

The Treasury

Official information regarding the Crown's support for Air New Zealand as a result of the COVID-19 pandemic

December 2022

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Treasury Report: Project 20: Update for the week of 6 December 2021

Date:	9 December 2021	Report No:	T2021/3059
		File Number:	SE-1-3-21

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	After Cabinet agrees, sign , but do not date, the execution documents annexed to this report	7.00pm 13 December 2021
Associate Minister of Finance (Hon David Parker)	Note the contents of this report	13 December 2021

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Daniel Madley	Analyst, Commercial Performance	[35]	
Juston Anderson	Principal Advisor, Commercial Performance		✓
Maureena van der Lem	Manager, Commercial Performance		

Minister's Office actions

Return the signed report and signed but undated execution documents to the Treasury before 7:00pm on Monday 13 December 2021.

Note any feedback on the quality of the report

Enclosure: [Annex 1: Crown Standby loan Facility Amendment Deed \(Treasury:4596250v1\)](#)
[Annex 2: Subscription Agreement for Redeemable Shares \(Treasury:4596253v1\)](#)
[Annex 3: Draft NZX announcement \(Treasury:4596278v1\)](#)

Treasury Report: Project 20: Update for the week of 6 December 2021

Purpose

1. This report asks the Minister of Finance to sign the attached execution documents in respect of the amendment of the Air New Zealand (Air NZ) Crown Standby loan Facility (CSF1) and entry into a Subscription Agreement for non-voting redeemable shares.
2. We ask that these documents be signed after Cabinet has agreed to the relevant recommendations (including appropriation changes) on 13 December 2021, so that the execution documents can be provided to Air NZ after 7:00pm on Monday 13 December 2021 in advance of an intended market announcement by Air NZ at 8.30am on Tuesday 14 December 2021.
3. After Cabinet has agreed to the relevant recommendations, this report also recommends that the Minister of Finance agrees that it appears to him to be necessary or expedient in the public interest to amend CSF1 on the terms outlined in the attached CSF1 Amendment Deed, for the purposes of section 65L of the Public Finance Act 1989 (the Act).

Background

4. You are taking a paper to Cabinet on Monday 13 December 2021, seeking agreement to, among other matters, the Crown amending the nature and quantum of its financial support for Air NZ. This includes the Crown having the ability to subscribe for up to \$1,000 million in non-voting redeemable shares in Air NZ, and amending CSF1 by reducing the total loan facility limit from \$1,500 million to \$1,000 million and extending the term from September 2023 to January 2026, in each case on the terms set out more fully in that paper.
5. We previously informed you that we were working with Air NZ, Air NZ's advisors and the Crown's advisors to prepare the necessary execution documents to give effect to the redeemable shares and CSF1 amendment proposals, operating on the basis that Cabinet confirms the paper (T2021/2918 refers).
6. The execution documents are attached to this briefing, as outlined below. Once Cabinet has agreed to the relevant recommendations in the paper, we ask the Minister of Finance to sign, but not date, these documents:
 - a. Crown Standby loan Facility (CSF1) Amendment Deed – **Annex 1** (page 5), and
 - b. Subscription Agreement for redeemable shares – **Annex 2** (page 12).
7. The amended CSF1 terms are set out in schedule 1 to Annex 1. As well as the reduced loan amount and increased tenure, the amended CSF1 terms also incorporate changes to the minimum domestic services requirements. This is in response to feedback on a recent briefing (T2021/2999 refers) from the Minister of Finance to ensure that these changes can be future-proofed if an Alert Level framework were reintroduced in the future.
8. As a result, the relevant wording on page 81 of CSF1 has been changed to state that:
 - Air NZ will maintain, as a minimum ... at least one return flight per day to each Domestic Destination, and
 - The Minimum [domestic] Services may require modification if the 'COVID-19 Protection Framework (traffic lights)' is replaced or materially varied (including if the Alert Level Framework is reinstated), and Air NZ and the Crown will agree any modifications required to reflect the new or varied framework.

