

3 August 2001

**CONFIDENTIAL**

Hon Dr Michael Cullen  
Treasurer & Minister of Finance  
Executive Wing  
Parliament Buildings  
WELLINGTON

By fax to (04) 495 8442

Dear Minister

**Air New Zealand Ownership Issues – Effect of Government Announcement 1 August**

I write to you in your capacity as Chairperson of the ad hoc Cabinet Committee appointed to consider Air New Zealand's re-capitalisation and related proposals that are before Government.

At a meeting of Air New Zealand's Committee of Independent Directors held yesterday afternoon, I was asked to communicate to Government the independent directors' grave concern about the situation now faced by this company and its directors. The present circumstances arise against the following background:

1. On 20 June 2001, Air New Zealand put to Government a formal request (unanimously supported by its Board) seeking Government policy modifications to facilitate:
  - merger of the company's A and B classes of ordinary shares; and
  - an increase to 49% in Singapore Airlines' permitted maximum shareholding.
2. Our early meetings with Ministers and senior officials from nominated Ministries and Departments confirmed that our request would be fully evaluated in a timely fashion, having regard to the company's need to address publicly on 4 September its substantial losses for FY2001 and its strategy for the future. In many meetings and discussions, Air New Zealand's representatives have emphasised the need to have the policy situation resolved in principle some weeks before the company's early September announcement.
3. Over the intervening six weeks, Air New Zealand has communicated frankly, expeditiously and constructively with Government's cross-functional team of officials, together with local and international consultant advisers retained to advise Government. Detailed submissions and large volumes of data have been provided. Officials and advisers have done an enormous amount of work on the Air New Zealand matter throughout the period, and we are grateful to them and to Government for that consideration.

4. At all times we have believed that Government was moving through an assessment of information and submissions that would result in our being advised of Government policy decisions – either accepting our proposals (with or without modification) or rejecting them.

To date, no acceptance or rejection of our request has been communicated to Air New Zealand. Instead, on 1 August the New Zealand and Australian Governments announced jointly a significant change in the process that had been in train. This involved:

- a) the formation of an Australia – New Zealand officials working party to consider the Australasian aviation market; the terms of reference of this group are not clear to us; and
- b) the appointment of a negotiating group to enter into "discussions with Air New Zealand and associated parties, including Qantas and Singapore Airlines, to flesh out the detail of the various proposals and to report back to the New Zealand Government."

While I have publicly affirmed that Air New Zealand will co-operate fully with Government's wishes, it is important that you know that Government's announcement has created a new air of uncertainty and instability for Air New Zealand. Inevitably that affects the stability of the Group's customer base, the morale of its staff, and the confidence of suppliers and creditors.

The Board had proposed a commercial course of action which it was confident (subject to Government policy endorsement) would underpin a robust strategy of development, competitiveness and ultimate profitability. In addition, the company's representatives have indicated to officials its readiness to comply with detailed governance provisions to safeguard New Zealand control, and to discuss how other national interest matters of a commercial character can be addressed to Government's and the company's satisfaction.

Government's latest initiative in conjunction with Australia appears to have jettisoned prospects of the Board's course of action being implemented. You are aware that the Air New Zealand Board was advised by SIA that it was not willing to sell its shares to Qantas. Unless the decision by the New Zealand Government to cause the Qantas proposal to be investigated reflects an understanding that SIA may be willing to change its position, it would seem that the Government has embarked on a high-risk and speculative course that has the danger of putting the Air New Zealand Group at risk.

The independent directors of Air New Zealand are therefore left in an invidious and potentially compromising position. With no reasonable clarity as to either outcome or timeline, they must review urgently how they can properly acquit their duties as directors, given the unstable situation that now exists.

As the position has become serious, it is necessary for all directors of the company to take advice on and consider their fiduciary duties. Accordingly I have instructed that a special meeting of the full Board be called for next Wednesday, 8 August. This will discuss the company's situation, including how we can best co-operate with Government's agents. I must emphasise again that time is of the essence as we move forward, more so now given the new directions taken by Government and the uncertainty thereby created. The complexities of an outcome based on the Qantas proposal (including major competition regulatory hurdles) and SIA's position are such that certainty by the end of August is most unlikely.

There seems to be a view in Government that an outcome in principle reached by the end of August will suffice. However, the company's representatives have repeatedly advised officials that resolution is necessary some weeks before that time. In the meantime, if the company is compelled to write down the value of its investment in Ansett, thereby creating a material adverse event under the company's borrowing covenants, that would trigger a requirement for the Group's unsecured facilities to be repaid forthwith.

I would be failing in my duty if I did not bring to your attention the seriousness of this situation and the grave financial risk faced by Air New Zealand Limited as a result of the current uncertainties.

Yours sincerely

**Dr J A Farmer, QC**  
**Acting Chairman**  
**Chairman of the Committee of Independent Directors**

cc Rt Hon Helen Clark, Prime Minister of New Zealand  
Hon Mark Gosche, Minister of Transport

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