

Commercial in confidence

AANZ-SH

11 May 2001

Minister of Transport

cc. Prime Minister
Minister of Finance
Associate Minister of Transport

MEETING WITH GEOFF DIXON, MANAGING DIRECTOR QANTAS AIRWAYS

1. Mr Geoff Dixon, Managing Director of Qantas Airways, has sought a meeting with Ministers. He has indicated that he wishes to discuss Qantas' view of the way in which the aviation system is evolving, and of the implications this has for Australasia. He has some ideas he wishes to put to Ministers.
2. Qantas hints that these ideas have arisen from its discussions with Singapore Airlines, and probably involves the Qantas purchase of shares in Air New Zealand.

Issues

Effects on the New Zealand market/consumer

3. Air New Zealand is the major marketer of New Zealand as a tourism destination in many overseas markets. If Qantas were to become a major shareholder in Air New Zealand, decisions on marketing could be influenced by Qantas' need to market Australia (which is essentially a directly competing market) as a destination. There would be significant negative implications for New Zealand's tourism industry, should this occur.
4. Acquisition by Qantas of shares in Air New Zealand would raise competition issues to be considered by the Commerce Commission pursuant to the Commerce Act, and by the Minister of Transport, pursuant to the Civil Aviation Act. Divestment of Ansett Australia may alleviate concerns relating to competition in the Australian market, but would not mitigate issues relating to competition in the New Zealand market.

5. At the time that Air New Zealand was privatised, Qantas acquired a 20% stake that it held until March 1997. Qantas had become dissatisfied with the amount of control that it was able to exercise over the shareholding and the two carriers have subsequently become far more competitive.

6. Qantas is a member of the Oneworld Alliance, while Air New Zealand is a member of the Star alliance. The New Zealand consumer benefits from having both major alliances operating to New Zealand with a significant presence. It is probable that if Qantas were to purchase equity in Air New Zealand, Qantas would seek Air New Zealand's exit from the Star Alliance. Although the Star Alliance would still have a presence in the New Zealand market without Air New Zealand, it would be greatly diminished which would have significant implications for competition.

7. Between them Qantas and Air New Zealand carry over 70% of international passengers into and out of New Zealand. Around 90% of passengers travelling across the Tasman do so on either Air New Zealand or Qantas. There would be no question that a combined Air New Zealand/Qantas would have a dominant position in the New Zealand market.

Air rights

8. The acquisition by Qantas of shares in Air New Zealand would require the approval of the Kiwi shareholder. The Kiwi Share in Air New Zealand is a single \$1 special rights convertible share, the purpose of which is to give the Government the ability to maintain substantial ownership and effective control of the airline in New Zealand, in order to protect the airline's designation under bilateral agreements. Section 3.5(d) of the Air New Zealand constitution provides that nobody who owns or operates an airline business may hold B shares without the consent of the Kiwi Shareholder. Such consent may be given on such terms and conditions as the Kiwi Shareholder thinks fit.

9. Many of New Zealand's older bilateral agreements contain provisions relating to airline designation that enable bilateral partners to refuse to accept the designation of any airline that is not substantially owned and effectively controlled by New Zealand interests. There is no agreed definition of what constitutes 'substantial ownership'.

10. New Zealand's policy, since 1997, has been to designate an airline only if non-New Zealand interests own no more than 49% of that airline. The policy limits ownership by a single foreign airline interest to 25%, and foreign airline interests to no more than 35% in aggregate.

11. The intent of the policy has been to ensure that Air New Zealand remains able to exercise the rights of a designated New Zealand airline under bilateral air service agreements.

12. Because of the overlap of the Qantas and Air New Zealand networks, it is considered that Qantas has less incentive than most other airlines (including Singapore Airlines) to ensure that Air New Zealand continues to be able to exercise these rights. In most cases, Qantas would be able to provide air services (via

Australia) between New Zealand and other countries through the exercise of Australian air rights. Qantas may thus be less concerned about the risk that its ownership would put Air New Zealand's traffic rights at risk that another foreign airline would be.

Conclusion

13. Any substantial shareholding by Qantas in Air New Zealand would raise serious competition issues, particularly if it were to lead to the withdrawal of Air New Zealand from the Star Alliance.

14. Air New Zealand is the major marketer of New Zealand as a tourism destination in many overseas markets. If Qantas were to become a major shareholder in Air New Zealand, decisions on marketing could be influenced by Qantas' need to market Australia as a destination. There would be significant negative implications for New Zealand's tourism industry, should this occur.

15. Because of the overlap of the Qantas and Air New Zealand networks, it is considered that Qantas has less incentive than most other airlines (including Singapore Airlines) to ensure that Air New Zealand continues to be able to exercise the rights of a designated New Zealand airline under bilateral air service agreements.

Recommendation

16. I recommend that you:

- a) **note** the contents of this report.
- b) **refer** a copy of this report to the Prime Minister and to the Minister of Finance.

John Bradbury
Deputy Secretary Air Services

Noted: _____

Mark Gosche
Minister of Transport

Date: ____ / ____ / 2001