THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Restricting Foreign Ownership of Auckland International Airport

Date:	29 February 2008	**Report No:**	T2008/297

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Dr Michael Cullen)	**Consider** the attached draft cabinet paper and **advise** Treasury of any revisions required to finalise it.	As soon as possible.

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Jeremy Corban	Assistant Secretary			
Len Starling	Manager			✓
Ivan Kwok	Principal Advisor			

Minister of Finance's Office Actions (if required)

Consider the attached draft cabinet paper and **advise** Treasury of any revisions required to finalise it.

Enclosure: **Yes**

29 February 2008 SH-8-3-2-1

Treasury Report: Restricting Foreign Ownership of Auckland International Airport

Executive Summary

You have requested a cabinet paper and draft legislation to enable the government to restrict the foreign ownership of Auckland International Airport Limited (AIAL). This is attached.

This report provides advice on the draft cabinet paper, including Treasury advice on the proposal, and a discussion of the risks and likely consequences.

The draft cabinet paper recommends legislating to restrict foreign ownership of AIAL. Specifically it proposes a 49.9% limit on foreign ownership, a 20% limit on individual foreign investors and some restrictions on board membership. 'Related party' clauses would also be required to avoid gaming of the 20% individual limit.

We consider this proposal inadvisable as it raises a number of costs and risks which in our view outweigh any likely benefits.

While there may be a case for restricting ownership of some sensitive assets, the benefits of special legislation restricting foreign ownership of AIAL are likely to be small relative to the detriments. Although international airports are important for the national economy, a foreign owner's interests in AIAL are likely to be closely aligned to local owners' interests and to national interests. The government has recently announced moves to review the way landing charges are set so as to deal with any concerns about monopoly pricing.

We advise against any intervention in the current share market transaction on:

- Legal grounds – it is almost certainly a breach of our international obligations under various multilateral agreements and legislation will likely be a breach our bilateral free trade agreements;

- Commercial grounds – while the government has no direct stake in the company, such an intervention would create considerable disruption and uncertainty. By affecting investors' property rights and reducing value, it may cause investors to be sceptical of the certainty of New Zealand's regulatory environment and more wary of investing in New Zealand firms; and

- Economic grounds – it is likely to negatively impact on international investors' perceptions of New Zealand. Perceptions of a volatile regulatory environment could also increase the risk premium for investment in New Zealand with potential to raise the cost of funds for all New Zealand companies.

This report also includes information on alternative methods of limiting foreign ownership that could be considered alongside the current proposal. In particular it may be possible to strengthen the criteria Ministers use to assess the Overseas Investment applications to ensure that all relevant issues are included in their considerations. While this still poses a number of risks, we believe it would have less impact on our key international agreements and relationships.

Recommended Action

We recommend that you:

a **note** the attached draft Cabinet paper which proposes a legislative solution as you requested;

b **note** that Treasury considers an intervention in the sale of AIAL to be inadvisable on legal, commercial and economic grounds;

c **note** that, should the government wish to proceed, there are alternative options for restricting foreign ownership in AIAL which would have less impact on our key international agreements and relationships:

(i) amend the regulations under the Overseas Investment Act 2005 with additional criteria to be considered by Ministers; or

(ii) issue a government policy statement which would need to be considered in assessing the Canadian Pension Plan Investment Board (CPPIB) application.

d **Indicate** if you would prefer to recommend one of these alternative options to Cabinet or would prefer to remain with the legislative option; and

e **advise** Treasury about any changes you require before finalisation of the Cabinet paper.

Jeremy Corban
Assistant Secretary
for Secretary to the Treasury

Hon Dr Michael Cullen
Minister of Finance

Treasury Report: Restricting Foreign Ownership of Auckland International Airport

Purpose of Report

1. You have requested a Cabinet paper and a draft bill to enable the government to restrict the foreign ownership of Auckland International (AIAL). This paper provides advice about that proposal including a method of achieving the government's objectives. A draft cabinet paper and draft bill is attached. We note that there are still some technical drafting issues in the bill that need to be resolved and we will address these with your office.

