



## Treasury and Ministry of Transport Report: Air New Zealand: Negotiation Strategy and Mandate

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<b>Date:</b>	1 August 2001	<b>Treasury Priority:</b>	High
<b>Security Level:</b>	Commercial Sensitive	<b>Report No:</b>	T2001/1233

### Action Sought

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	Action Sought	Deadline
Treasurer/Minister of Finance	Note	ASAP
Minister of Transport	Note	ASAP
Associate Minister of Finance (Hon Trevor Mallard)	Note	Nil
Associate Minister of Finance (Hon Paul Swain)	Note	Nil

### Contact for Telephone Discussion (if required)

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Name	Position	Telephone	1st Contact
Dr Alan Bollard	Secretary to the Treasury	471 5040 (wk)	✓
Alastair Bisley	Secretary for Transport	498 0664 (wk)	

1 August 2001

GD/44/5

## Treasury and Ministry of Transport Report: Air New Zealand: Negotiating Strategy and Mandate

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### Executive Summary

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Air NZ is to announce its 2001 financial results on 4 September. To prepare for that announcement, the Board is due to meet on 29 August. It is very important that, in time for that board meeting, Air NZ has all the agreements and approvals needed to allow it to present a credible strategic plan to the market.

If the SIA/Crown recapitalisation option is to be progressed, Air NZ would, at a minimum need to be able to present to the market on 4 September the following information:

- an agreement from the New Zealand Government to allow SIA to increase its shareholding, and to merge the 'A' and 'B' share structure;
- description of the commercial benefits that the additional SIA equity stake will bring to Air NZ;
- clear articulation of the Crown's equity stake (including agreement on price and number of shares) and the conditions that attach to the equity stake (including the Crown's intentions with respect to nominating a board member, its longer term intentions for its equity stake (eg its exit strategy) and its appetite for meeting any future capital calls or otherwise); and
- clearance of regulatory hurdles, particularly Australian Foreign Investment Review Board (FIRB) approvals.

If the Qantas option is to be progressed, by 4 September, officials have concluded that Air NZ will need to present to the market the following information:

- an agreement in principle for SIA to sell its Air NZ shares to Qantas;
- an agreement in principle, at a price that serves Air NZ's short term financing requirements, to divest Ansett to SIA (that may be subject to due diligence);
- description of the commercial benefits that the Qantas stake will bring to Air NZ; and
- robust assurance that the Australian and New Zealand competition and foreign investment issues in this proposal could be overcome.

Officials note that the requirements of the Qantas option are challenging within such a short period of time. SIA has little, if any, incentive to sell its shares in Air NZ to Qantas or to facilitate a quick negotiation of either the share or Ansett purchase transactions. Consideration of competition issues relating to the NZ domestic market and trans-Tasman market are likely to be complex and time consuming. There are also risks to bilateral air traffic rights that would need to be addressed with Qantas.

In negotiations for the SIA option, the Crown would need to engage actively with Air NZ and SIA over share allocation and price. The Crown's proposed 10% equity stake in Air NZ has been costed at \$186 million. This cost could increase significantly in the absence of either a merger of the 'A' and 'B' shares (and removal of the underlying foreign ownership limits) or with a decrease in the strike price of \$1.31 per share (for example, without lifting the foreign ownership limits, the cost

could be \$400 million for the Crown's stake). There may be the opportunity to negotiate options with SIA that lead to SIA contributing the full amount of capital sought by Air NZ but the Crown retaining some rights in the national interest.

For both SIA and Qantas, the Crown would seek to extract a package of measures that address New Zealand's national interest.

Timing is critical. Officials consider that while a two-track negotiation with both Qantas and SIA has the potential benefit of ensuring some competitive tension between the two parties, the timing demands of achieving regulatory clearances and, in the case of the Qantas option, commencing Ansett divestment negotiations, pose a significant risk to this negotiations' strategy. It should also be noted that both options require SIA's agreement, and that they are unlikely to facilitate a serious two-track negotiation.

