

## Treasury Report: Air New Zealand - Meeting with Deputy Prime Minister of Australia

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<b>Date:</b>	31 July 2001	<b>Treasury Priority:</b>	<b>Ministerial Deadline</b>
<b>Security Level:</b>	Commercial Sensitive	<b>Report No:</b>	T2001/1230

### Action Sought

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	<b>Action Sought</b>	<b>Deadline</b>
Treasurer/Minister of Finance	Note Aide Memoire for your meeting with the Deputy Prime Minister of Australia	Wednesday, 1 August at 9am
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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<b>Name</b>	<b>Position</b>	<b>Telephone</b>		<b>1st Contact</b>
Linda Dixon	Senior Analyst, Commercial Markets Section	471 5079 (wk)		✓
John Wilson	Director, International and Government	471 5936 (wk)		

31 July 2001

GD/44/5

**Treasury Report: Air New Zealand - Meeting with Deputy Prime Minister of Australia**

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**Purpose of Report**

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1. At 9am on Wednesday 1 August you and the Minister of Transport are meeting with John Anderson, Minister for Transport and Regional Services and Deputy Prime Minister of Australia. The meeting is to discuss the future ownership of Air New Zealand (Air NZ) and Ansett Australia.

**Analysis**

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2. The key issues likely to be raised by Mr Anderson are the Australian Government's perspective on:
  - the future ownership structure of Ansett and in particular, whether the Australian government has a preference for direct ownership of Ansett by Singapore Airlines (SIA) or indirectly through an increased equity stake in Air NZ; and
  - whether the Foreign Investment Review Board (FIRB) and the ACCC (the Australian competition authority) are likely to have concerns over either a Qantas/Air NZ partnership or a Singapore/Air NZ partnership.
3. You might also wish to hear his views with respect to any ownership stake the New Zealand Government might take in Air NZ.
4. There are significant implementation risks attaching to the Qantas/Air NZ option that Ministers are currently considering. Therefore, we consider it important to signal to Mr Anderson that the Government is currently considering the merits of both options.
5. Attached is an Aide Memoire for your meeting.

**John Wilson**

Director, External and Government  
for Secretary to the Treasury

**Hon Dr Michael Cullen**

Treasurer/Minister of Finance

## **AIDE MEMOIRE**

### **MEETING WITH JOHN ANDERSON, DEPUTY PRIME MINISTER OF AUSTRALIA**

#### **AIR NEW ZEALAND**

##### **New Zealand's National Interest**

Some key points with respect to New Zealand's national interest that might be relevant to raise with Mr Anderson include:

- maintaining the benefits of competition for New Zealanders;
- tourism growth which can be facilitated through bringing tourists into New Zealand from Australia and bringing in tourists directly to New Zealand to capture the greatest amount of tourist dollars as possible;
- maintaining freight services; as a small island nation, New Zealand depends heavily on being able to transport goods by air both frequently and reliably; and
- maintaining a national flag carrier; without Ansett, Air NZ's viability in future will be put at risk as it gets competed off its most profitable routes by Qantas and Ansett (SIA). With Qantas, Air NZ is at risk of being marginalized as a regional feeder airline since Qantas is already the regional carrier for the OneWorld alliance.

##### **Foreign Ownership Limits**

The Australian and New Zealand regulatory regimes both provide for foreign investment limits in their national carriers of 25% for a single foreign airline, 35% for all foreign airlines and 49% for all foreign investment.

Each proposal has the following implications for the foreign ownership limits:

- the Qantas option does not require a change to the foreign ownership limits. It does, however, include Qantas' purchase of Brierley Investment's 30% stake that Qantas proposes to hold in a New Zealand-based trust. This would effectively give Qantas 55% ownership of Air NZ; and
- the SIA/Air NZ option will require the foreign ownership limits to be lifted (although a limit on investment by a foreign airline could be retained). If the limits were to be kept in place, the Crown would need to subscribe to a higher shareholding at a higher cost.

##### **Durable and Effective Competition**

The Australian Government's only avenue to control the investment decision is through the Treasurer's decision rights with respect to applications for foreign investment. In the case of

an application, the Foreign Investment Review Board (FIRB) will assess an application to ensure that it is in the national interest. However, its recommendations are made to the Treasurer who may, or may not, take into account the FIRB's recommendations when making his decision.

Key points that you might make to the Australian Deputy Prime Minister in response to these issues are:

- Air NZ is as important to New Zealand as a national flag carrier as Qantas is to Australia. Without SIA's agreement to divest its 25% shareholding to Qantas, there is no other option for Air NZ's recapitalisation. SIA has repeatedly said it will not sell that stake.
  - Why does Mr Anderson think SIA would sell its 25% stake in Air NZ to Qantas? (Qantas would be SIA's main competitor in the Australasian market and selling its Air NZ stake to Qantas would appear to serve to strengthen Qantas' ability to respond);
  - Does Mr Anderson have any suggestions as to how a solution might be found if SIA does not sell its shares to Qantas?
- the respective financial positions of Air NZ and SIA have not changed since last year when the Australian government approved Air NZ purchasing the second 50% tranche of Ansett shares. Therefore, it is unclear why today the Air NZ investment in Ansett is any less desirable from the perspective of the Australian national interest;
- when it approved the Air NZ purchase of the second tranche of Ansett shares, the Treasurer took the FIRB's recommendations and imposed conditions on Air NZ relating to, among other things, retaining employment in Australia and in its regions, maintaining services to regions, supporting growth opportunities for Ansett International to the extent consistent with its level of ownership in Ansett International. Are there questions as to whether Air NZ has met these conditions?
- the proposal from SIA will strengthen Air NZ's financial position and enable it to deliver strong competition within the Australian and trans-Tasman markets;
- SIA prefers the Air NZ/Ansett option over any proposal that would see it owning Ansett directly reflecting potentially its view on how competition is best fostered in the Australian domestic and trans-Tasman markets.

## **Qantas**

If the Australian Government favours the Qantas option, you might note to Mr Anderson that the loss of competition on the trans-Tasman and New Zealand domestic routes will affect New Zealanders to a greater extent than Australians. The following questions may be relevant:

- How does Mr Anderson see competition hurdles (Australian ACCC and NZ Commerce Commission) being overcome?
- Would the Australian ACCC accept undertakings that are likely to be difficult to enforce given they pertain to SIA (as the new owner of Ansett) bringing Ansett into the Tasman and New Zealand domestic market?

- How could a deal be structured that would guarantee Ansett being brought into the Tasman and New Zealand domestic market?
- Why does Mr Anderson think SIA would sell its 25% stake in Air NZ to Qantas? (Qantas would be SIA's main competitor in the Australasian market and selling its Air NZ stake to Qantas would appear to serve to strengthen Qantas' ability to respond).

In June, the Australian Department of Transport and Regional Services provided its assessment of the relative market shares between airlines in Australia. It noted that the Qantas/BA partnership has combined revenue per passenger kilometre of \$177 billion and Air NZ/Ansett/SIA \$102 billion. This translates to Qantas/BA being 75% larger than Air NZ/SIA/Ansett in revenue terms. If this information is correct, assertions of the SIA/Air NZ partnership being a threat to Qantas' future viability would appear questionable.