Proposal

2. The attached draft Bill will achieve the following key restrictions on foreign ownership and control of AIAL:

- A 49.9% cap on total shareholding that may be held by all foreigners;
- A 20% cap on the shareholding of any single foreign shareholder;
- Related parties provisions to ensure these caps are not breached via the backdoor;
- A majority of the Board must be New Zealand citizens, and at least three must be New Zealand residents;
- The board chairperson must be a New Zealand citizen / resident [decision required]; and
- Detailed requirements on the company to keep sufficient records to enforce these restrictions.

Analysis

3. Most countries consider it in their national interest to have some foreign ownership restrictions on some classes of assets. However, assets judged to be sensitive vary from country to country. Restrictions on land ownership are the most common but media companies, aviation and infrastructure monopolies are also considered sensitive in some countries. New Zealand has a generic overseas investment screening regime and specific restrictions on ownership of some specific companies (both described below).

4. The case for specific regulation of AIAL's ownership comes down to a judgement about the relative weights of the detriments and benefits of such regulation. The main issues are described below.

Case for restricting foreign ownership of AIAL

5. AIAL is an important part of the regional and national economy, and has a number of features characteristic of a monopoly. Ministers maybe concerned about the risk of owners extracting monopoly rents and these rents going offshore. The government has recently announced moves to review the way landing charges are set with a view to addressing any concerns about monopoly pricing.

6. Ministers may also be concerned about foreign owners incentives for ongoing investment in AIAL, and continuity of the services provided. In our view a foreign owner of AIAL would have interests that are closely aligned to local owners' interests and to national interests. A foreign owner would be at least as likely to want the company to provide attractive services, expand aeronautical and other activities, and increase efficiency. The airport cannot be moved or used for other purposes. Reducing aeronautical activity would negatively impact on associated profitable activities such as car parks, freight facilities and retail outlets. It is therefore difficult to see foreign ownership creating a significant threat to New Zealand's national interest.

7. We also note that, as there are no existing ownership restrictions, the company may already have a significant element of foreign ownership although, if so, this must be widely distributed.

8. The proposal from the Canadian Pension Plan Investment Board (CPPIB) involves very high debt levels and would arguably place the company at greater risk of failure. However, this situation is not unique to foreign ownership and the amount of leverage the company uses is an appropriate decision for shareholders to make. A loss of shareholder equity might result in another change of ownership but, as the underlying business is sound, it is unlikely to affect continuity of service provision.

9. Ministers may be potentially also be concerned about wider national security issues. While outside our area of expertise we would argue that the concern for security remains irrespective of ownership.

Implications for other NZ airports

10. Some observers may question why the ownership restrictions apply only to Auckland Airport. While AIAL is currently the only listed airport in New Zealand we note that the majority owner of Wellington airport is a publicly listed company that could itself be subject to takeover by a foreign company. However AIAL is much more significant as an international gateway. All the other airports are either jointly owned by central and local government, or are majority owned by local councils.

11. We also note that foreign investment in airports around the world is not uncommon. For instance, Infratil itself owns airports in England, Scotland and Germany.

Economic impact of foreign ownership restrictions

12. Any 'national interest' considerations need to be weighed against the possible detrimental effects of foreign ownership restrictions. Restrictions on the foreign ownership of companies are likely to have negative effects because they:

- Increase the cost of capital to affected companies;
- Reduce the sale price available to existing investors;
- Limit access to governance expertise and the opportunities for synergies that may arise from an international owner; and
- Reduce the pressure for performance on boards and managers because of the reduced likelihood of takeover of a poorly performing company

13. All investors appreciate regulatory certainty. A government intervention in this sale process arbitrarily changes the property rights of existing shareholders, which may cause both domestic and foreign investors to be sceptical about the certainty of New Zealand's regulatory environment and therefore be more wary about investing in New Zealand firms. Foreign investors are likely to be particularly sensitive to regulatory changes that appear to them to arbitrarily restrict their returns or that could be taken to imply that their investment is not welcomed. Perceptions of a volatile or arbitrary regulatory environment could also increase the risk premium for investment in New Zealand, with potential to raise the cost of funds for all NZ companies.

14. The AIAL shareprice is likely to drop immediately following the announcement of this intervention. Existing shareholders are likely to see the government as responsible for the immediate loss in value of their shares and as such, potentially liable for the full difference between the new share price and the full value of the CPPIB offer.