9. If all or part of New Zealand was ever to return to Alert Levels 3 or 4, Air NZ would be unable to meet the minimum domestic services (being one flight a day from all 20 domestic airports that it currently serves). Nor would the Government likely wish the company to operate at this level. Therefore, both parties would have a strong incentive to agree new, more appropriate minimum services, with the current schedule for Alert Levels 3 and 4 being the logical starting point.
10. The latest (draft) version of the release that Air NZ will make to the NZX regarding the redeemable shares and CSF1 amendments is provided as **Annex 3** for your reference. This document is currently with the NZX for approval, as this was one of the conditions on which the NZX provided waivers to the NZX Listing Rules. NZX's substantive comment to date was to request more details of the Crown's support be disclosed by Air NZ, which Air NZ has now provided. We are supportive of this.

Lending money under section 65L of the Public Finance Act 1989

Power under section 65L of the Public Finance Act 1989 to lend money on behalf of the Crown

11. The CSF1 Amendment Deed amends the terms of the existing CSF1 loan. Section 65L of the Act empowers the Minister of Finance, as the Minister responsible for the administration of the Act, to lend money to a person or organisation in New Zealand or elsewhere if it appears to you to be 'necessary or expedient in the public interest' to do so, and to make such a loan on any terms and conditions that you think fit.
12. Section 65P of the Act provides that any lending under section 65L must be made from a capital expenditure or other authority approved by Parliament for the purpose.
13. Given that the terms of CSF1 are to be amended in some material respects (including by way of a tenure extension), the Minister of Finance will need to be satisfied that it is necessary or expedient in the public interest for the Crown to amend the CSF1 terms by entering into the CSF1 Amendment Deed.

Officials' assessment that amending CSF1 on the terms outlined in the CSF1 Amendment Deed is 'necessary or expedient in the public interest'

14. At the time the original CSF1 was approved, officials considered that the Crown loan to Air NZ could fairly be described as securing public policy outcomes in the public interest (T2020/1185 refers). Officials similarly considered that the May 2021 amendments to CSF1 (including a loan amount increase and a tenure extension) could fairly be described as securing public policy outcomes in the public interest (T2021/644 refers).
15. It is now a matter for the Minister of Finance to decide whether you are satisfied that it is necessary or expedient in the public interest to amend CSF1 on the terms outlined in the CSF1 Amendment Deed.
16. The following paragraphs set out factors that officials consider are relevant to that assessment. You may decide to ignore these factors, or take into account other factors you consider relevant, and you may give such weight to the factors referred to below as you deem fit. You should make an independent decision and are not bound to accept the assessment below as to the appropriateness of the CSF1 Amendment Deed.

Public interest

17. The Act does not define 'the public interest'. However, it is generally accepted that the public interest is broadly equivalent to the concept of the public good and can cover a wide range of values and principles relating to the public good, or what is in the best interests of society. In the context of the Act, the public interest should be viewed in a New Zealand context, that is, in the interest of the New Zealand public.

18. The COVID-19 pandemic has had a significant impact on people and the economy, domestically and internationally. The extensive travel restrictions imposed to slow down the spread of the virus have had a material adverse impact on the business of airlines.
19. Officials consider it is in the public interest that there be continued availability of air freight capacity (particularly for pharmaceuticals and other critical, time sensitive cargo). In addition, continuing support for Air NZ will ensure maintenance of a domestic aviation network covering all the major centres so that business activity is maintained, and the local tourism industry is supported, and (as the border re-opens) will also allow access to and from overseas markets, to, among other matters, promote and build people-to-people links, tourism, regional growth, trade and export growth. The Crown's broader objectives for Air NZ are set out in the Cabinet paper currently under consideration. There are no alternative businesses that could achieve the same Crown objectives to the extent sought to be achieved through Air NZ.
20. The amendments to CSF1 in the terms set out in the CSF1 Amendment Deed can fairly be described as securing public policy outcomes in the public interest.

