

Office of the Associate Minister of Finance  
Office of the Minister of Transport

19 November 2002

Chair  
Cabinet Policy Committee

## **AIR NEW ZEALAND GOVERNMENT DECISION-MAKING: NATIONAL INTEREST CONSIDERATIONS AND INFORMATION**

### **Proposal**

1. We are seeking Cabinet Policy Committee's agreement to:
  - the matters for consideration to assist Government decision-making, from a national interest perspective, on the proposed Air New Zealand and Qantas commercial alliance; and
  - the consequent information required from the two airlines on specific aspects of their operations to assist the Government's evaluation.

### **Background**

2. Qantas and Air New Zealand have revealed to the public that the two airlines are in discussions about a strategic partnership that includes Qantas taking an equity stake in Air New Zealand.
3. At its meeting on 18 November 2002 Cabinet agreed to a process and timeline for the Government's consideration of any proposal by Qantas to purchase a stake in Air New Zealand [Cab Min (02) 31/23 refers]. If the commercial proposal is publicly announced within the next week the Government will make an in-principle decision on the ownership case, and a conditional decision from a Kiwi Shareholder perspective, in December 2002.
4. A favourable Kiwi Shareholder decision in December 2002 will mean Qantas will be advised that approval has been given for the entire shareholding sought by Qantas, subject to:
  - there being no material changes to the commercial proposal, or significant new information revealed, during the subsequent competition and other regulatory processes; and
  - approval of the transaction by Air New Zealand shareholders, with respect to any portion of shares requiring shareholder approval.
5. As part of its 18 November 2002 decisions Cabinet authorised the Cabinet Policy Committee on 20 November 2002 to have Power to Act in considering the national interest criteria that should be applied as part of the Government's evaluation of the proposal.

## Proposed Approach to Government Evaluation

6. The Air New Zealand company constitution creates the role of the Kiwi Shareholder. The Kiwi Shareholder is defined as the Crown, and certain decisions are reserved to the Crown in this capacity. The device is a way of maintaining government control of aspects of the operation of a publicly listed company, sufficient to ensure that wider public interests can be protected. The Kiwi Shareholder device has been used to protect the public interest in telecommunications as well as the airline industry.
7. In Air New Zealand's case, the main consideration the Kiwi Share protects is Air New Zealand's ability to exercise the traffic rights negotiated in air service agreements. The company's constitution, however, does not purport to limit in any way the types of matters that the Government can consider in the course of granting or refusing Kiwi Shareholder approval. It is to be expected that different proposals, in different contexts, will raise different issues for the Government. Applications that have had minimal impact on Air New Zealand's commercial relationships have been assessed largely for their effect on air traffic rights. By contrast the shareholding proposals submitted by Singapore Airlines and Qantas in 2001 would have resulted in major changes to the governance of the airline and its commercial relationships. Accordingly, the Government took a broad view on the public interest matters that would inform its actions as Kiwi Shareholder. This is reflected in the draft national interest agreement negotiated with Qantas at the time, which covered commitments in areas such as:
  - promotion of New Zealand tourism;
  - employment in New Zealand;
  - protection of Air New Zealand's access to New Zealand traffic rights;
  - strengthening Air New Zealand's position within the international aviation industry;
  - protection and future enhancement of Air New Zealand's route structure;
  - fleet replacement and enhancement; and
  - competition in New Zealand and on the trans-Tasman routes in particular.
8. Although there is no formal constraint in the Air New Zealand constitution on the matters that the Government can consider as Kiwi Shareholder, in practice the Crown needs to articulate for the companies the issues that are likely to be of interest to it and on which it will require information. This paper outlines key matters that we expect will require consideration, and the nature of the information that should support decision making by the Government. It should be borne in mind that all competition issues will be addressed by the Commerce Commission and Australian Competition and Consumer Commission.
9. The Government needs to consider in advance the process by which it will take any Kiwi Shareholder decisions. In 2001, the issues confronting the companies, and the Government's view of the national interest issues with which it would be concerned, resulted in officials becoming significantly involved in the detail of the commercial negotiations. The Crown is now precluded from a similar role, because of its own shareholding in the company. If it were to become involved in the formulation of a proposal in any detail, legal advice is that it would risk being

prevented from voting on the transaction at any shareholders' meeting. The Government's role as Kiwi Shareholder must therefore be conducted with greater distance and formality, and will in essence be restricted to giving or refusing the necessary approvals, once it has obtained and examined the information that it considers necessary.

10. The information we will request will be generally on the airlines' expectations of the future arrangements under the commercial proposal. Government approval will be conditional on there being no material changes to the commercial proposal, and no new material information being revealed, during the Commerce Commission and other regulatory processes.

### **Proposed considerations**

11. The following considerations represent important aspects of the Government's decision-making:
  - 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.
12. These considerations are discussed in turn. It should be borne in mind, however, that the commercial proposal might raise other issues of relevance to the national interest evaluation which are not covered in the considerations listed in paragraph 11.

