

Treasury Report: Air New Zealand: Letter to Chairman - Government's Expectations for Process and Timing regarding Air NZ's Partnership Proposals

Date:	21 June 2002	Treasury Priority:	Medium
Security Level:	Commercial-Sensitive	Report No:	T2002/833

Action Sought

	Action Sought	Deadline
Treasurer/Minister of Finance	Sign and send attached letter to the Chairman of the Board of Air New Zealand	ASAP

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Linda Dixon	Senior Analyst		✓
David Taylor	Manager, Commercial Investments		

Enclosure: Yes

21 June 2002

AL-4-1-3

Treasury Report: **Air New Zealand: Letter to Chairman -
Government's Expectations for Process and
Timing regarding Air NZ's Partnership Proposals**

Purpose of Report

This report updates you on timing for the Air New Zealand (Air NZ) proposals for a strategic partnership with Qantas.

Attached is a letter to the Chairman of the Board of Air NZ for your signature advising the Crown's requirements with respect to timing.

Analysis

We reported to you on Air NZ's progress in developing its proposals for a partnership with Qantas (Treasury report T2002/648, dated 10 May 2002 refers). You agreed that Air NZ should be advised that the Government would require a period of six weeks to consider any proposals and business cases and for Ministers to take decisions.

You also agreed that the Treasury seeks to engage consultants as soon as possible to provide advice on any proposals received from Air NZ.

Timing Update for Proposals

Air NZ has advised that draft proposals are likely to be provided to you at the end of July. Air NZ has requested that you consider the proposals and provide it with a signal as to whether you are likely to have any objections to the proposals by 21 August.

It should be noted that neither airline would actually communicate either the Government's or your views, as major shareholder, on the acceptability of the proposals. They would simply advise the market that proposals for a strategic partnership between the two airlines had been agreed and had been submitted to the Government for consideration. In the event of a positive signal from you, the proposals will be formally signed and re-submitted formally to you and to the Minister of Transport.

We would expect the Government to come under considerable pressure from 22 August to comment on the proposals and its process for their consideration. We will develop and agree a media strategy with your office and Air NZ.

In order for you to be able to signal your views on the acceptability or otherwise of the proposals, the following timetable will need to be met:

End July	Draft proposals received by the Government from Air NZ
9 August	Consultants provide preliminary advice to the Treasury
16 August	Treasury provides preliminary advice to you on the ownership issues associated with the proposal
21 August	You advise Air NZ if there are likely to be any issues arising from the proposals that could prevent it proceeding; If your signal is positive, Air NZ will submit formal proposals to you and the Minister of Transport for consideration
22 August	Qantas and Air NZ advise the market that the proposals have been submitted to the Government
Week beginning 26 August	Ownership and regulatory cases are submitted to Cabinet Committee
Week beginning 2 September	Ownership and regulatory cases are submitted to Cabinet

This timetable provides officials with a window of two and a half weeks in which to provide advice to you on the proposals. However, we understand that Air NZ will be able to make some of the detail of the proposals available to us prior to the end of July. This will enable us to have our consultants (yet to be appointed) commence work prior to the Government's receipt of the proposals. Therefore, provided Air NZ's business cases are complete and accurate, and the final proposals received at the end of July are representative of prior presentations and discussions with the Treasury and its consultants, we consider the timeline is achievable.

We intend to approach First New Zealand Capital (formerly CS First Boston) early next week to discuss the proposed consultancy with a view to briefings commencing between Air NZ and its advisers and the Treasury and its advisers in the week beginning 1 July.

Process for Government Consideration of Proposals

We understand that:

- you will consider only the ownership issues associated with Air NZ's proposals;
- the Minister of Transport, as Kiwi Shareholder, will consider the regulatory issues of the proposals and the Ministry of Transport will co-ordinate other agency comment and input (eg Ministry of Foreign Affairs and Trade, Ministry of Economic Development, Treasury's Regulatory and Tax Policy Branch) into advice to the Minister of Transport, the Associate Minister of Finance, the Minister of Commerce and the Minister of Foreign Affairs.

Letter Attached

We consider it desirable to seek Air NZ's agreement to the Government's proposed timetable and process in writing to ensure there is clear understanding of each party's requirements. The letter requests Air NZ to advise if the Government's proposed timeline is likely to give rise to any adverse consequences for Air NZ.

The letter also:

- advises Air NZ that the Treasury will wish to engage consultants to consider the ownership implications of any proposals prior to their receipt to ensure that the consultants can be adequately prepared and to ensure consideration of the proposals is undertaken as effectively and efficiently as possible. The letter advises that the Treasury will discuss its approach with Air NZ, including seeking its views on the proposed consultancy, in particular to ensure there are no conflicts of interest;
- advises Air NZ of the roles in which other Government departments (aside from the Treasury) would take in providing advice to Ministers on any proposals and proposes that those agencies are not notified of the proposals until they are officially submitted to the Government (Air NZ has previously requested this information);
- notes that it would be desirable for the Treasury and Air NZ to agree a media strategy prior to the Government being asked to consider any proposals.

Recommended Action

It is recommended that you **sign** and **send** the attached letter to the Chairman of the Board of Air New Zealand.

David Taylor

Manager, Commercial Investments
for Secretary to the Treasury

Hon Dr Michael Cullen

Treasurer/Minister of Finance

Mr John Palmer
Chair
Air New Zealand
Private Bag 92.007
AUCKLAND

Dear John

Discussions between Air New Zealand and Qantas are clearly progressing towards developing proposals regarding Qantas acquiring an equity stake in Air New Zealand. The Treasury, in discussions with Air NZ, has advised me that the likely timing for the Government to receive proposals from you, should they eventuate, is late July. I further understand that you seek a signal from me of my views as to whether the proposals would be acceptable to me, from an ownership perspective only, by 21 August.

The Government will be particularly concerned to assess the proposal from the perspective of both its ownership interest in Air NZ (which will be considered by me as shareholding Minister and then by Cabinet with recommendations made by me) and the national interest (which will be considered by Cabinet together with the ownership case).

In particular, I would see the primary national interest goals as protection of bilateral air landing rights held by Air NZ, ensuring competition issues are addressed and international connections are maintained.

The Treasury will commission independent advice on the ownership implications of any proposals that you may present. In order to be adequately prepared and to ensure consideration of the proposals is undertaken as effectively and efficiently as possible, the Treasury will seek to engage a consultancy prior to receiving any proposals. The Treasury will discuss its approach with you, including seeking your views on the proposed consultancy, in particular to ensure there are no conflicts of interest. The role of the consultancy will be to independently assess your proposals and underlying business cases.

Government Time Requirements to Consider Proposals

The Government would require six weeks to complete its decision-making processes from the date of delivery of proposals. This time period includes the time it will take for consultants to deliver their opinions and advice and time for Ministers to consider that advice and make decisions. The key risk to this timetable would be if the supporting business cases were incomplete or lacked particular information that would require the Government to revert back to you for more information.

While I will make every effort to accommodate your request for a signal of my views as to whether the proposals are acceptable to me as shareholding Minister by 21 August, I cannot give any guarantees. To improve the chances of me being able to provide that signal, it will

be imperative that Air NZ is able to provide briefings on the content of the proposals to the Treasury and its consultants prior to proposals being delivered at the end of July. It will be equally as important that the preliminary information provided is representative of the information presented in the final proposals. I wish to make it quite clear that in providing you with a signal of my views, I will not be either guaranteeing that those views will be my final views or that the Cabinet, in considering the proposals, will agree with my views.

Following 21 August, I would intend taking a further three weeks to fully consider the advice provided to me by the Treasury and its consultants and to complete Government decision-making processes on the package of ownership and regulatory decisions required by you. I would be aiming for the Government to have made final decisions on both the regulatory and ownership aspects of the proposals in the week commencing 3 September.

I would like your feedback as to whether this full time period of six weeks following receipt of formal proposals, with best endeavours to provide a signal of my views from the ownership perspective by 21 August, would cause any adverse consequences for Air NZ. If it does not, I would like you to provide me with this advice in writing.

Roles of Other Government Departments

In considering proposals, the advice of several Government departments is likely to be sought by Ministers. Those with primary responsibility for providing advice on the proposals would be:

- the Treasury - on the ownership aspects of the proposal and second opinion advice on regulatory aspects;
- the Ministry of Transport - on the consequences for bilateral air services agreements and measures for mitigating any risks. The Ministry would also provide advice on any applications made by Air NZ and Qantas under section 88 of the Civil Aviation Act seeking authorisation of contracts, arrangements, and understandings relating to international air carriage;
- the Ministry of Economic Development - on process and issues arising for addressing regulatory issues such as competition and Takeovers Code. The Ministry will also provide advice on competition implications of any application made to the Minister of Transport under section 88 of the Civil Aviation Act;
- the Ministry of Foreign Affairs and Trade - on any Government to Government relationship issues that may arise; and
- the Department of Prime Minister and Cabinet - on a proposal in its entirety.

It is my expectation that you will make submissions to the Ministry of Transport independently of the submission you make to me. The Ministry will seek and co-ordinate advice from other Government departments as necessary.

Media Strategy

I note that both Air NZ and Qantas have advised the media that discussions between the two airlines are underway on a variety of business issues, including the possibility of Qantas subscribing for an equity stake in Air NZ. It would be desirable for the Government and Air NZ to jointly consider a media strategy to address the likely issues that would arise during the period of time following the presentation of a proposal from Air NZ to the Government, assuming such a proposal eventuates. The Treasury will advance discussions with you on this matter in due course.

I note the improvement in operating results that Air NZ has achieved over the past couple of months and the consequential improvement in Air NZ's full year forecast operating surplus. I understand the improved position to result partly from Air NZ's initiatives to reduce internal operating costs. I am also pleased to see Air NZ turning its attention, as a matter of priority, to restructuring its operations towards being better positioned to deal with the changing aviation market in this part the world.

Yours sincerely

Hon Dr Michael Cullen
Minister of Finance