Necessary or expedient

21. As noted above, the Minister of Finance may lend money under the Act if it appears to him to be 'necessary or expedient' in the public interest to do so. In the circumstances the Treasury considers the proposed loan amendments to be necessary and expedient in the public interest.
22. In Air NZ's current operating environment, it has had a limited ability to operate due to COVID-19 restrictions and a resulting negative impact on its financial performance. As at 3 November 2021 Air NZ had drawn down \$505 million of CSF1. This is forecast to increase to around \$970 million by the end of March 2022 as Air NZ continues to have negative operating cash flow, it is required to meet approximately \$300 million in PAYE to Inland Revenue (that has been previously deferred), and as Air NZ takes delivery of new aircraft and makes final payments on them to the manufacturer (the arrival of which was deferred in 2020 to decrease capital expenditure in that year).
23. As a result, the available liquidity in CSF1 is forecast to decrease to approximately \$530 million by the end of March 2022, with this liquidity forecast to decrease by \$370 million in the first three months of 2022 alone. This forecast substantial reduction in liquidity available to Air NZ is of concern to Air NZ's directors.
24. While a capital raise is the best option to recapitalise Air NZ on an enduring basis, there is no guarantee that a capital raise will be able to be completed in the first quarter of calendar 2022 as intended by Air NZ. The successful completion of a capital raise will be subject to several factors, including the ability of capital and debt markets to meet the size and composition of the capital raise once these details have been finalised.
25. We also understand that the capital raise should not ideally occur during a period when the Government intends to announce significant policy decisions that would have a material impact on Air NZ's forecast financial position, for example, decisions on border openings. It would also be undesirable for the capital raise to be completed shortly before such decisions are announced. This means the capital raise would ideally not occur until such decisions have been taken and made public. Material uncertainty, including around the timing of announcements of border openings, has previously deferred Air NZ's attempts to complete a capital raise.
26. As majority shareholder, it is in the Crown's interest for Air NZ to be well-placed to undertake a capital raise, not only to achieve the Government's objectives but also given that a counter-factual is significantly increased levels of Crown support with no contribution by minority shareholders. The 28-month term extension of CSF1, in conjunction with the redeemable shares, would enable the Crown to support Air NZ

and provide 'a bridge' to a capital raise, and to ensure that this support is future-proofed should a capital raise be deferred beyond the first quarter of calendar 2022.

27. Further and continuing financial support for Air NZ as a company, its shareholders, or its creditors is not an objective of the proposed loan per se, the overriding purpose being instead to support the Crown's public policy outcomes in the public interest.

Risks and mitigations

28. Extending the tenure of CSF1 increases financial risk for the Crown, although this is mitigated to some extent by the reduction in loan amount from \$1,500 million to \$1,000 million. While it is intended that the capital raising would allow for the repayment of the loan facility, if the capital raising did not go ahead the Crown would face ongoing financial exposure through CSF1. The capital raising could be affected by general equity market conditions or other shocks; the obvious example being new adverse COVID-19 news.
29. If the capital raising did not go ahead, CSF1 contains certain approval and supervision rights to potentially mitigate the financial risk taken on by the Crown. CSF1 also provides the Crown security over some of Air NZ's assets.

Benefits

30. The principal benefit of providing the loan is that it stabilises Air NZ's financial position, thereby enabling the Crown's objectives to be achieved.
31. Further, the Crown loan amendment does not close off any options in the future, including the proposed capital raising and raising private debt. Rather, the loan amendment facilitates other options by giving the time and space necessary for all the options to be considered and developed in a considered manner. In addition, the loan is an asset for the Crown that is expected to be repaid (i.e. it will be recoverable).