15. Beyond the effects on the company concerned, restrictions on foreign ownership may also have negative implications for our relationships with other countries. Traditionally New Zealand has sent a signal that it welcomes foreign investment. While we screen large foreign investments in clearly defined sensitive land, we do not have a track record of preventing non-land foreign investments. The last time a non-land foreign investment was declined by the New Zealand government was in 1984.

International Obligations & Implications

16. New Zealand has entered into multilateral and bilateral agreements that restrict the ability of the Government to impose new restrictions on foreign investments in New Zealand. If we were to not follow the obligations we have entered into under these agreements, it would likely seriously diminish the attractiveness of New Zealand as a country with whom others choose to enter into FTA trade negotiations with.

17. Intervening in the sale of Auckland Airport would be a breach of the OECD Codes of Capital Liberalisation and the WTO General Agreement on the Trade in Services (GATS). New Zealand tends to put a lot of weight on maintaining the rules-based multilateral trading system under the WTO that imposes obligations on all countries.

18. The bilateral agreements, such as the NZ-Singapore CEP and the NZ-Thailand FTA require screening of foreign investments above certain thresholds, but do not bind in the criteria that are used within that screening. However, a move to a new, more restrictive ownership regime would be in breech of those agreements.

19. The proposed changes to restrict foreign investment in AIAL would send negative signals to countries with whom we have entered in, or about to enter into, FTA negotiations with. These negotiations would include:

    (i) China, with whom we have concluded negotiations but have not yet signed an agreement;
    (ii) the Trans-Pacific Strategic Economic Partnership (P4) investment negotiations with Brunei, Chile, Singapore and the United States; and
    (iii) ASEAN-CER negotiations.

Conclusion

20. Overall Treasury is of the view that the economic and international costs and risks of intervening would outweigh any national interest considerations. As such we would advise against any such intervention.

Other intervention mechanisms

Overseas Investment Act options

21. There are two options to strengthen the *Overseas Investment Act 2005* screening of this application without amendment to the Act. If the government considers that the range of factors currently used to assess the AIAL application under the *Overseas Investment Act 2005* (the Act) is inadequate then it could either amend the overseas investment regulations or release a government policy or strategy statement.

22. The government may add criteria into regulations that would need to be considered alongside legislated factors for determining the benefit to New Zealand of an application that are currently included in the Act. This would need to be done before Ministers start to consider the application in the next 5-8 days.

23. Alternatively, the government could issue a policy statement that would need to be considered in assessing the CPPIB application. Regulation 28 requires that Ministers in considering overseas investment applications must give consideration to whether the purchase will *advance* a significant government policy. If the government publicly released a new strategy or policy in the next 5-8 days that would be advanced by preventing the sale of AIAL, then the relevant ministers would be required to consider this under existing legislation. The wording and framing of this policy or strategy, however, would need to be very carefully worded in order to reduce the risk of judicial review.

24. The key advantage of both these options is that they would have relatively less impact on our key international relationships and agreements. A regulatory change or policy statement would only amend the criteria that are used to assess overseas applications; it would not change what is actually screened. As our free

trade agreements bind in only what is screened rather than the criteria we would be acting within the bounds of our international commitments.

25. Changes to the OIA regime would however make it easier for future governments to take a more selective approach to foreign investment and this in itself may raise uncertainty.

Other Relevant Information

The CPPIB takeover offer

26. The Canadian Pension Plan Investment board bid for AIAL closes at 5:00pm on 13 March 2008.

27. The Cabinet paper proposes that you announce the government's intention to act after both NZX and ASX are closed on Monday to minimise the risk of some investors trading on incomplete information.

Recent regulatory changes affecting airports

28. The government has recently announced changes affecting airports including:

- Amendments to the Income Tax Act to ensure that when a debt instrument that would normally give rise to tax deductions is stapled to a share it will be treated as equity for tax purposes;
- Changes to the Airport Authorities Act and Commerce Act to force disclosure of certain pricing information; and
- A review of the regulatory regime for landing charges, including consideration of whether airports should be subject to other forms of price regulation such as a negotiate arbitrate regime.

