 preservation of New Zealand based employment;
- 25 **noted** that the Alliance that has been negotiated between Qantas and Air New Zealand represents a framework for future co-operation, and at this time the airlines have not formulated specific plans in areas such as domestic and international scheduling, joint marketing, global alliance membership, and initiatives impacting on employment;
- 26 **noted** that the maintenance of effective control of Air New Zealand is the most significant national interest issue raised by the Alliance, outside of competition issues, and is discussed in paragraphs 12 to 15 above;

- 27 **noted** that the Alliance is likely to enhance Air New Zealand's options to manage its international network profitably, and can deliver a durable domestic network, but reduced competition may adversely affect consumers;
- 28 **noted** that given the airlines claim that the Alliance will deliver better scheduling, new services, increased tourism, enhanced freight services and other public benefits, the Commerce Commission can be expected to closely examine most of the issues of concern to Ministers with respect to the following national interest considerations:
- 28.1 the provision of effective channels for international tourism and travel;
- 28.2 the provision of a durable domestic air services network;
- 29 **noted** that there is an opportunity to allow the Commerce Commission's authorisation process to be the primary mechanism for testing the claims made by the airlines with respect to the considerations in paragraph 28 above;
- 30 **noted** that the Alliance satisfies the national interest considerations with respect to:
- 30.1 continuation of Air New Zealand's ability to exercise New Zealand's existing and future air rights;
- 30.2 preservation of the unique New Zealand identity of Air New Zealand;
- 30.3 preservation of New Zealand based employment;

### **Decision on Air New Zealand - Qantas Alliance**

- 31 **agreed** that the relevant Ministers should grant:
- 31.1 Qantas unconditional Kiwi Shareholder consent to acquire an interest of up to 4.99% of the equity securities in Air New Zealand;
- 31.2 Qantas Kiwi Shareholder consent to acquire the balance of equity securities they are seeking, up to 22.5% of total Air New Zealand equity securities, subject to the conditions set out in paragraph 5 above;
- 31.3 Air New Zealand conditional Kiwi Shareholder consent to make changes to the Air New Zealand constitution, subject to the conditions set out in paragraph 5 above;
- 31.4 in-principle approval of the Alliance from an ownership perspective, subject to the conditions set out in paragraph 5 above;

### **Next Steps**

- 32 **invited** the Minister of Finance to advise the Chairs of Air New Zealand and Qantas of the Government's decisions, prior to any public announcement;
- 33 **invited** the Minister of Finance, Associate Minister of Finance (Hon Trevor Mallard) and Minister of Transport to jointly announce the Government's decisions;

- 34 **noted** that Ministers' oral and written statements, including media releases, will need to be carefully constructed to manage the legal risks arising from the Crown being an insider with respect to Air New Zealand;
- 35 **noted** that all Ministers will receive separate legal advice prepared by the Treasury in consultation with the Crown Law Office, on what they can and cannot say in oral and written statements concerning this proposal;
- 36 **invited** the Minister of Finance to write to the Air New Zealand Board setting out the principal shareholder's expectation that Air New Zealand will retain the capacity to operate autonomously in the event the Alliance terminates, as set out in the attached annex; and
- 37 **invited** the Kiwi Shareholder (Hon Paul Swain) to write to the Chief Executive Officers of Qantas and Air New Zealand before 20 December 2002 advising them of the Government's decision to grant conditional approvals for the Kiwi Shareholder applications made by the airlines, including unconditional approval for Qantas to acquire up to 4.99% of the equity securities in Air New Zealand.

Sarah Egan  
Secretary

Reference: CBC (02) 170

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**Present:**

Rt Hon Helen Clark (Chair)  
Hon Dr Michael Cullen  
Hon Jim Anderton  
Hon Phil Goff  
Hon Annette King  
Hon Trevor Mallard  
Hon Pete Hodgson  
Hon Margaret Wilson  
Hon Parekura Horomia  
Hon Lianne Dalziel (part of item)  
Hon Mark Burton  
Hon Paul Swain  
Hon Marian Hobbs

**Officials Present:**

Office of the Prime Minister  
Department of the Prime Minister and Cabinet

**Copies to:**

Cabinet Business Committee  
All Cabinet Ministers  
Chief Executive, DPMC  
Mary Anne Thompson, DPMC  
Secretary to the Treasury  
Solicitor-General  
Chief Executive, Ministry of Economic Development (Commerce)  
General Manager, Ministry of Tourism  
Secretary for Transport