No viable alternatives to the loan amendment

32. It is proposed that the Crown would, through the Subscription Agreement, make available up to \$1,000 million by way of an agreement to subscribe for non-voting redeemable shares, separate to CSF-1. This has allowed CSF1 to be reduced in quantum from \$1,500 million to \$1,000 million. However, officials consider that there are no viable alternatives to the remaining CSF1 of \$1,000 million.
33. Other alternatives to a loan, such as the Crown offering to take over Air NZ by purchasing shares from other shareholders, would not improve Air NZ's solvency or support achievement of the Crown's objectives. Instead, Crown funding would go to minority shareholders.
34. As noted above, there are no alternative businesses that could achieve the same Crown objectives to the extent sought to be achieved through Air NZ.
35. Air NZ has explored the possibility of alternative debt financing support. It has considered options such as a New Zealand retail bond issue, an Australian Medium Term Note issue, or further debt financing support from its bankers. However, any such debt financing would be contingent upon an underwritten equity raise being undertaken and successfully completed. In light of the proposed capital raising deferral, these debt financing options are not currently available to Air NZ. Air NZ therefore has few, if any, other options for support besides the amended CSF1. There is, therefore, clear support for a conclusion that support for Air NZ through the proposed amendments to CSF1 is necessary to achieve the public interest identified above.

Assessment of risks and benefits against the public interest threshold

36. In light of the above, officials consider there is a clear public interest in achieving the Crown's objectives as outlined in the Cabinet paper; the benefits of the proposed loan amendments outweigh the risks when mitigations are taken into account; and there are no viable alternatives. Accordingly, officials are of the view that the legal test that the loan amendments be necessary or expedient in the public interest is met.

Next steps

37. We are providing you with the execution documents now so that you have more time to review them in advance of the Cabinet meeting, particularly given the tight timeframes that will be required on the Monday afternoon.
38. Once Cabinet has agreed to the relevant recommendations in the Cabinet paper (including appropriation changes), we ask the Minister of Finance to sign, but not date, Annexes 1 and 2 on the afternoon of Monday 13 December 2021, and for the Minister of Finance's office to subsequently provide the signed documents back to the Treasury.
39. We will then arrange for the execution documents to be provided to Air NZ after 7.00pm on Monday evening (after the New Zealand and Australian share markets have both closed).
40. We will arrange for the execution documents to be dated once they have been signed by all parties. Air NZ will also provide usual condition precedent documents (such a general counsel's certificate) to Treasury as part of the signing process.
41. Air NZ will then make a disclosure of the redeemable shares and the changes to CSF1 at 8:30am on Tuesday 14 December 2021 prior to the New Zealand stock exchange opening (the current draft is attached as **Annex 3**).
42. No comment needs to be or should be made regarding the delegated authority for joint Ministers to agree the Crown's participation in Air NZ's planned capital raise. This will be announced next year, at the appropriate time.

Recommended action

We recommend that you:

- a after Cabinet has agreed to the relevant recommendations (including appropriation changes), **agree** that it appears to you to be necessary or expedient in the public interest to amend CSF1 on the terms outlined in the attached CSF1 Amendment Deed for the purposes of section 65L of the Public Finance Act 1989

Agree/disagree.

Minister of Finance

- b after Cabinet has agreed to the relevant recommendations (including appropriation changes), **agree** on behalf of the Crown to amend the terms of CSF1 on the terms outlined in the attached CSF1 Amendment Deed by, among other things, extension of the tenure of CSF1

Agree/disagree.

Minister of Finance

- c after Cabinet has agreed to the relevant recommendations (including appropriation changes), **agree** on behalf of the Crown to subscribe for up to \$1,000 million of non-voting redeemable shares in Air NZ

Agree/disagree.

Minister of Finance

- d after Cabinet has agreed to the relevant recommendations (including appropriation changes), **sign** the attached CSF1 Amendment Deed and Subscription Agreement for redeemable shares and return them to the Treasury.

Agree/disagree.

Minister of Finance

Maureena van der Lem
Manager, Commercial Performance

Hon Grant Robertson
Minister of Finance

Hon David Parker
Associate Minister of Finance