#### ***Maintenance of effective control of Air New Zealand by New Zealand nationals***

13. It is important that the effective control of Air New Zealand remains in the hands of New Zealand nationals, to provide assurance that the strategic direction set for the airline, and its operations, are aligned with New Zealand's interests. In this regard any proposed amendments to the company Constitution, and any arrangements entered into that give Qantas rights in the governance of Air New Zealand, would require scrutiny as part of the Government approval process.

#### ***Continuation of Air New Zealand's ability to exercise New Zealand's existing and future air rights***

14. Ensuring Air New Zealand's ability to exercise rights as New Zealand's international airline under air services agreements was an important reason for the creation of the Kiwi share. Under the majority of New Zealand's air services agreements (including those with Japan, Fiji, France, and the United Kingdom)

the other state has the right to refuse Air New Zealand operating authorisation if it is not “substantially owned” and “effectively controlled” by New Zealand nationals. New Zealand’s more recent agreements drop the “substantial ownership” criterion. However, they include “principal place of business”, and “place of incorporation” criteria. Last year the Government approved amendments to the Air New Zealand Constitution to require that the airline meet these latter two criteria.

15. As a matter of policy to prevent a designation being refused by another country, the New Zealand Government will not designate as a New Zealand airline any airline that has more than 25% shareholding held by a foreign airline or 35% owned by foreign airlines in total.
16. An alliance with Qantas may have implications for New Zealand’s ability to make progress on removing restrictions with some air services partners, particularly those that have air services disagreements with Australia. Consideration of this aspect of the transaction is unlikely to rely on information provided by the airlines.

***Preservation of the unique New Zealand identity of Air New Zealand***

17. This is a highly subjective area of consideration and encompasses a wide range of factors, some of which are listed below. Air New Zealand’s unique national identity includes the contribution that Air New Zealand makes to building New Zealand’s profile as a desirable tourist destination. This involves the marketing of New Zealand as a destination, and supporting the travel industry infrastructure with international media programmes and industry travel support.
18. Air New Zealand marketing aligns closely with the overall Tourism New Zealand global campaign. Consequently advertising and establishing brand presence in key markets is an important contributor to enhancing New Zealand’s profile internationally. Air New Zealand’s physical presence in key markets also contributes to New Zealand’s profile.
19. Ongoing support of inbound tour operators by Air New Zealand at trade events is an important element of building a more comprehensive set of opportunities for international visitors. Furthermore, effective marketing of packages internationally is critical to ensuring that New Zealand maximises tourism benefits.

***Provision of effective channels for international tourism and travel***

20. New Zealand tourism is almost totally reliant on air travel for visitor arrivals. Consequently the quality and convenience of inbound channels is a vital determinant of how the New Zealand tourism industry performs.
21. A key element is the number of non-stop flights to New Zealand from key markets in the Pacific Rim, and one-stop flights from Europe. This is a significant contributor to ensuring that the inbound channels are cost effective and convenient.
22. Alliance relationships are also important for New Zealand. Currently both One World and the Star Alliance are well represented in New Zealand (though each alliance dominates some key markets for New Zealand). These alliances collectively have 40% of the global aviation market. It is important to ensure

continued access to this pool of potential visitors. Frequent flyer programmes play a role in this.

***Provision of a durable domestic air services network***

23. A further national interest consideration is the network of domestic air services that is expected to be provided. The future plans of the two airlines will be significant for regional development, tourism, and the future of provincial airports.
24. The implications of any realignment will be important with respect to the future of Qantas' current partner, Origin Pacific, which has developed a comprehensive network of provincial services in recent years.
25. The proposal is also likely to have implications for other international and domestic airlines that interline with Air New Zealand and Qantas. Without their passengers being able to interconnect with a domestic New Zealand carrier at competitive airfares, other international carriers may find New Zealand a less attractive destination. Similar considerations apply for smaller domestic airlines wishing to offer connecting services.

***Preservation of New Zealand based employment***

26. It is reasonable to expect that any rationalisation of operational functions of the two airlines may have a consequent affect on direct and indirect employment. It will be important for the Government to have an understanding of the magnitude and distribution of any expected employment changes. We recommend seeking information on any expected changes to both the quantum and type of jobs in New Zealand under the proposal.

**Proposed Information**

27. In light of the above considerations, officials have identified a range of information that will be required to assist the Government's evaluation. These information requirements are not intended to be exhaustive, but provide guidance to the airlines' about the type of information they will need to provide to help inform the Government's decision. Officials are also likely to require information from sources other than the airlines. With respect to the airlines, both the quality and timeliness of the information provided by them will have a significant influence on whether the Government will be in a position to make an informed decision in December 2002.
28. The base information required from the airlines is:

***Maintenance of effective control by New Zealand nationals and ensuring Air New Zealand continues to exercise existing and future air rights***

- Any proposed amendments to the Air New Zealand Constitution
- Information on any proposed governance and ownership changes