It is proposed the Crown Negotiating Team is led by Rob Cameron, Principal, Cameron & Company and team members include a senior Treasury and Transport official, an aviation expert from PA Consulting, a commercial markets expert from Cameron & Co and a legal expert. It is proposed that the Team reports directly to the Minister of Finance, on behalf of the ad hoc Ministers' group.

## Recommended Action

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It is recommended that you:

- a **mandate** the following Crown Negotiation Team to engage with the parties on behalf of the Crown:
  - John Wilson, Director, The Treasury
  - John Bradbury, Deputy Secretary Air Services, Ministry of Transport
  - Richard Clarke, Legal
  - Murdo Beattie, Partner, Cameron & Co, Commercial Markets
  - Sam Fairchild, PA Consulting, Aviation
  
- b **agree** Rob Cameron of Cameron & Company as the lead negotiator;
 

*Agree/disagree.*
  
- c **direct** the Crown Negotiating Team to conduct negotiations on the following basis and with the following accountabilities:
  - negotiate in principle a national interest package with separately, SIA/Air NZ and Qantas with the objective of securing the greatest benefit for Air NZ and New Zealand;
  - report, through the Minister of Finance, to ad hoc Ministers on the outcome of those negotiations, seeking a decision from Ministers as to which option is the preferred option to progress in detail, by Friday 10 August;
  - negotiate with the preferred airline towards a Heads of Agreement;
  - report, through the Minister of Finance, to ad hoc Ministers where necessary to seek approval of negotiating points outside an approved strategy; and

- seek ad hoc Ministerial intervention if necessary to break any stalemates between the parties (this would be done between Ministers and the Air NZ and preferred party's boards).

d **agree** the matters for negotiation to be:

- number of shares, price per share and conditions attaching to the Crown's equity stake as well as variations on the joint recapitalisation option (for the SIA/Crown option);
- air services agreement conditions for inclusion in the Air NZ Constitution; and
- national interest package.

*Agree/disagree.*

e **direct** the Crown Negotiating Team to report directly to the Minister of Finance on behalf of ad hoc Ministers to provide progress reports, seek approval to negotiating points outside the approved strategy, advise final 'in principle' package for Ministerial approval;

f **invite** the Minister of Finance, on behalf of ad hoc Ministers, to report to Cabinet with details of the final package and to seek necessary appropriations; and

g **refer** a copy of this report to other ad hoc Ministers - the Prime Minister, Deputy Prime Minister, Minister of Tourism and Minister of Commerce.

**Alan Bollard**  
Secretary to the Treasury

**Alastair Bisley**  
Secretary for Transport

Prime Minister  
Deputy Prime Minister  
Minister of Tourism  
Minister of Commerce

Referred: Yes/No

**Hon Dr Michael Cullen**  
Treasurer/Minister of Finance

**Hon Mark Gosche**  
Minister of Transport

## Treasury Report: **Air New Zealand: Negotiating Strategy and Mandate**

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### Purpose of Report

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1. This report seeks a mandate for a Crown negotiating team to engage with Air New Zealand (Air NZ), Singapore Airlines (SIA) and Qantas as necessary to progress proposals for Air NZ's future.
2. It also presents a negotiating strategy for approval of the ad hoc Ministers group.

### Analysis

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3. We understand that at its meeting on Monday 30 July, Cabinet delegated authority for mandating a Crown negotiating team and approving a negotiating strategy to an ad hoc group of Ministers comprising the Minister of Finance, Minister of Transport, the Prime Minister, Deputy Prime Minister, Minister of Commerce and Minister of Tourism (Cabinet minute confirming these recommendations yet to be received).
4. We understand that Cabinet noted that both the SIA and Qantas proposals regarding ownership in Air NZ would be progressed towards ultimately securing the one presenting the greatest net benefits for Air NZ and New Zealand.
5. This report is in two parts as follows:
  - Part I discusses timing and risks that may arise as each proposal is progressed; and
  - Part II presents a strategy and presents a proposed negotiating team for mandating.

