

Hon Dr Michael Cullen **Minister of Finance**
Hon Trevor Mallard **Associate Finance**
Hon Paul Swain **Minister of Transport**



18 December 2002

Media Statement

Govt approves Air NZ Qantas proposal proceeding to Commerce Commission

The government today agreed to Qantas taking a 4.99 per cent stake in Air New Zealand and gave conditional support to a strategic alliance between the two airlines. It has reserved final approval until the completion of inquiries by competition authorities on both sides of the Tasman.

Under the proposal the two airlines enter a Joint Airline Operation to be managed by Air New Zealand including all Air New Zealand's flights and all Qantas' flying operations into, out of and within New Zealand. Qantas would end up with a 22.5 per cent shareholding in Air New Zealand. The government would retain a majority 64 per cent shareholding.

In taking this decision, the government has acted to secure Air New Zealand's long term viability as an international airline. The substantial investment by Qantas of over \$500 million will give it a powerful reason to ensure that Air New Zealand is a successful airline.

The 4.99 per cent stake is a first instalment and will cost Qantas \$98 million. Air New Zealand will retain that money even if the rest of the deal fails to achieve the necessary consents.

The government is aware that the proposed alliance will reduce competition in New Zealand and across the Tasman and has made it very clear to the airlines that they will need to get authorisation from both the New Zealand Commerce Commission and the Australian Competition and Consumer Commission.

Applications were lodged with these organisations on 9 December. The hearings are expected to run well into next year.

The Ministers leading the government's response to the Air New Zealand – Qantas proposal are: Finance Minister Michael Cullen as holder of the Crown's 82 percent shareholding in Air New Zealand, Transport Minister Paul Swain as holder of the Kiwi Share, and Associate Finance Minister Trevor Mallard.

“The government is concerned at the potential impact on consumers of any reduction in competition but has confidence in the ability of the Commerce Commission, and of the regulatory framework in which it works, to deal effectively with these matters.

“In our previous term, we introduced a number of reforms to strengthen New Zealand’s pro-consumer and pro-competition law and are satisfied that we now have one of the toughest regimes in the world,” the Ministers said.

As principal shareholder, the government had to assess whether the Qantas alliance was in the best commercial interests of Air New Zealand going forward. This involved measuring it against other options which might be available to Air New Zealand, and against likely scenarios should the deal fail.

“Our advice from officials, supported by First New Zealand Capital which was employed by the Treasury to advise it on this issue, was that the Air New Zealand/Qantas proposal would not only deliver significant benefits to the company and its shareholders but would also be the best option for Air New Zealand to secure its position as an international airline.

“The alternatives were found to be much less attractive in terms of revenue generation, cost savings and protection of Air New Zealand’s competitive position. This was particularly true given Air New Zealand’s assessment that the most likely scenario, if the alliance was rejected, was that Qantas would enter a war of attrition against Air New Zealand which Air New Zealand would be hard-placed to win,” the Ministers said.

“The reality is that Air New Zealand’s overall profitability is heavily dependent on the profitability of its domestic services. Its long haul services, with one exception, are not profitable.

“There is a risk in the long term that Air New Zealand would shrink to being merely a domestic airline with little long haul capacity.

“There would also be a real risk that the government as the principal shareholder would be called on for further substantial funds, diverting government expenditure away from higher priorities in health and education.

“The second perspective from which the government had to judge the proposal was as Kiwi Shareholder and guardian of the national interest. The considerations we used to guide this judgement were:

- maintenance of effective control of Air New Zealand by New Zealand nationals;
- continuation of Air New Zealand’s ability to exercise New Zealand’s existing and future air rights;
- preservation of the unique New Zealand identity of Air New Zealand;
- provision of effective channels for international tourism and travel;
- provision of a durable domestic air services network; and
- preservation of New Zealand based employment.

“On balance, we considered the proposal cleared these hurdles. The criterion which proved most problematic, and which caused considerable difficulty to the government, was the first one.

“The proposal provides that the Air New Zealand board will retain absolute authority over Air New Zealand and manage the day to day operations of the joint venture. Qantas will have significant influence principally through the Strategic Alliance Advisory Group [which will comprise three representatives from each company]. Qantas will recommend two appointees to the Air New Zealand Board and Air New Zealand will recommend one appointee to the Qantas Board.

“Joint ventures typically provide for such power sharing and consultative structures, and they are to be expected given the size of the investment Qantas is proposing and the fact that it would have to hand over 15 per cent of its air network to Air New Zealand to manage.

“But the government needs to be satisfied that the governance arrangements will preserve Air New Zealand’s autonomy and welfare.

“Air New Zealand considers the best way to achieve this is to protect the company’s ability to quit the alliance at minimal cost.

“The government agrees with that assessment. It has agreed that Dr Cullen, as the shareholding minister, should reinforce the message by setting out his expectations in a letter to the chair of Air New Zealand, John Palmer.

“We are putting that letter on the public record by releasing it today,” the Ministers said.

“The airlines are claiming that the alliance will create public benefits through scheduling efficiencies, new trans-Tasman services, increased tourism and improved freight operations and that these benefits will outweigh the anticipated reduction in competition.

“These claims will be submitted to and tested by the competition authorities on both sides of the Tasman.

“The government expects the competition authorities will carefully assess these claimed benefits and costs. That process will allow for public concerns to be heard and considered.

“Only if the proposal gets Commerce Commission and ACCC approval, will we give it final support,” the Ministers said. “If it is significantly altered during the competition processes or if significant new information emerges, the government will need to reappraise it.”

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Documents:

Letter of expectation from Dr Cullen to Air New Zealand.

Cabinet minute relating to the Air New Zealand/Qantas proposal.