***Preservation of the unique New Zealand identity of Air New Zealand***

- Expectations of branding, marketing and promotion of Air New Zealand

- Expectations of destination marketing of New Zealand
- Any changes to the nature, distribution and quantum of Air New Zealand's activities globally

*Provision of effective channels for international tourism and travel*

- International routes, frequencies, and schedules
- Alliance implications, and expected costs and benefits, including changes to expected passenger volumes, and seat capacities
- Air New Zealand's role and influence in alliance and code sharing arrangements
- International competition processes including US antitrust timelines
- Frequent flyer programmes' status and data
- Structuring of holiday packages

*Provision of a durable domestic air services network*

- Routes, frequencies, and scheduling
- Domestic partnership and international inter-line arrangements

*Preservation of New Zealand based employment*

- Any changes to the location and skill mix of direct and indirect employment in New Zealand

**Process**

29. Officials intend to communicate the considerations, and associated information requirements, as soon as Cabinet Policy Committee's decisions are confirmed. This communication will stress the need for high quality and timely information provision.
30. To ensure clarity and consistency of communications and information flows to and from the airlines, a single contact point within the public sector on the national interest evaluation will be established.

**Financial Implications, Legislative Implications, Regulatory Impact Statement, Treaty Implications, Human Rights Act Implications**

31. None.

**Publicity**

32. At its meeting on 18 November 2002 Cabinet agreed that a sub group of Ministers develop a communications strategy and sanction all communications on this issue.

## Consultation

33. The Treasury and Ministry of Transport have consulted the Ministry of Tourism during the preparation of this paper, and its views have been incorporated. The Department of the Prime Minister and Cabinet and Solicitor-General have also been consulted.

## Recommendations

34. We recommend that Cabinet:
1. **note** that Qantas and Air New Zealand have revealed to the market that the two airlines are in discussions about a strategic partnership that includes Qantas taking an equity stake in Air New Zealand;
  2. **note** that should a proposal by the airlines be received within the next week the Government will make an in-principle decision on the ownership case, and a conditional Kiwi Shareholder decision, in December 2002 [Cab Min (02) 31/23];
  3. **note** that the Kiwi share is a device for maintaining government control of aspects of the operation of a publicly listed company, sufficient to ensure that wider public interests are able to be protected;
  4. **note** that a favourable Government decision in December 2002 will mean Qantas will be advised that Kiwi Shareholder approval has been given for the entire shareholding sought by Qantas, subject to:
    - 4.1 there being no material changes to the commercial proposal, or significant new information being revealed, during the subsequent competition and other regulatory processes;
    - 4.2 approval of the transaction by Air New Zealand Shareholders, with respect to any portion of shares requiring Shareholder approval;
  5. **note** that all competition issues will be addressed by the Commerce Commission and Australian Competition and Consumer Commission;
  6. **agree** that the following considerations should be used to assist the Government's national interest evaluation:
    - 6.1 Maintenance of effective control of Air New Zealand by New Zealand nationals;
    - 6.2 continuation of Air New Zealand's ability to exercise New Zealand's existing and future air rights;
    - 6.3 preservation of the unique New Zealand identity of Air New Zealand;
    - 6.4 provision of effective channels for international tourism and travel;
    - 6.5 provision of a durable domestic air services network; and
    - 6.6 preservation of New Zealand based employment;
  7. **note** that the commercial proposal may raise other issues of relevance to the national interest evaluation which are not covered in paragraph 6 above;

8. **note** that in light of the considerations in paragraph 6 above, the information to be sought from the airlines, without prejudice to further information that may be needed, is:
  - 8.1 Any proposed amendments to the Air New Zealand Constitution;
  - 8.2 Information on any proposed governance and ownership changes;
  - 8.3 Expectations of branding, marketing and promotion of Air New Zealand;
  - 8.4 Expectations of destination marketing of New Zealand;
  - 8.5 Any changes to the nature, distribution and quantum of Air New Zealand's activities globally;
  - 8.6 International routes, frequencies, and schedules;
  - 8.7 Alliance implications, and expected costs and benefits, including changes to expected passenger volumes, and seat capacities;
  - 8.8 Air New Zealand's role and influence in alliance and code sharing arrangements;
  - 8.9 International competition processes including US antitrust timelines;
  - 8.10 Frequent flyer programmes' status and data;
  - 8.11 Structuring of holiday packages;
  - 8.12 Domestic routes, frequencies, and scheduling;
  - 8.13 Domestic partnership and international inter-line arrangements;
  - 8.14 Any changes to the location and skill mix of direct and indirect employment in New Zealand
9. **note** that to ensure clarity and consistency of communications and information flows to and from the airlines, a single contact point within the public sector on the national interest evaluation will be established;
10. **direct** the officials in paragraph 9 above to inform Qantas and Air New Zealand of these considerations and request information from the two airlines, as appropriate, to assist the Government to make an informed decision; and
11. **note** that both the quality and timeliness of the information provided by the airlines will have a significant influence on whether the Government will be in a position make an informed decision in December 2002.

**Hon Paul Swain**  
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