Existing Company specific restrictions

29. Air New Zealand and Telecom are the two major examples of company specific restrictions currently in place in New Zealand. Details of these arrangements are appended. We note that these restrictions are given effect through those companies' constitutions, which were agreed to by the shareholders.

International parallels – Australian Airport rules

30. Although the Australian situation differs in an important respect (the Federal Government owns airport land which the airport companies lease), the Australian Airports Act (1996) has the following key restrictions on airport-operator companies ownership:

- a 49% limit on foreign ownership;

- a 5% limit on airline ownership;

- a 15% limit on cross-ownership for Sydney/Melbourne, Sydney/Brisbane and Sydney/Perth airports;

- the central management and control of an airport-operator must be exercised at a place in Australia; and

- A majority of directors of an airport-operator company must be Australian citizens and/or residents.

Appendix 1

1. Air NZ is 77% government owned. Its constitution includes a Kiwi Share which contains the following restrictions:

   - No airline may own Air NZ shares without Kiwi Shareholder consent;
   - Non-NZ Nationals may not own more than 10% of Voting Rights without Kiwi Shareholder consent;
   - Kiwi Share protects all key provisions of the constitution (ie Kiwi Shareholder has a veto over significant changes to Air NZ's constitution);
   - Kiwi Shareholder approval is required for sale of main undertaking (ie has veto over any proposal to sell or dispose of Air NZ's "principal business undertaking");
   - At least three directors must be NZ residents (out of a board of 5-8 directors);
   - A majority of the board must be NZ citizens;
   - The board Chairperson must be a NZ citizen;

2. Telecom New Zealand had a number of ownership restrictions included in its constitution when it was sold by the government. These include the following restrictions on ownership and governance:

   - no person can take 10% or more total voting shares in Telecom without the prior written approval of the Kiwi Shareholder and the Telecom Board;
   - no person who is not a NZ national can have a relevant interest in more than 49.9% of the total voting shares without, and in accordance with the terms of, the prior written approval of the Kiwi Shareholder;
   - consent of Kiwi Shareholder is required to give effect to the amendment, removal or alteration of the effect of the following:
     a a number of key definitions in the Constitution;
     b the provision that the registration of any transfer of equity securities shall not prejudice, among other things, the powers of the Kiwi Shareholder in the event that a person holds shares in breach of the veto right provisions above;
     c the First Schedule to the Constitution (which lists rights of Kiwi Shareholder)
     d the requirement that half the Board be NZ citizens;
     e rules governing voting on resolutions by Telecom directors;
     f rule that the Chairperson shall not have a casting vote.

Chair
CABINET

AUCKLAND INTERNATIONAL AIRPORT LIMITED

Proposal

1. I seek Cabinet's agreement to the introduction of a Bill into the House this week to restrict foreign shareholding in Auckland International Airport Limited (AIAL). The aim is to ensure that the airport remains under New Zealand control.

Background

2. As you know, we have been watching developments with the Canadian Pension Plan Investment Board's offer to AIAL shareholders over the past weeks with growing unease. If the offer is successful, the effect will be that New Zealand's main gateway to the world will effectively have passed into foreign ownership.

3. A large number of countries have some form of foreign ownership restrictions on some classes of assets because they consider it in their national interest to do so. Assets thought sensitive vary from country to country but restrictions on land ownership are the most common. Media companies, aviation and infrastructure monopolies are also common targets. New Zealand has specific restrictions on ownership of some individual companies, for example Telecom and Air New Zealand, and a generic Overseas Investment regime.

4. For over a decade, Australia has had restrictions on foreign ownership of its airports. Although the Australian situation differs in an important respect (the Federal Government owns airport land which the airport companies lease), the Australian Airports Act 1996 includes the following key restrictions on airport-operator companies ownership:

   - a 49% limit on foreign ownership
   - a 5% limit on airline ownership
   - A majority of directors of an airport-operator company must be Australian citizens and/or residents

5. I believe the time has come for us to apply similar restrictions to Auckland Airport to ensure that our most important access-point to the rest of the world remains in New Zealanders' hands. As the current offer to AIAL shareholders closes on 13 March, it is important that the government move quickly this week if we are to preserve New Zealand's interests in the airport. Consequently, I propose that the attached draft Bill ("……………….") be introduced into Parliament as soon as possible this week.

