

K Proposal - Government Expectations

Any proposal that requires regulatory approval (for a purchase of Air NZ shares by an airline) or has an impact on ownership will raise the following key issues for the Government:

- Valuation implications (ownership interest)
- Consumer welfare (public welfare)
- National interest implications (public interest)

The Treasury expects to be asked to advise the Minister of Finance on these factors arising out of any proposal put forward by Air NZ. We expect Air NZ to present a case to the Government that addresses these issues. We set out below some preliminary thoughts for your consideration.

The case should include:

- Costs, benefits and risks of the current proposal;
- Costs, benefits and risks of other options (eg do it later or contestable process late);
- Risk mitigation strategies (eg exit strategy);
- Clear identification of cost and revenue drivers;
- Clear documentation of assumptions.

Valuation Issues

- the implications for the Government if SIA not offered the opportunity to participate (as has been communicated to them earlier) and the implications on value from not running a wider contestable process;
- whether now is the optimal time for selling a strategic stake (eg current state of the aviation markets);
- risks of locking in a strategic partner now effectively precluding any alternative and possibly higher value partner at a later date;
- whether the sale of a small parcel now might lead to a stalemate over any further sell down in future (ie would be a spoiling stake).

Consumer Welfare

The Government will take a wider interest in the impacts of a proposal on New Zealanders. In particular, the impacts on competition will be relevant.

- competition issues would be assessed by the Commerce Commission and can be expected to take some time;
- concerns would at least be around losses in consumer welfare arising from changes in Air NZ/Qantas operations and also from reduction in services by Star Alliance carriers;

- concern may also relate to the future potential for influence to be exerted by the partner.

National Interest

The Government is likely to want national interest initiatives to be forthcoming to accompany any acquisition of shares by a strategic partner. This package is not linked to the Government's ownership interest in Air NZ; it is linked to its role as regulator and is seen as the *price* of achieving regulatory consents. The Government will want to be satisfied that any airline buying into Air NZ will *at least* not be detrimental to the public interest and ideally provide additional benefits to it.

The key national interest issues could possibly be:

- tourism (how will the partner improve tourism outcomes);
- protection of bilateral air traffic rights;
- ensuring that direct flights in and out of New Zealand continue.

It is possible that initiatives such as employment and/or engineering services in Christchurch may be raised.

When considering national interest initiatives, there are three key issues that require consideration:

- how are the initiatives defined/quantified;
- how is the success of the initiatives measured; and
- what opportunities are there for sanctions for missing targets.

Attached are the draft NIPs that Air NZ, Qantas and SIA were indicating were acceptable in 2001. The copies are those that will be released as part of the upcoming Official Information Act release.