#### Part I: Timing and Risks

##### ***Singapore Airlines/Crown Recapitalisation Proposal***

6. This is a variation to the Air NZ/SIA proposal for SIA to lift its equity stake in Air NZ to 49% and a merger of the 'A' and 'B' shares. It provides for SIA's equity stake to be lifted to 35% and the Crown to take a 10% stake. It would require a merger of the 'A' and 'B' shares.
7. Officials have set out a 35% SIA/10% Crown option for indicative purposes. Air NZ may argue that it needs more new capital than this configuration would provide. In addition, there is a risk that the price to be paid for the new equity will be set lower than the \$1.31 provided in the original Air NZ/SIA proposal given SIA is to take a lower shareholding. This will lead to a higher cost to the Crown due to it needing to subscribe to a higher proportion of equity (the burden will fall disproportionately on the Crown due to the foreign ownership limit of 35% set for SIA).
8. Without a merger of the shares (and removal of the underlying foreign ownership limits), the Crown would be required to take a higher equity stake in Air NZ to ensure foreign ownership limits are in line with regulated caps.
9. The key requirements of this proposal are:
  - the Crown to seek the agreement of the Air NZ and SIA boards to the proposal and advise the boards that the original proposal is not acceptable at this time;

- regulatory approvals from competition authorities and foreign investment commissions in New Zealand and Australia; and
  - negotiation on the following aspects of the package:
    - the number of new shares the Crown and SIA would each subscribe to and the price to be paid for each share;
    - undertakings required by each party to take up their allocation of rights to purchase ordinary shares in a subsequent rights issue to all shareholders;
    - specification of terms and conditions that might attach to the shareholdings – for the Crown, that might be an exit strategy, nomination of a Board member; and
    - undertakings required from SIA, Air NZ and the Crown to accompany the deal (eg the Crown may require SIA to provide a national interest package).
10. There is a risk that SIA will decline to pursue negotiations for any proposal other than the original Air NZ/SIA 49% proposal presented. In that case, the Crown would need to decide whether it would prefer:
- the exit of SIA from the negotiations (with no certainty as to whether SIA will retain its 25% shareholding in Air NZ which would preclude the Qantas proposal); or
  - to reconsider the Air NZ/SIA 49% proposal.

#### *Other Singapore Airlines/Crown Recapitalisation Options*

11. There are three possible ways in which a package may be structured that would allow SIA to provide Air NZ with its total financing needs while at the same time minimising concerns about control. These options would not require Crown financing. These are:
- SIA buys 49% but assigns the voting rights to 14% of its holding to the Crown, in the national interest. SIA would be recorded as a 49% shareholder in Air NZ but it would be transparent that SIA could not control Air NZ to that extent;
  - SIA buys 49% of Air NZ and Air NZ issues the Crown with enough shares to dilute SIA to 35% - the shares would be non-participation shares (ie no dividends, no voting rights). While SIA would be recorded as a 35% shareholder in Air NZ, the Crown's inability to act under its shareholding would be transparent and accordingly may be challenged by bilateral air services partners; and
  - SIA loans the Crown the capital to purchase 10% of Air NZ shares, subject to put/call option (Crown/SIA) to convert the loan into shares to be held by SIA. While SIA would be recorded as a 35% shareholder in Air NZ, its financing of the Crown's 14% would be transparent.
12. These implications of these options will be further considered by officials (eg their impact on bilateral air traffic rights would need to be assessed) and explored as appropriate as part of negotiations with SIA/Air NZ.

#### ***Qantas Proposal***

13. This provides for Qantas to purchase SIA's current 25% shareholding in Air NZ and purchase the 30% Brierley (BIL) shares, to be held in a New Zealand-based trust which Qantas submits is in accordance with the 'A' shareholding requirements of the Air NZ Constitution. It

does not require a merger of the 'A' and 'B' shares and Qantas submits that it meets the underlying foreign ownership limits. It has yet to be established whether the Trust breaches the 'A' shareholding requirements in the Air NZ Constitution. Whether or not the Trust structure is legal, Qantas' effectively holding 55% of Air NZ shares may place air traffic rights at risk.

14. The key requirements of this proposal are:
- SIA to agree to sell its 25% shareholding in Air NZ to Qantas;
  - the Crown to seek the agreement of the Air NZ board to the proposal;
  - BIL to agree to divest its shares to the Qantas New Zealand-based Trust;
  - regulatory approvals from competition authorities and foreign investment commissions in New Zealand and Australia;
  - Air NZ and SIA to conclude an agreement for sale and purchase for Ansett at least to the point of an agreement in principle at a price which serves Air NZ's short term financing requirements (this cannot be commenced until a decision has been made regarding the preferred option of the Air NZ board); and
  - negotiation for undertakings required from Qantas to accompany the deal (eg the Crown may require Qantas to provide a national interest package in return for the Crown accepting the risks that accompany Qantas owning 55% of Air NZ).
15. It would seem most unlikely that these hurdles could be cleared in substance by 4 September. If Air NZ cannot present sufficient certainty to the market by that date, it is likely to face an adverse market reaction that may trip debt covenants.
16. We further note that this option is likely to require Air NZ to divest Ansett before it has the necessary regulatory clearances in place. This means that Air NZ is exposed to the risks inherent in a "do nothing" option. (That is, if the Crown elected not to act, Air NZ would need to divest Ansett). Without the feeder traffic brought to it by owning Ansett, and without having a strong equity partner that would assist it to gain strategic alliance benefits, Air NZ's future viability could be at risk. If regulatory clearances required under the Qantas option were not provided, or if Qantas withdrew from negotiations without a completed deal, Air NZ would find itself 'going it alone'.
17. As the Air NZ board has no formal relationship with the Qantas proposal, we do not consider it appropriate that Air NZ participate in the negotiations alongside Qantas. Air NZ would however need to also satisfy itself as to the robustness of the trust structure.

### ***Timing and Logistics of Negotiations***

18. It has been proposed that both the SIA and Qantas options be kept on the table to be subject to the Crown negotiating with each party. While this has the potential benefit of ensuring some competitive tension between the two parties, it should be noted that the timing demands of achieving regulatory clearances and, in the case of the Qantas option, commencing Ansett divestment negotiations, poses a significant risk to achieving an optimal outcome. It should also be noted that both options require SIA's agreement, and, in our view is unlikely to facilitate a serious two-track negotiation.
19. We consider a preferred option needs to be selected by Friday 10 August with meaningful negotiations to agree sufficient detail for that option thereafter. These negotiations would

build upon any undertakings provided in the preliminary negotiations between the parties and would be intended to reach a Heads of Agreement by 24 August.

20. Annex One provides a table setting out a proposed timeline for Crown and Air NZ actions.
21. Following the 4 September announcement, Air NZ will need to:
- get 75% approval of each class of shareholders to the issuing of new equity (in the case of the SIA/Crown proposal) or the divestment of Ansett (in the case of the Qantas option) and changes to the Air NZ Constitution. A key respondent will be Brierleys (BIL) – under the SIA/Crown option, if it is not accompanied by a merging of the ‘A’ and ‘B’ shares and lifting of the underlying foreign ownership limits, BIL may be reluctant to endorse the proposal;
  - get 50% approval of all unaffected shareholders to either proposal under the Takeovers Act. Under the Qantas option, if the BIL shares are bought by Qantas at an advantageous price, other ‘A’ shareholders may be somewhat aggrieved and refuse to approve the proposal. This may lead to Qantas varying its proposal to seek only SIA’s 25% shareholding. If this was the case, and given that transaction would not require a merging of the ‘A’ and ‘B’ shares and lifting of the underlying foreign ownership limits, BIL may be reluctant to endorse the proposal;
  - achieve any outstanding regulatory approvals (ie competition approvals are likely to be the most time consuming)
  - confirm a sale and purchase transaction with SIA for Ansett, if the Qantas option is the preferred option; and
  - issue new equity and make a rights issue to current shareholders in the case of the SIA option.
22. Following the 4 September announcement, and subject to Air NZ achieving the necessary regulatory clearances still outstanding and shareholder approvals, the Crown will need to:
- subscribe to new equity and a subsequent rights issue, if the SIA option is progressed (this will require a capital appropriation);
  - determine how it would deal with its shareholder rights to nominate a Board member; and
  - put in place a monitoring regime to enable it to assess value for money and potential risks from its equity holding.

### ***Regulatory Approval Timelines***

23. We note the following approval periods are provided for competition and foreign investment agencies and will apply to both the SIA and Qantas proposals:
- the New Zealand Commerce Commission has a statutory timeframe of 60 days to consider an application. Where additional time is required, an extension to the statutory timeframe can be negotiated between the parties;
  - the Australian ACCC undertakes to provide responses to applications within 28 days. It does, however, retain the right to extend that deadline if necessary;



- the New Zealand Overseas Investment Commission (OIC) normally considers an application within 10 working days. Where a Ministerial decision is required, this is normally achieved within 25 working days. Both are contingent upon the Commission being furnished with all the information required to take a decision; and
- the Australian Foreign Investment Review Board (FIRB) has a statutory timeframe of up to 30 days to consider an application. It can, however, make an interim order and then take a further 90 days before issuing a final decision. During this period, it would be expected to complete consultation. It makes a recommendation to the Treasurer that can include options to implement alongside the approval.

## **Part II: Crown Negotiating Team and Negotiating Strategy**

### ***Crown Negotiating Team***

24. It is proposed that:

- ad hoc Ministers take the role of principals – deal breakers and final approvers of the in principle package. We would anticipate the Air NZ board taking a similar role; and
- ad hoc Ministers mandate a Crown Negotiating team, comprising the following:
  - an independent lead negotiator;
  - officials - a senior Treasury official reflecting the negotiation being commercial in nature and a senior Transport official to deal with aviation-specific issues that may arise and in particular issues relating to air traffic rights; and
  - advisers – a legal expert, a commercial markets expert and an aviation expert.

25. We recommend the following individuals be appointed to the team:

- independent lead negotiator - Rob Cameron, Principal, Cameron & Company. Rob has recently been acting for NZ Dairy Foods in negotiations with GlobalCo over the separation process and milk supply issues, long term coal transport contracts between TranzRail and Solid Energy among other things;
- Treasury official – John Wilson, Director – External and Government. John has considerable experience in the Treasury’s commercial branch where he negotiated the sale of State assets;
- Transport official – John Bradbury, Deputy Secretary Air Services. John has considerable experience negotiating bilateral air traffic rights for New Zealand including 12 years leading those negotiations;
- Legal expert – Richard Clarke has been involved in air issues since Air NZ was sold in 1988;
- Commercial markets expert – Murdo Beattie, Partner, Cameron & Company. Cameron & Co have been advising the Treasury on the capital markets aspects of the Air NZ proposal and options and have knowledge of the specific issues facing Air NZ; and
- Aviation expert – Sam Fairchild, PA Consulting based in Washington DC. Sam has extensive experience in the global aviation markets and would be instrumental in

assessing the merits of aviation-related arguments around the national interest package.

26. It is proposed that this Team:

- negotiates in principle for a national interest package with separately SIA/Air NZ and Qantas with the objective of securing the greatest benefit for Air NZ and New Zealand;
- reports, through the Minister of Finance, to ad hoc Ministers on the outcome of those negotiations, seeking a decision from Ministers as to which option is the preferred option to progress in detail;
- negotiates agreements with the preferred airline towards a Heads of Agreement;
- reports, through the Minister of Finance, to ad hoc Ministers where necessary to seek approval of negotiating points outside an approved strategy; and
- seeks ad hoc Ministerial intervention if necessary to break any stalemates between the parties (this would be done between Ministers and the Air NZ and preferred party boards).

27. It is proposed that the Crown Negotiating Team reports directly to the Minister of Finance and that his office seeks agreement from other Ministers as appropriate. It would be critical that quick and immediate response be available to the Team.

### ***Negotiating Strategy***

28. The following table depicts the key matters for negotiation from the Crown's perspective:

<b>Air NZ/Singapore Airlines</b>	<b>Qantas</b>
Number of shares	Air services agreement conditions for Air NZ Constitution
Price of shares	National interest package (including competition and risks to bilateral air traffic rights)
Conditions attaching to shareholdings	
Air services agreement conditions for Air NZ Constitution	
National interest package	

### ***Singapore Airlines***

#### *Number and Price of Shares*

29. This factor is driven by Air NZ's requirement for equity. To date, Air NZ has advised that its equity requirement is \$850 million. Air NZ considers that with the original SIA proposal, this level of initial equity will meet its needs and allow it to progress to a capital notes (debt) issue. However, Air NZ has indicated informally that if SIA increases its stake to less than 49%, the certification effect is weaker and this may impede the success of Air NZ in a future debt raising exercise. Therefore, Air NZ may seek to raise more equity (possibly \$1 billion) through initial new equity.

30. The higher the equity raising target, the greater the total cost of both SIA's and the Crown's requirements. The effect of a foreign airline investment limit however places the burden disproportionately on the Crown.

31. At 49%, SIA and the Air NZ board had agreed a strike price of \$1.31, being the average of the 'A' and 'B' share prices on a particular date. Since then, the price of 'A' shares is \$1.07 and the price of 'B' shares is \$1.36. The average price is \$1.22. At a lower equity stake, SIA may seek to negotiate a lower strike price. As noted earlier in this report, the lower the strike price, the more shares that will need to be purchased by both SIA and the Crown with the burden falling disproportionately on the Crown since SIA is limited to its 35% holding.
32. The strike price for the shares will be dependent on whether the 'A' and 'B' share structure is merged. If it is not, then the Crown would purchase 'A' shares and SIA would purchase 'B' shares at their respective market prices. The underlying foreign ownership limits would need to be adhered to, causing the Crown to have to purchase proportionately more shares. In the absence of foreign ownership limits, the Crown's equity stake may cost around \$186 million (assuming a strike price of \$1.31 as per the original Air NZ/SIA proposal). With ownership limits still in place, the price of the Crown's equity stake could be around \$400 million according to Air NZ's financial advisers.
33. In addition, variations to this option could be considered further by officials and negotiated with SIA as appropriate as discussed in paragraphs 11-12 of this report.

*Conditions Attaching to Shareholding*

34. The Crown may wish to set conditions on its shareholding relating to:
- its intentions with respect to board nominations (to be nominated through the usual CCMAU appointment process based on competency for the task);
  - its intentions with respect to dividends (ie cash dividends or dividend reinvestment); and
  - its exit strategy and, if agreed to provide SIA with a right of first refusal, the Crown would need to seek SIA's agreement to its proposed conditions (discussed below).

**Air Services Agreement Provisions – Qantas and SIA**

35. The existing Air NZ constitution contains a number of provisions designed to ensure that the New Zealand nature of the airline is preserved. These provisions relate to restrictions on nationality of shareholders, requirements for approval of foreign airline investment, nationality of directors and chairperson, the appointment of directors, the name of the company, the head office of the company and an affected shares provision that requires shares to be sold where Air NZ's operating authorisations are at risk.
36. It will be necessary, for both options, to carry these provisions over to the extent they are consistent with any new policy the government puts in place for Air NZ. If the 'A' and 'B' share structure is merged, some of the provisions will require amendment as they currently rely on the 'A' and 'B' share structure for implementation.
37. Under either option it would be desirable to seek an amendment requiring Air NZ to have its place of incorporation and principal place of business in New Zealand and for the chairperson to be a New Zealand resident as well as citizen. This would better reflect New Zealand's more modern Air Services Agreements that focus on effective control, place of incorporation and principal place of business rather than ownership.
38. Any changes to the Air NZ constitution will require the approval of 75% of each of the classes of other shareholders as well as the kiwi shareholder.

**Qantas**

39. The Qantas proposal does not require any changes to the 'A' and 'B' share structure of Air NZ. Thus no changes would be required to the mechanisms by which the 'A' and 'B' share structure preserves New Zealand control of the company.

**Singapore Airlines**

40. The SIA option requires a merger of the 'A' and 'B' share classes. This would necessitate amendments to the Air NZ constitution to ensure that measures similar to those that already exist are carried over into the new structure (other changes relating to special resolutions and other matters would also require amendment as a result of this change). The principal amendments would be:
- a replacement of the procedure for appointing 'A' directors and 'B' directors with another mechanism for ensuring both that New Zealanders continue to appoint a majority of the directors and that a majority of those directors are New Zealanders;
  - a new provision for kiwi shareholder approval to be required before a foreign airline or other specified classes of foreigners purchased shares in Air NZ and before any foreign entity purchased shares which took it to more than 10% ownership of Air NZ;
  - a new procedure requiring the sale of affected shares where Air NZ's traffic rights are at risk; and
  - a new procedure for monitoring overseas ownership in Air NZ to allow, inter alia, implementation of the new affected share provision referred to above.

**National Interest Package**

41. The greatest leverage for achieving the national interest package (NIP) is with SIA. This is because the Government is being asked to make regulatory changes to facilitate the SIA proposal. However, it should also be noted that SIA is in a very strong negotiating position and this, coupled with the lower shareholding that is to be proposed to SIA, is likely to result in the Crown having less traction to achieve the full NIP.
42. The Crown's hand in the NIP negotiation may be strengthened by it proposing to give SIA an option to purchase the Crown's equity stake at a later date. The conditions under which SIA could take that equity could include:
- demonstration that it has met the NIP and will continue to do so (ie that the extra shareholding is in the national interest); and
  - demonstration, to the satisfaction of the Kiwi shareholder, that any risks to bilateral air services agreements are manageable.
43. Provided that questions arising over the proposed Qantas Trust arrangement can be resolved, the Qantas option does not require regulatory change and there is nothing to which the Crown could tie specific performance. Nevertheless, Qantas may still be prepared to provide some undertakings with respect to the national interest, particularly if it considers further shareholdings in future to be possible.
44. We recommend that the Crown negotiating team seek to negotiate the following items as part of a NIP:

- a requirement for the foreign airline to achieve airline alliance benefits for Air NZ, those benefits being difficult for Air NZ to achieve in its own right because of its relatively insignificant size within an Alliance;
  - a commitment to investing in tourism promotion for New Zealand (linked possibly to a tourism growth index rather than being an outright expression of expenditure required);
  - leasing aircraft, and providing other services, to Air NZ at market rates by treating Air NZ as a most favoured airline (i.e. this could require the foreign airline to give Air NZ the same price that it gives its best customers);
  - a commitment to Air NZ fleet replacement/expansion (linked possibly to a regional market growth index or to required load factors);
  - an undertaking to protect against conversion of existing direct flights into and out of New Zealand into direct ones over Australia or Singapore, and to ensure commitment to improving the quality of New Zealand's air services; and
  - an undertaking that, in the case of the Qantas option, competition will be brought into the New Zealand domestic market and trans-Tasman market.
45. Many of these items go to the future viability of Air NZ as a national flag carrier. They require commercial negotiations between the parties and will require Air NZ and SIA/Qantas to take a lead negotiation role. However, it will be necessary for the Crown to ensure its objectives are achieved. The presence on the Crown team of the aviation expert will be vital to assure the negotiation is successful.

## Annex One

## Negotiating Timeline

Week ending 3 Aug	Week ending 10 Aug	Week ending 17 Aug	Week ending 24 Aug	Week ending 31 Aug
Air NZ board advised of two options to be progressed	National interest packages in principle are negotiated with both parties (ie high level prescription)	Air NZ and the preferred airline seek regulatory clearances (competition and foreign investment) in both Australia & NZ	For the Qantas option, ongoing negotiations between Qantas and SIA over SIA's 25% shareholding in Air NZ and Ansett	Air NZ board meets to finalise presentation of 2001 financial results to the market, including the ownership package.
Ministers agree negotiation mandate and strategy (as per this paper)	A preferred option is decided by the Crown (ad hoc Ministers) and the Air NZ Board	If Qantas is the preferred option and SIA agrees: <ul style="list-style-type: none"> <li>• Qantas &amp; SIA negotiate sale and purchase of SIA's 25% Air NZ shareholding</li> <li>• Air NZ &amp; SIA negotiate sale and purchase of Ansett</li> </ul>	Final decision made by Government and Air NZ board and foreign airline as to nature of package	Ad hoc Ministers agree a package for reporting back to Cabinet and seeking necessary capital appropriations
Negotiations with SIA/Air NZ and with Qantas commence		Crown and preferred airline negotiate further detail of national interest package		