Proposed Restrictions

6. The attached Bill will achieve the following key restrictions on foreign control:

- A 49.9% cap on total shareholding that may be held by all foreigners; and
- A [20%] cap on the shareholding of any single foreign shareholder
- Related parties provisions to ensure these caps are not breached via the backdoor
- A majority of the Board must be New Zealand citizens, and at least three must be New Zealand residents
- The board chairperson must be a New Zealand [citizen][and][resident]
- Detailed requirements on the company to keep sufficient records to enforce these restrictions

Other airports

7. At this stage I believe legislative action only needs to be taken in respect of AIAL. AIAL is currently the only NZ airport which is listed on the stock exchange. With exception of Wellington International Airport, all the other airports are either jointly owned by central and local government, or are majority owned by local councils. This would suggest that there is little risk at present of foreign interest in any of those airports.

8. Wellington International Airport has been delisted and is majority owned (66%) by Infratil, with the Wellington City Council retaining the remaining minority share. Although a foreign takeover of Infratil is a potential risk at Wellington, there is no indication that this is an imminent or even a likely eventuality.

9. Accordingly, the draft Bill applies only to Auckland International Airport.

Economic and International Implications

10. There is a risk that foreign investors and rating agencies will view New Zealand's country risk as having increased, with consequential risk premium built into our sovereign risk rating. This is because the government's decision to legislate may create a perception of regulatory uncertainty, which would lead to foreign investors being less likely to invest in New Zealand companies. If this leads to decreased investment of overseas capital into New Zealand, it will result in an increased cost of capital for New Zealand firms wishing to grow.

11. Cabinet should also be aware of possible implications for our international obligations. New Zealand has entered into a number of multilateral and bilateral agreements that restrict the ability of the Government to impose new restrictions on foreign investments in New Zealand. The multilateral agreements are the OECD Codes of Capital Liberalisation, and the WTO General Agreement on the Trade in Services (GATS). The bilateral agreements, such as the NZ-Singapore CEP and the NZ-Thailand FTA require screening of foreign investments above certain thresholds, but do not bind in the criteria that are used within that screening. The proposed restrictions on foreign shareholding levels in AIAL violate the obligations that New Zealand has under these agreements as such a move is more restrictive than the present screening of such foreign investments.

12. The proposed changes to restrict foreign investment in AIAL may therefore diminish the attractiveness of New Zealand as a country with whom others choose to enter into FTA trade negotiations with. These negotiations include:

    (i) China, with whom we have concluded negotiations but have not yet signed the agreement;

    (ii) the Trans-Pacific Strategic Economic Partnership (P4) investment negotiations with Brunei, Chile, Singapore and the United States; and

    (iii) ASEAN-CER negotiations.

Consultation

13. Treasury and the PCO were consulted on this proposal. Given the extreme commercial sensitivity of this, no other consultation has occurred.

14. Treasury considers this proposal to be inadvisable on the basis that the economic and international obligation risks substantially outweigh any benefits.

Financial Implications

15. There are no financial implications for the Government in this proposal.

Human Rights

16. A Bill of Rights report will be provided prior to the introduction of the Bill.

Legislative Implications

17. The attached draft Bill incorporating these decisions will be introduced as soon as possible this week.

Regulatory Impact and Business Compliance Cost Statement

18. There has been insufficient time to prepare this statement.

Gender Implications

19. None.

Disability Perspective

20. None.

Publicity

21. If Cabinet agrees with this proposal, I intend announcing the Government's decision tonight after the markets on both sides of the Tasman have closed for trading.

Recommendations

22. It is recommended that Cabinet:

a. Agree to place the following restrictions on shareholding in Auckland International Airport Limited to ensure control remains in New Zealanders' hands:

- A 49.9% cap on total shareholding that may be held by Non-New Zealnd Nationals;
- A 20% cap on the shareholding any single foreign shareholder may own;
- A majority of the Board must be New Zealand citizens, and at least three must be New Zealand residents
- The board chairperson must be a New Zealand [citizen][and][resident]

b. Agree to the introduction of the [………………..] Bill

c. Note that the Minister of Finance will announce the government's decision to legislate after the Australian share market has closed for trading on Monday 3 March

Hon Dr Michael Cullen
Minister of Finance

Date: