



Report of the
Controller and Auditor-General

on

Airways Corporation of New Zealand Limited:
Review of Certain Matters Concerning the National
Air Traffic Services (UK) Consortium

30 June 2000

Summary Report

This report concerns the proposed involvement of Airways Corporation of New Zealand Limited (“Airways”) in a consortium formed to bid for a portion of the National Air Traffic Services (“NATS”) organisation based in the United Kingdom.

The consortium transaction has a number of unusual characteristics – perhaps the most significant being that it gave rise to potential conflicts of interest on the part of three senior executives of Airways who were closely involved in negotiating it on behalf of the Board. Moreover, the Board’s management of the potential conflicts of interest became the subject of serious allegations of impropriety.

Airways’ Shareholding Ministers sought advice from me about:

- the nature of the potential conflicts of interest;
- how the Board of Airways had handled the potential conflicts; and
- whether a payment made by Airways to its former General Counsel, under a severance agreement, was made solely or substantially with a view to keeping him from disclosing concerns which he had expressed to the Airways’ Board about the potential conflicts.

I agreed terms of reference with the Shareholding Ministers that confined me to conducting an inquiry as to the adequacy and appropriateness of the controls and procedures used by Airways when it negotiated and concluded the consortium agreement and the severance agreement. The reasons why I agreed to relatively narrow terms of reference relate to the Audit Office’s limited mandate in the audit of State-owned Enterprises, which is set out in paragraphs 108-111.

I am aware that the NATS project has been the subject of extensive public and parliamentary comment. My Office’s limited mandate means that some of the public expectations of our involvement cannot be met.

Because of the unusual circumstances surrounding this review, I think it necessary to make some further preliminary comments to set the scene for our report.

Review of the consortium transaction

We reviewed Airways' internal controls and procedures in respect of the consortium negotiations. For this purpose, it was necessary for us to establish:

- what happened during the negotiations;
- the roles of the Board (including a special subcommittee set up to oversee Airways' involvement in the project), the Chairman, the other directors, the Chief Executive Officer, and the former General Counsel in respect of the negotiations;
- how these various parties identified and understood the potential conflicts of interest which arose during the negotiations in respect of certain key Airways executives; and
- how the potential conflicts were handled by the Chairman and the Board.

We found sharply differing perspectives on each of these points. Some of the differences concerned parties' recollections of actual events and conversations. Other differences concerned the interpretation they placed on events and key documents.

In many respects the differences were irreconcilable.

As Controller and Auditor-General I am not a judicial officer. It is not for me – and nor was it the purpose of the inquiry – to make findings on whose version of the events was the more credible. Nor do I think it productive for this report to traverse the events, and the different recollections of them, in great detail.

However, our review of the documentation and the interviews we conducted lead us to certain conclusions which form the basis for assurance on the terms of reference. We state these conclusions on pages 5-7.

Serious allegations were made publicly and in Parliament against Airways and, in particular, the Chairman, the Chief Executive and two other senior executives. We recognise the importance of this report in relation to their reputations.

Where we consider it useful, our report also outlines some of the more important events that gave rise to differences of view on the potential conflicts of interest and their management by the Board. We have done our best to present the different perspectives in respect of those issues fairly, along with our conclusions.

During the period of the consortium negotiations, the former General Counsel reported to the Airways Board about the nature of the potential conflicts of interest which they raised, and the manner in which the Board was managing those potential conflicts. The former General Counsel complied with his legal and ethical obligations to provide independent advice to the Board on the potential conflict of interest situation. Board members made it clear to us that the advice which the former General Counsel gave to the Board during and after the negotiations played a valuable part in the exercise of their governance responsibilities.

We have had the advantage of reviewing all of the relevant documentation and discussing the events in question at length – not only with the former General Counsel but also with others who were involved. Some of our conclusions differ from the views which the former General Counsel reported to the Board.

We must emphasise that we reached our different conclusions on the basis of the information available to us. These conclusions do not imply any criticism of the professional judgement which the former General Counsel exercised at the time, nor of the genuineness of the concern which he had to ensure that Airways' conduct in the negotiations met appropriate standards of corporate governance and probity.

Review of the severance agreement with the former General Counsel

We have not investigated the reasons for the former General Counsel's departure from Airways' employment in January 2000. That was, and is, a matter for the parties concerned. No inference should be drawn from our report as to what gave rise to the departure.

We note that:

- the former General Counsel's employment by Airways (and, consequently, his involvement in the NATS project) ended in January 2000; and
- the former General Counsel gave assistance to our inquiry voluntarily, despite having no legal obligation to do so and notwithstanding that there were no allegations made against him.

Summary of our conclusions

Did Airways' Board correctly identify the extent of, and obtain advice from, appropriate sources on any conflict of interest for senior management in terms of potential personal gains in relation to the proposed NATS transaction and the consortium arrangements?

The Board became aware in September 1999 of the possibility that its executives would obtain senior positions in NATS, if the consortium's bid was successful.

The Chairman became aware of the possibility of management incentives in mid-October 1999.

The NATS subcommittee of the Board became aware of the possibility of management incentives on 11 November 1999.

The Chairman was advised of a specific proposal as to management incentives, including as to amounts payable, on the weekend of 20-21 November 1999. The Chairman informed members of the NATS subcommittee of this proposal at an informal meeting on 30 November 1999 and the full Board on 3 December 1999.

The first time the full Board learned of the possibility of management incentives, or the amount being proposed, was on 3 December 1999.

The Board obtained legal advice from appropriate sources on the potential conflicts.

Did the Board deal with any conflict of interest in an appropriate and robust way?

In general, the steps taken by the Board in December 1999 to manage the potential conflicts of interest were appropriate and robust. We summarise these steps in paragraph 328.

However, with the benefit of hindsight, in our view:

- the Board ought to have considered its legal advice, and taken formal steps to manage the potential conflicts of interest, earlier than it did;
- the Chairman ought to have recorded the matter of the possible management incentives, and informed the Board, earlier than he did;
- the uncertainty which arose over the status of proposed management incentives in November 1999 could have been averted had –

- the Chairman recorded the result of his discussions on the issue in October 1999 and made that information available to the former General Counsel; and
- the former General Counsel been given written instructions concerning his role in the consortium negotiations, specifically in respect of the question of management incentives.

We also noted that the Board did not take independent financial advice on the financial return proposed for Airways under the consortium agreement – as recommended by the external legal advice obtained on 1 October 1999.

Did the Board or relevant senior executives act in breach of their legal or ethical obligations to the company in relation to Airways’ involvement in the proposed NATS transaction, as identified in the signed consortium agreement?

The actions of the Chief Executive Officer, the Chairman, and other senior executives in negotiating the terms of the consortium agreement were authorised by the Board.

The Board complied with all its legal obligations to the Shareholding Ministers in respect of the consortium agreement.

Allegations that Board members – in particular the Chairman – stood to gain personally from the NATS transaction are without foundation.

The three executives were in a potential conflict situation. However, they forwarded monthly reports to the Board updating it on progress with the NATS project, and they had Board authority to progress the NATS project in the way that they did. Moreover, both the Chairman and the Chief Executive told us that there was a clear understanding that the three executives should not be involved in negotiating the management incentives.

Was the £10 million in management incentives proposed for senior management, which has been referred to publicly, included in the agreement between Airways and the consortium partners and, if it was, on what basis was it offered and was it accepted by Airways’ Board?

There is no reference to specific management incentives in the consortium agreement.

Management incentives capped at £10 million were proposed during the negotiation of the agreement.

Based on the documentation, were the severance arrangements with the former General Counsel:

- (a) lawful and made in accordance with the Board's powers?*
- (b) made solely, or substantially, with a view to keeping the former General Counsel from disclosing his concerns about proposed management incentives?*

The severance agreement with the former General Counsel was lawful and made in accordance with the powers of the Board.

The agreement contained confidentiality clauses. However, we are satisfied that the agreement was not made solely or substantially with a view to keeping the former General Counsel from disclosing his concerns about proposed management incentives.

D J D Macdonald
Controller and Auditor-General
30 June 2000

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1 – Introduction

The nature of the inquiry, and how we became involved

- 101 On 30 May 2000 we were asked by the Minister for State-Owned Enterprises, Hon Mark Burton, and the Minister of Finance, Hon Dr Michael Cullen (“the Shareholding Ministers”), to review certain documentation concerning Airways Corporation of New Zealand Limited (“Airways”). The documentation related to Airways’ proposed involvement in a consortium, which had subsequently been formed in early-2000, to bid for a portion of the National Air Traffic Services (“NATS”) organisation based in the United Kingdom.
- 102 NATS is the equivalent organisation to Airways in the United Kingdom. NATS is owned by the United Kingdom Government, which intends to partially privatise it in 2001.
- 103 The Shareholding Ministers’ request followed allegations – made in the House of Representatives by Rt Hon Winston Peters MP on 3, 10 and 11 May 2000 – that:
- certain executives and directors of Airways stood to benefit personally from the consortium agreement, through the payment of management incentives (to the amount of £10 million) and the receipt of an international directorship;
 - the former General Counsel and Company Secretary of Airways (“the former General Counsel”) had warned the Board of Airways about the conflict of interest;
 - the former General Counsel had been paid a large sum to leave Airways, which may have been “hush money”, to stop him from speaking publicly about his concerns; and
 - because of the involvement of Airways’ executives and directors in the proposed NATS bid, Airways had decided not to put to tender a new air navigation system for New Zealand, but instead had contracted with another consortium member, Lockheed Martin Air Traffic Management (“Lockheed Martin”), to purchase its Skyline system.

Our terms of reference

- 104 The Shareholding Ministers initially sought information from the former General Counsel, and from Airways, to see whether there was

any substance to these allegations. After a period of consultation, the Ministers asked us to advise on the following:

Did Airways' Board correctly identify the extent of, and obtain advice from, appropriate sources on any conflict of interest for senior management in terms of potential personal gains in relation to the proposed NATS transaction and the consortium arrangements?

- ii. *Did the Board deal with any conflict of interest in an appropriate and robust way?*
- iii. *Did the Board or relevant senior executives act in breach of their legal or ethical obligations to the company in relation to Airways' involvement in the proposed NATS transaction, as identified in the signed consortium agreement?*
- iv. *Was the £10 million in management incentives proposed for senior management, which has been referred to publicly, included in the agreement between Airways and the consortium partners and, if it was, on what basis was it offered and was it accepted by Airways' Board?*
- v. *Based on the documentation, were the severance arrangements with the former General Counsel:*
 - (a) lawful and made in accordance with the Board's powers?*
 - (b) made solely, or substantially, with a view to keeping the former General Counsel from disclosing his concerns about proposed management incentives?*

105 Subject to the limitations on our mandate as Airways' auditor (see paragraphs 108-111), we decided to inquire into the matter and we adopted the above five questions as our terms of reference.

106 On 1 June 2000 Mr Peters asked us also to inquire into Airways' decision not to use a tender process for the replacement of the New Zealand air navigation system.

107 We declined the request because of limitations on our mandate and because there appeared to be no foundation to the claim that the decision in relation to the New Zealand system had been the subject of a conflict of interest. Rather, it appeared that Airways had negotiated the purchase of equipment for the New Zealand system as part of its publicly announced wider partnership with Lockheed Martin.

Limits on our powers of inquiry

- 108 Airways is a State-owned Enterprise (“SOE”) and is incorporated as a company under the Companies Act 1993. Its shareholders on behalf of the Crown are the Shareholding Ministers.
- 109 Parliament has appointed the Audit Office as the auditor of every SOE.¹ However, our role in respect of SOEs is considerably narrower than that in respect of the Crown. Essentially, our role is the same as that of an auditor of a company under the Companies Act – which is to audit the financial statements of the company and report to the shareholders.
- 110 However, in carrying out our audit function, we can exercise our normal powers under the Public Finance Act 1977 – including those to obtain information and to report such matters as we consider appropriate (see sections 26 and 34 of the Public Finance Act 1977).
- 111 In practical terms, this means that:
- We could review transactions which were, or would be, reflected in Airways’ financial statements. Specifically, the transactions which we reviewed were the consortium agreement and the severance agreement with the former General Counsel.
 - We could give assurance to the Shareholding Ministers on whether the controls and procedures used by Airways, when it negotiated and concluded those transactions, were adequate and appropriate.
 - We had no mandate to consider the effectiveness or efficiency of Airways’ actions, or otherwise evaluate its commercial judgements.

What we did

- 112 We conducted our inquiry by:
- reviewing the relevant documentation which had been supplied to the Shareholding Ministers by the former General Counsel and Airways;
 - reviewing relevant business plans, accountability documentation, and minutes of the Airways’ Board and of the subcommittee of the Board which oversaw the consortium negotiations;

¹ Section 19, State-Owned Enterprises Act 1986.

- reviewing the advice given to the Shareholding Ministers by the Crown Company Monitoring Advisory Unit (CCMAU) and the Treasury; and
- interviewing the Chairman, the Chief Executive Officer, two other directors of Airways, and the former General Counsel.

113 In keeping with our usual practice, we circulated a draft of this report to affected parties and gave them an opportunity to comment on it. We also discussed aspects of the draft report with affected parties.

Chronology of key events

114 We set out in the Appendix on pages 39-42 a chronology of the key events relating to the NATS project and the matters covered by our inquiry.

2 – The Context

The nature of Airways' business

201 The core business of Airways is to provide air navigation services (ANS) in New Zealand and the international airspace around it. Airways is unusual among equivalent bodies world-wide, because of the high level of commercialisation which the SOE model permits. Indeed, Airways considers itself to be a world leader in the industry by virtue of its competitive pricing, return on shareholders' investment, and safety record.

202 In 1998 Airways embarked on a major strategic business review. The results of the review were summarised in its 1999-2002 Business Plan:

The principal business of Airways – the provision of air navigation services (ANS) – is experiencing considerable change world-wide as commercialisation and globalisation of services occurs. As Airways' domestic business matures, the company intends to grow its business in international markets by exploiting the value of the intellectual capital it has built up as a world leader in managing ANS for shareholder value and the introduction of new ANS technology.

Meanwhile, Airways has consolidated its position in the domestic market following the successful implementation of the restructure of its operations. This has produced significant benefits to both our shareholders and customers. Accordingly, Airways is now:

(a) positioned to respond to likely increasing competitive pressures and customer demands; and

(b) in a position to grow offshore taking advantage of the opportunities arising in a rapidly changing international ANS market.

203 Accordingly, Airways defined two business goals:

Goal #1: Consolidate our position as the leading provider of Air Navigation Services in New Zealand ie everywhere an Air Navigation Service is required in New Zealand we will provide it and make a profit.

Goal #2: Be part of a major ANS provider alliance grouping.

204 To ensure that it continues to achieve the first goal, since late-1998 Airways has had an Operating Board which concentrates on day-to-day safety and service delivery in New Zealand.

The NATS partial privatisation

- 205 Airways' interest in the NATS partial privatisation is a direct result of the second of its business goals – to be a part of a major ANS provider alliance grouping. The interest arises from a decision by the United Kingdom Government to sell 46 percent of NATS, under a model known as a Public Private Partnership (PPP). The UK Government proposes to retain 49 percent, together with a “golden share” for national security reasons. Management control of the organisation will pass to the private partner. The remaining 5 percent of the equity in NATS will be offered to its existing staff.
- 206 We were told that the NATS PPP will be the first genuine privatisation of an ANS business anywhere in the world. Because of the size and importance of NATS, Airways' involvement in the proposal would provide an important opportunity for it both to achieve a global competitive advantage and to advance its goal of becoming part of a major alliance.

Airways' involvement with Lockheed Martin

- 207 In financial terms Airways is a small player in the global ANS industry. It could not have hoped to be involved in the PPP except in conjunction with other parties. Its own contribution to any joint venture would be its expertise in ANS management. Financial backing and technological expertise would be required from others.
- 208 During 1999 Airways explored with Lockheed Martin – a major supplier of air navigation technology – the possibility of a joint bid for NATS. The discussions were part of a wider dialogue between the two organisations, which has since resulted in the formation of a strategic partnership.
- 209 Under the partnership, Airways and Lockheed Martin have agreed to participate in a bid to provide a satellite-based ANS for the US Federal Aviation Administration. The parties have also entered into a technology agreement under which Lockheed Martin will supply its Skyline ANS for use by Airways in New Zealand and establish a Joint Software Development Centre for developing and supporting Lockheed Martin technologies in the Asia Pacific region.

The consortium for the NATS bid

- 210 In September 1999 Airways, with the help of its financial advisers (NM Rothschild and Sons), managed to secure financial backing for the NATS project bid from a United Kingdom based venture capital

provider, APAX Partners Ltd (“APAX”). As a consequence, Lockheed Martin confirmed its involvement as the technology partner to the proposal.

- 211 The consortium agreement was signed on 29 February 2000 by Airways, Lockheed Martin and APAX. The parties agreed to form a company (described in the agreement as the Special Purpose Vehicle, or SPV) for the purpose of making the bid and, if successful, acquiring the interest in NATS. Airways, Lockheed Martin and APAX would each contribute one director of the SPV.
- 212 The preparation and management of the bid would be overseen by a steering committee on which all equity parties to the bid would be represented.
- 213 The three senior executives concerned (to whom we refer as “the three executives”) are now based in London and are working full time on the bidding process. The Chief Executive Officer has retained his New Zealand position at Airways in the meantime, but a Chief Operating Officer has also been appointed to manage the New Zealand side of the business.
- 214 We were told that the Board is keeping under review whether the Chief Executive Officer’s responsibilities in relation to the NATS project affect his ability to fulfil his responsibilities in respect of Airways’ core business activities in New Zealand.
- 215 The consortium agreement provides that, if the bid is successful, Airways may nominate executives to assume senior positions in NATS. The agreement states that the first nominees would be the three executives. In addition, Airways must provide support for the executive management team by way of further secondments and advisory work carried out by Airways’ management.

Rewards

- 216 The consortium agreement specifies the rewards which each party to the consortium is to receive should the bid be successful. Those rewards are in part contingent on successful management of NATS over a period from its acquisition until the date on which the shares would be listed.
- 217 Under the current proposal, Airways would receive a cash payment of £2 million on the successful conclusion of the bid, and shares worth up to the value of £15 million on listing, subject to performance against business plan targets.²

² Reported in *Hansard* 18 May 2000.

218 The consortium agreement also provides for financial incentives for the executives who would be employed to manage NATS if the bid is successful. No provision has been made as to the nature or amount of such incentives. However, a specific incentive package was proposed during the consortium negotiations. We return to this in Part 5 of this report.

Other New Zealand involvement in the consortium

219 At the time the consortium agreement was being negotiated, Airways was proposing to invest a substantial amount of equity in the project.

220 To meet conditions which were imposed by the current Shareholding Ministers in January 2000, Airways will now contribute intellectual capital only. New Zealand financial backing will be provided by Infrastructure & Utilities NZ Limited (Infratil), under a separate joint venture agreement entered into with Airways.

The NATS bidding process

221 The NATS bidding process will spread through the rest of 2000. We understand that the final selection of the UK Government's preferred partner will take place early next year.

222 Until then, the details of the Airways/Lockheed Martin/APAX consortium and the bid have a high level of commercial sensitivity. They will also remain the subject of ongoing commercial negotiations.

3 – Management of Potential Conflicts of Interest

301 In this part of the report we address the first two questions in the terms of reference (see page 10). The consequential questions that arise are:

- Did the Airways’ Board correctly identify any conflict of interest for senior management in terms of potential personal gains in relation to the proposed NATS transaction and the consortium arrangements?
- Did the Board obtain advice from appropriate sources on any such conflict?
- How did the Board deal with the potential conflicts which it identified?
- Did it do so in an appropriate and robust way?

The nature of a conflict of interest

302 A conflict of interest may arise when an individual or individuals are put in a situation where the potential exists for the individual or individuals to benefit personally – which may or may not be to the detriment of the organisation they are representing.

Identification of potential conflicts of interest

303 In our review of the NATS proposal and the consortium agreement we identified two distinct potential conflicts of interest for the three executives. These were:

- the possibility that the three executives would obtain senior positions in NATS upon success of the consortium bid (“potential conflict 1”); and
- the possibility that the three executives would be offered management incentives from holding those NATS positions (“potential conflict 2”).

304 In our view, there was a potential risk for Airways that the three executives could act in a “conflicted” way in the following phases of the negotiation and bidding process:

- *during the formation of the consortium*, at which time the roles of the parties (including the roles of individual employees of the parties) were discussed;
- *during the negotiation of the consortium agreement*, which included provision for rewards and remuneration for the parties to the agreement and for management incentives; and
- *during the bidding process*, when the Chief Executive Officer is Airways' representative on, and chairperson of, the consortium steering committee.

305 The Airways' Board had the responsibility to take appropriate steps to ensure that its decisions in respect of the project were made in a transparent and fully informed way.

When the potential conflicts arose

Potential conflict 1 – the three executives obtaining senior positions in NATS

306 Airways executives identified in early-1999 that involvement in the NATS PPP was a way to further Airways' international business goal. With full Board knowledge, the Chief Executive Officer played the leading role in putting the consortium together for the bid.

307 The process began formally in June 1999 when the Chief Executive Officer retained NM Rothschild and Sons as Airways' financial advisers and to assist with the identification of suitable financial backers for the project. He then took a leading role in getting Lockheed Martin (the technology partner) to join the consortium.

308 The idea that Airways' executives would be transferred to NATS emerged as the expectations of the parties to the consortium were discussed. Airways was leading the project, and would be contributing the ANS management expertise. For these reasons, we were told that the other consortium partners expected that Airways would contribute senior personnel – not only to take a leading role in the preparation of the bid, but also to become involved in the management of NATS in the event of the bid being successful.

309 In our view, such expectations would not have been unusual for a consortium of this nature. The Airways' Board was informed of this possibility in a memorandum dated 30 August 1999, which was discussed at a full Board meeting on 1 September 1999.

Potential conflict 2 – the three executives earning management incentives for their positions in NATS

- 310 The possibility that the three executives could earn their own rewards (in the form of management incentives) for their involvement in the management of NATS on completion of a successful bid was first raised in discussions between a representative of APAX and the Chairman of Airways in London during October 1999.
- 311 We accept that management incentives are a common feature of major commercial transactions involving returns on large capital investments such as this.
- 312 In the case of the NATS project, it is clear that, if the bid were successful:
- a very large sum would be invested by the consortium over a significant period of time; and
 - the amount of return on the consortium’s investment would depend substantially on the performance of a business plan which, it is anticipated, would be implemented with the substantial involvement of the three executives.
- 313 We note that APAX expressed the view that such incentives are a pre-requisite in any transaction it is involved with.
- 314 No one to whom we spoke expressed concern about this approach, in principle.

Did the Airways’ Board correctly identify the potential conflicts?

- 315 We are satisfied that the Airways’ Board knew of the existence of potential conflict 1 – the possibility of the three executives obtaining senior positions in NATS – by 1 September 1999.
- 316 We are also satisfied that the Chairman correctly identified the existence of potential conflict 2 – the possibility that management incentives would be offered to the three executives – at the time it arose during discussions with a representative of APAX in October 1999. However, no amounts were identified at that time.
- 317 In August 1999 the Board had established a subcommittee (“the NATS subcommittee”) to oversee the development of the NATS project. The subcommittee was first alerted to the possibility of management incentives on 11 November 1999, when it considered a document described as the Heads of Terms for Consortium Agreement. That

document referred to equity compensation being “available, at the discretion of the Parties, for senior management and staff”.

318 On the weekend of 20-21 November 1999, during the negotiation of the consortium agreement in London, the former General Counsel informed the Chairman by e-mail of a proposal by APAX that the amount of the proposed management incentives be £10 million. The Chairman did not report this to the Board until 3 December 1999, when he revealed both the proposal for management incentives in principle and the proposed quantum to a special teleconference meeting of directors.

319 The Chairman had earlier informed those directors who were members of the NATS subcommittee of the proposed quantum, at an informal meeting after the Board meeting on 30 November 1999. Accordingly, the first time the full Board learned of the possibility of management incentives, or the amount being proposed by APAX, was on 3 December 1999 (by which time the Chairman had rejected the APAX proposal).

Did the Airways’ Board obtain advice from appropriate sources on the potential conflicts?

320 After learning of the existence of potential conflict 1, the former General Counsel sought external legal advice on whether a conflict of interest existed and, if so, what steps should be taken to manage it. The resulting legal opinion (dated 1 October 1999) confirmed the existence of a potential conflict of interest on the part of the three executives, arising from the possibility that they would obtain senior positions in NATS if the bid was successful.

321 The legal opinion recommended a number of steps to manage the potential conflict – one of which was that the Board obtain an assessment of the transaction from an experienced adviser who would be independent of the consortium.

322 The legal opinion was circulated to members of the Board at the conclusion of its meeting on 1 October 1999. The former General Counsel noted on the original of the document that directors “agreed” with the advice. He told us that the agreement was given during an informal meeting of the NATS subcommittee following the Board meeting. This was not minuted. We found no evidence that the Board was invited to take any steps to consider or formally adopt the advice until 1 December 1999.

323 On 1 December 1999 the former General Counsel gave written legal advice to the Chairman and Deputy Chairman on the potential conflicts of interest. He recommended that the independent advice of 1 October

1999 be adopted and implemented by the Board, and that the three executives no longer have a lead role in the NATS negotiations.

324 The former General Counsel asked the Chairman and the Deputy Chairman to convey his advice to the Board. They did not do so, but on 6 December 1999 (acting on the instructions of the Board given during its teleconference meeting of 3 December 1999) they took further external legal advice (from a different legal firm) on the potential conflicts of interest (including that in respect of management incentives) that the Board had by that time identified.

325 The Chairman told us that he and the Deputy Chairman sought the further legal advice because the Board did not consider that all of the recommendations contained in the opinion of 1 October 1999 could practicably have been implemented.

How did the Airways' Board deal with the potential conflicts?

326 The Chairman said, in his response of 16 May 2000 to the Shareholding Ministers on the matter, that:

- “it was always understood” that a conflict of interest existed in respect of the three executives; and
- “appropriate checks and balances” were structured into the decision-making process.

327 The Chairman said that it was “obvious to all concerned” that additional governance processes would have to be in place because:

- the three executives were “the primary asset” being contributed to the project; and
- it was intended that they would (if the bid was successful) transfer from being Airways' employees to being NATS' employees.

328 We have identified those additional processes as being as follows:

- Throughout Airways' involvement, the full Board considered major issues concerning the NATS project.
- The Board used its NATS subcommittee to enhance the level of directorial oversight of the project.
- The Board adopted formal corporate governance arrangements on 21 December 1999, based on the external legal advice of 1 October

1999 and 6 December 1999 and the former General Counsel's advice of 1 December 1999.

329 Those governance arrangements stated that:

- *The Board is entitled to have the full benefit of the information and advice of its three senior executives who have an intimate knowledge of the details in the full knowledge that there is a conflict of interest.*
- *The Board's deliberations and decisions on NATS issues should be made in the absence of the Airways executives.*
- *The Board should obtain independent advice on management incentives.*
- *The Airways representative on the consortium Steering Committee should be subject to an agreement and letter of understanding relating to the procedures to be adopted for consultation on significant commitments.*

330 The Chairman also informed us that, during his meeting with APAX in October 1999, he:

- formed the view that if APAX wished the consortium to offer such incentives they should be considered separately from Airways' own reward for its participation in the project; and
- expected that in due course APAX would send him its proposal for the management incentives (which would still be subject to the agreement of all consortium partners).

331 The Chairman told us he took steps to ensure that APAX should deal with him, and not the three executives, about the incentives.

332 We were also told of a clear understanding between the Chairman and all concerned (which we took to mean the three executives) that they should not talk to APAX or the other consortium partners about management incentives.

Did the Airways' Board deal with the conflict of interest issues in an appropriate and robust way?

333 We considered this question against the background that the Board of Airways:

- identified that the loss of the three executives would be an outcome of a successful bid for NATS, and had addressed that issue by –

- seeking adequate compensation for the loss of the three executives;
 - considering the need for succession planning; and
 - taking steps to ensure the efficient and effective continuation of operations in New Zealand; and
- accepted in principle that the three executives should be rewarded (including by management incentives) for their performance in managing NATS – particularly as the principal financier for the project had made it clear that such incentives would be critical to its investment.

334 We expected that the Board would have used appropriate governance procedures to manage the potential conflicts of interest involved, and to ensure that Airways’ interests were not compromised.

335 In general, we are satisfied that the steps taken by the Board (see paragraph 328) were appropriate and robust. However, we have four specific comments in respect of this issue.

The Board was slow to formally adopt governance arrangements

336 First, we note that the Board did not formally adopt the corporate governance arrangements until its meeting of 21 December 1999. This occurred after the Chairman and Deputy Chairman had sought legal advice on 6 December 1999 and prepared a paper for the Board on the issue.

337 However, the former General Counsel had commissioned legal advice (which identified the potential conflict existing at that time) two months earlier – this advice was given to directors on 1 October 1999. The legal advice also recommended a number of procedures to manage the potential conflict.

338 The Chairman and Deputy Chairman told us that the 1 October 1999 independent legal advice – supplemented by the further legal advice of 1 December 1999 (from the former General Counsel) and 6 December 1999 (from another independent legal firm) – formed the basis of the proposals ultimately adopted by the Board on 21 December 1999 and subsequently implemented.

339 Airways told us that, in its view, the Board had acted between August 1999 and December 1999 in a manner consistent with those proposals. In particular, it said:

- members of the Board had considerable commercial experience;

- the Board had already established (on 3 August 1999), and placed great significance on, its NATS subcommittee to enhance oversight of the project;
- there was regular reporting by executives to both the NATS subcommittee and the Board;
- both the Board and the NATS subcommittee sometimes met in private (i.e. without the three executives) to discuss issues relevant to the consortium transaction;
- the Chairman, the Deputy Chairman, and other directors had ongoing contact with members of the executive not involved in the project; and
- the Chairman visited London in October 1999 to assure himself that the Airways proposal in respect of NATS was “competitive”.

340 Despite the many appropriate actions taken by the Board as described above, with the benefit of hindsight we consider that the Board ought to have formally adopted governance arrangements earlier than it did.

Information about management incentives could have been disclosed to the Board earlier than it was

341 We noted (paragraph 405) that the Chairman was authorised to discuss the NATS project with APAX during October 1999, and that he decided to deal initially with the issue of management incentives himself. The Chairman did not record this decision in writing or convey it to anyone else. The former General Counsel subsequently learned of a specific proposal from APAX and informed the Chairman of it on 20 and 23 November 1999.

342 The Chairman had two opportunities to mention the issue of management incentives to the Board:

- at the Board meeting on 1 November 1999, when the possibility of management incentives existed in principle; and
- on 30 November 1999, by which time he was aware of the specific proposal made by APAX .

343 The Chairman chose not to take those opportunities to mention the proposed management incentives. Instead, he waited until an informal meeting of members of the NATS subcommittee following the full Board meeting on 30 November 1999 (which followed the General Election on 27 November 1999 but preceded the new Shareholding

Ministers taking office). The full Board meeting (without executives present) was informed of the issue during the teleconference on 3 December 1999.

344 The minutes of the Board meeting on 30 November 1999 record that the Board agreed with the scheme proposed by the three executives for Airways' reward – which had been negotiated in London earlier that month – subject to further detail being provided. The scheme met the expectations laid down by the NATS subcommittee on 11 November 1999. We were told that the further information requested by the Board was given on 3 December 1999 during the Board's teleconference.

345 The Chairman's non-disclosure of the proposed management incentives on 30 November 1999 does not appear to have had any material effect on the Board's decision-making. (See Part 5 of this report on the related question of whether the management incentives proposed by APAX were intended to be linked to Airways' reward.)

346 However, the decisions made by the Board on 30 November 1999 and 3 December 1999 had significant consequences, because:

- On 6 December 1999, Airways executives met with officials of CCMAU and the Treasury and presented a draft of the consortium agreement. Draft minutes of the meeting (prepared by Airways) record that the Chief Executive Officer advised CCMAU officials that the consortium agreement was "basically ready to be signed" and that "all major issues had been resolved by the three parties in a satisfactory manner".
- On 13 December 1999, CCMAU advised the Shareholding Ministers on whether they ought to approve Airways' involvement in the consortium.

347 The significance of the Board's decisions on 30 November 1999 was such that we would have expected the information which the Chairman held about the proposed management incentives to have been disclosed to all directors in the interests of fully informed decision-making.

348 We accept that:

- the Chairman's discussion with APAX had been only preliminary and that no specific proposal had been made to him;
- the NATS subcommittee had been informed of the possibility of management incentives on 11 November 1999 when it considered the draft Heads of Terms; and
- between the Board meeting of 30 November 1999 and the teleconference Board meeting of 3 December 1999, the Chairman

consulted with members of the NATS subcommittee (on 30 November 1999) and faxed APAX (on 2 December 1999) rejecting its specific proposal on management incentives.

349 However, with the benefit of hindsight we consider that the Chairman ought to have recorded the result of his meeting with APAX in respect of management incentives – and informed the Board of the APAX proposal – earlier than he did.

The role of the former General Counsel in the negotiations was uncertain

350 In our view, much of the uncertainty which arose over the question of management incentives for the three executives (which we discuss in Part 5 of this report) arose from different perceptions about the role of the former General Counsel in the consortium negotiations. We would have expected that the General Counsel’s role in the negotiations was clearly understood by him, the Board, and the Chief Executive Officer – especially because the three executives had potential conflicts of interest.

351 The Chief Executive Officer and the Chairman both told us that:

- they understood that the role of the former General Counsel in the negotiations would be limited to legal matters, including the drafting of the proposed consortium agreement; and
- the former General Counsel would be subject to instructions by the Chief Executive Officer on all aspects of the negotiations, except in relation to management incentives (which was to be handled by the Chairman).

352 The former General Counsel agreed that he was responsible for legal matters but told us that, because he was a member of the senior executive team of Airways, he understood that his role was also wider than that. Moreover, in his view he was the only member of the negotiating team who was “unconflicted” – which he said APAX recognised when its representative raised the question of management incentives with him (at a meeting on 18 November 1999) without the three executives being present.

353 Part of the role of an in-house counsel is to provide advice directly to the Board where it is necessary and appropriate to do so. When the matter of management incentives was unexpectedly raised with the former General Counsel by APAX, he clearly considered it his duty to report the matter directly to the Chairman. Although he and the Chairman discussed the matter on 22 November 1999, accounts differ over what (if any) explanation the Chairman then conveyed to the

former General Counsel (see paragraphs 517-518). In any event, no written instructions were given at that time.

354 In our view the uncertainty over management incentives could possibly have been averted had:

- the Chairman recorded the result of his discussions with the APAX representative in October 1999, and made that information available to the former General Counsel; and
- the former General Counsel been given written instructions concerning his role in the London negotiations, specifically in respect of the question of management incentives.

The Airways' Board did not obtain independent financial advice on the consortium agreement

355 Finally, we would have expected the Board to obtain independent financial advice on the consortium agreement and the proposed return on Airways' investment. We note in particular that:

- under the consortium agreement as drafted in November 1999, Airways expected to make a substantial equity investment in the consortium;
- the three executives, who negotiated the proposed return on investment on behalf of the Board, had conflicts of interest; and
- the external legal advice dated 1 October 1999 recommended that it would be desirable for the Board to obtain an independent assessment of the transaction from an experienced and independent adviser.

356 The Board did not accept this recommendation, because it considered that the cost of obtaining independent advice on the NATS transaction would more than likely exceed the value to be obtained from it. The Board considered that it would be sufficient for it to act on advice from:

- the three executives, while recognising their conflict;
- the other consortium partners who were “extremely interested and highly commercially focused”;
- the consortium's professional advisers; and
- other sources of independent professional advice if the need arose.

357

The Board expressly adopted this position on 21 December 1999, acting on a recommendation by the Chairman and Deputy Chairman. Their recommendation was based on the external legal advice which they had obtained on 6 December 1999.

4 – Legal and Ethical Obligations to Airways

401 In this part of the report we consider:

- whether the representatives of the Airways' Board, or relevant senior executives, acted with the authority of the Board; and
- whether the Airways' Board, or relevant senior executives, acted in breach of their legal or ethical obligations to Airways in relation to its involvement in the proposed NATS transaction.

Did the representatives of the Airways' Board, or relevant senior executives, act with the authority of the Board?

The Chairman

402 The Chairman visited London during 14-19 October 1999 to meet with advisers, consortium partners and key government officials to discuss the NATS consortium bid.

403 The Board was aware of the need to ensure that it had a clear picture of the negotiating framework for the NATS proposal and the Chairman told us that, with this in mind, he visited London to obtain a personal view of what was happening there. For example, he could:

- determine how Airways was viewed by the consortium partners;
- obtain a feeling for what the consortium partners were looking for; and
- assess the ability of partners to contribute to the consortium;

and then subsequently report this to the Board.

404 The Chairman's impending visit to London was discussed at a NATS subcommittee meeting on 29 September 1999 where the Board was advised of his objectives. The Chairman's London visit was also discussed at a full Board meeting on 1 October 1999. The Board agreed that a recommendation on the financial return to Airways would be put to the Board following the visit.

405 We accept that the Chairman was authorised to discuss the NATS project when visiting London.

Senior Executives

- 406 The Board minutes show that, from the beginning of the NATS project, senior executives provided monthly updates to the Board on the NATS proposal. These updates covered:
- the timing of the proposed NATS sale;
 - briefings on meetings with potential partners and government officials; and
 - various other matters related to the development of the NATS proposal.
- 407 The Board resolved at its meeting on 8 July 1999 that Airways should continue to scope an involvement in NATS. It also requested that senior executives provide the Board with all information necessary to enable the Board to make a decision on proceeding with the bid for NATS at its 1 September 1999 meeting.
- 408 Senior executives subsequently presented a proposal at that meeting and the directors resolved to authorise executive management to proceed to form a consortium to bid for NATS. This authorisation was given subject to:
- *Approval to the proposal by the shareholding Ministers; and*
 - *Directors being further advised as to the financial reward that would be derived by Airways from its contribution to the consortium.*
- 409 Both these conditions were later satisfied. Accordingly, we believe that the three executives always acted with appropriate Board authority.

Did the Airways' Board, or relevant senior executives, act in breach of their legal or ethical obligations?

Board members

- 410 Directors of a company have a number of statutory duties, which are set out in Part VIII of the Companies Act 1993. They include, relevant to this report, duties to:
- act in good faith and in what the director believes to be the best interests of the company (section 131); and

- disclose to the Board the nature and extent of any interest which the director has in a transaction or proposed transaction with the company (section 140(1)(b)).

411 It was alleged in Parliament that “a group of senior executives and board members [of Airways] may be planning to act illegally over an overseas contract” and that one of them stood to benefit personally from the NATS consortium agreement through an “international directorship”.³

412 We are unsure what the reference to an “international directorship” means.

413 However, the consortium agreement signed on 29 February 2000 provided only for each party (including Airways) to appoint one representative to the board of directors of the SPV (see paragraph 211) and, if the bid was successful, acquiring the interest in NATS. The agreement contemplated that the SPV would be a limited liability company incorporated in England and Wales.

414 The Chairman told us that he gave no thought to the SPV directorship during the negotiations and he has no ambitions for the role. We accept that assurance. No evidence exists that the Chairman ever talked to anybody about any gain arising to him from a successful NATS consortium bid. And we are satisfied that the Chairman and other directors were motivated solely by the interests of Airways in relation to the consortium negotiations.

415 We are also satisfied that no other overseas directorship opportunities for Airways directors are foreseeable in respect of the NATS project.

The three executives

416 An employee of a company owes duties of loyalty and good faith to the company. An employee must not put himself or herself in a position where those duties may conflict with any personal interest or obligation to another person.

417 The potential conflicts of interest of the three executives have been identified and discussed in Part 3 of this report. The Board minutes show that the three executives:

- forwarded monthly reports to the Board updating it on progress with the NATS project; and
- had Board authority to progress the NATS project in the way they did.

³ *Hansard* 3 and 11 May 2000.

- 418 Moreover, both the Chairman and the Chief Executive Officer told us that there was a clear understanding that the three executives should not talk to APAX about management incentives.
- 419 In his written advice to the Chairman and Deputy Chairman dated 1 December 1999, the former General Counsel said that the three executives “were being offered”, and were considering, management incentives to a potential value of £10 million. He also told us that the Chief Executive Officer had been involved in drafting the relevant clause of the draft consortium agreement.
- 420 No written evidence was available to us to support the former General Counsel’s assertions. We questioned the Chief Executive Officer on these points and on whether he or his colleagues had breached the “clear understanding” given by the Chairman that they should not talk to APAX about management incentives. The Chief Executive Officer denied receiving any offer of management incentives, and denied any involvement in discussing or drafting the relevant clause of the consortium agreement.

5 – The Proposed £10 million in Management Incentives

- 501 Public reference has been made to management incentives to the value of £10 million, payable to the three executives, in respect of the NATS project. The fourth question in the terms of reference (see page 10) asked us to consider whether incentives of this value were included in the consortium agreement and, if so, on what basis were they offered to and accepted by the Airways' Board.
- 502 The short answer to the question is that the consortium agreement does not contain reference to management incentives of any specified value. The consortium agreement states that, in the event of a successful bid, financial incentives may be provided (at the time of listing) to the senior management and staff of the SPV and the senior management and staff of NATS who are appointed by the consortium. Such incentives must be agreed to by all parties and are also subject to the approval of the parties' respective shareholders (which, in respect of Airways, means the Shareholding Ministers).
- 503 However, because the proposed incentives (in the event of a successful bid) have been the subject of much public speculation and debate, we consider that further comment is desirable.

What incentives were proposed?

- 504 As noted earlier (paragraph 310), incentives for senior management of NATS were first proposed to the Airways' Chairman by a representative of APAX (the primary financier to the consortium agreement) in October 1999.
- 505 APAX made it clear from the outset that it wished substantial performance incentives to be in place for the NATS management team, and that its wish was consistent with its usual mode of operation. APAX believed from its experience that properly structured management incentives can directly contribute to the success or failure of an investment. APAX's incentives were commonly designed in such a way as to avoid the need for the investor to become involved in close management supervision of the investment.
- 506 The Chairman told us that, when the issue of management incentives was first discussed between APAX and himself in October 1999, he agreed in principle to management incentives, but there was no discussion as to detail. As noted earlier in paragraph 330, the Chairman expected that a proposal would be put to him in due course and that Airways would consider the proposal in isolation from the

issue of Airways' own reward for the involvement of its executives in the project.

507 However, a proposal was communicated to the former General Counsel of Airways by the APAX representative in a meeting during consortium negotiations in London on 18 November 1999. (None of the three executives were present during the discussion.) A capped value of £10 million was mentioned, payable to the three executives jointly on successful completion of the business plan.

508 The former General Counsel conveyed the offer to the Chairman by e-mail on the weekend of 20-21 November 1999 (NZ time). The Chairman did not respond to the e-mail, but the former General Counsel contacted him by telephone on 22 November 1999 (NZ time) and discussed the matter. The former General Counsel:

- received on 22 November 1999 (UK time) a written proposal from APAX relating to both the Airways reward and the management incentives; and
- e-mailed this to the Chairman the same day, but the Chairman told us that he had no opportunity to discuss it by telephone before the former General Counsel returned to New Zealand.

509 The Chairman did not discuss the issue further with the former General Counsel. However, after consulting with the NATS subcommittee on 30 November 1999, the Chairman contacted APAX by fax on 2 December 1999 and rejected the management incentives proposal on the basis that the amount proposed:

- was unacceptably high;
- produced an unacceptable consequence of a potential conflict of interest for the three executives; and
- would be politically unacceptable.

510 APAX subsequently confirmed that incentives of this value – payable to the three executives subject to performance in meeting business plan targets – were in its opinion entirely appropriate for the time periods involved and the increases in value sought.

511 We understand that APAX is currently preparing a paper to the other consortium members setting out its approach and recommendations in respect of the proposed incentives. APAX has indicated that its proposal will be independently reviewed by an accountancy firm.

512 Adherence to the formal governance procedures adopted by Airways on 21 December 1999 will ensure Airways takes independent advice in respect of the proposal.

Linkage of management incentives to Airways' reward

- 513 When APAX made its proposal to the former General Counsel on 18 November 1999 (involving management incentives capped at £10 million) there was uncertainty whether this amount was linked with the amount which Airways itself would receive from the venture in the event of a successful bid for NATS and satisfactory implementation of the proposed business plan.
- 514 The former General Counsel advised the Chairman in his e-mail of 20 November 1999 that the two sets of rewards were all available to Airways and that it was up to Airways to decide how it should split its rewards with the three executives.
- 515 In discussion with us, the former General Counsel was adamant that his understanding of the proposal was correct, and that he conveyed it to the Chairman in this form.
- 516 The proposal in its written form referred to both the Airways' reward and the management incentives. It was ambiguous. The former General Counsel understood it to mean that the Airways' reward and the management incentives were effectively a single pool of rewards.
- 517 The Chairman told us that:
- as a result of his earlier discussion with the APAX representative in London in October 1999, he remained of the view that there ought to be no connection between the two sets of rewards; and
 - he had explained this to the former General Counsel during their telephone conversation on 22 November 1999.
- 518 The former General Counsel told us that he received no such explanation.
- 519 We have formed no view on which of the recollections is the more accurate.
- 520 The Chairman conveyed the management incentives proposal to members of the NATS subcommittee on 30 November 1999 and to the full Board on 3 December 1999. The Chairman insisted to us that the APAX proposal had no direct relevance to the question of Airways' reward, or its involvement in the consortium, which the Board had discussed on 30 November 1999.
- 521 The Chairman's expectation was that management incentives would be addressed much later, once Airways' own position was consolidated. He was aware of the proposal conveyed by APAX to the former General Counsel, and it was this proposal which he rejected in his fax

to APAX on 2 December 1999. He had not seen the version contained in the draft consortium agreement, but remained clear in his mind that the two sets of rewards were not linked.

522 Had, in fact, the two sets of rewards been linked, knowledge of the proposal and its detail would have been essential information for the Board when it met on 30 November 1999 to consider the adequacy of the reward negotiated for Airways by the three executives in London earlier that month. The Board would have had to consider whether it could have extracted greater value for itself out of the “pool” of rewards available.

523 However, APAX subsequently confirmed – in conversations with Airways’ legal adviser and correspondence with the Chairman – that the management incentives were intended to be distinct from the reward to Airways.

6 – Severance Arrangements with the Former General Counsel

- 601 The former General Counsel resigned his position on 14 January 2000. The resignation resulted from the settlement of a dispute between him and Airways.
- 602 In determining whether the severance arrangement with the former General Counsel was lawful and made in accordance with the Board’s powers we considered whether:
- the Board took proper advice when negotiating a resolution of the employment dispute;
 - the Board authorised the severance arrangement; and
 - the severance arrangement was consistent with employment law principles.
- 603 The severance arrangement was negotiated on an arm’s length basis, with lawyers acting for both parties. A subsequent report to the Board from Airways’ legal advisers confirmed that the settlement was within the accepted range for cases of this type, and that the litigation risks had been properly considered. The Chairman and Deputy Chairman had been authorised by the Board to oversee the matter on its behalf, and they approved the terms of the settlement before they were accepted.
- 604 We accept that the severance agreement was lawful and was made in accordance with the Board’s powers.
- 605 Under the settlement, the former General Counsel received \$80,500 for loss of earnings, \$80,500 (non-taxable) in compensation under section 40(c)(i) of the Employment Contracts Act 1991, and his legal costs and all outstanding entitlements. Airways made the payments without any admission of liability.
- 606 The remaining issue concerns whether the severance arrangement was made solely, or substantially, with a view to keeping the former General Counsel from disclosing his concerns about the proposed management incentives (i.e. whether it was “hush money”, as has been alleged).
- 607 We believe the answer is no.
- 608 The severance agreement provided that:
- the former General Counsel would remain bound by the confidentiality provisions included in his employment contract with

Airways, and, in particular, that he would not disclose any information held by him in confidence except as directed by Airways or otherwise permitted or required by law; and

- the parties would keep confidential all matters leading up to the settlement, the terms of the settlement, and the contents of the deed of settlement.

609 The documentation shows that both parties clearly wished the settlement to contain a confidentiality clause which would ensure that commercially sensitive information known to the former General Counsel would continue to be protected on the same basis as when he had been an employee of Airways.

610 The reasons for both parties wanting confidentiality are not set out in the documentation we reviewed. However, there is no suggestion that either the severance arrangement or the confidentiality clause were made solely or substantially to stop the former General Counsel disclosing his concerns about the management incentives. In fact, the opposite is true. The barrister acting for the former General Counsel stated that there was nothing in the discussed settlement which “bought” silence.

Appendix – Chronology of Key Events

1998

Airways strategic business review; development of business goal to be part of a major ANS provider alliance grouping.

2 March 1999

Chief Executive Officer presents international strategy to Board.

May 1999

Visit by executives to London to scope the NATS PPP process and assess and appoint adviser.

June 1999

UK Government announces NATS privatisation proposal.

8 July 1999

Board advised of:

- agreement between Airways and Lockheed Martin to form exclusive global partnership; and
- appointment of NM Rothschild and Sons as Airways' financial adviser.

Board agrees that Airways should continue to scope involvement in NATS.

3 August 1999

NATS subcommittee established by Board: membership Chairman, Deputy Chairman and two other directors.

17 August 1999

First meeting of NATS subcommittee.

30 August 1999

NATS project proposal forwarded to CCMAU and the Treasury for analysis.

1 September 1999

Board resolves to authorise executive management to form consortium, subject to shareholder Minister approval and further advice as to financial reward.

17 September 1999

Advice from Minister for SOEs that shareholders were supportive of Airways continuing to develop the NATS proposal, but reserving right to withdraw support at any stage prior to the binding bid being submitted in late 2000.

29 September 1999

Meeting of NATS subcommittee discusses Chairman's proposed visit to London.

30 September 1999

Former General Counsel receives first draft of Heads of Terms for Consortium Agreement. External legal advice on conflicts of interest is commissioned.

1 October 1999

Board is informed of Chairman's impending visit to London. Legal opinion on conflicts of interest is delivered to General Counsel and distributed to members of the Board.

13 October 1999

Minister for SOEs authorises Airways to execute Heads of Terms, subject to conditions to protect Crown's future options, and an understanding that shareholder consultation will occur on the Consortium Agreement itself.

14-19 October 1999

Chairman and Chief Executive Officer attend meetings in London with interested parties. Chairman meets with APAX representatives and discusses principle of management incentives for executives.

1 November 1999

Chairman briefs Board (without executives present) on London meetings. Chairman and Chief Executive Officer meet with CCMAU and the Treasury. Question of loss of three executives discussed, and assurances given.

5 November 1999

Draft Heads of Terms (including reference to possibility of management incentives) forwarded to Shareholding Ministers (subject to further consultation) and further outlining developments on the potential developments of the NATS consortium.

11 November 1999

NATS subcommittee meets and considers draft Heads of Terms, which refers to management incentives, and advice prepared by former General Counsel. Subcommittee decides on minimum Airways' reward for negotiation purposes.

17 November 1999 (UK time)

Meeting between Airways executives (including former General Counsel) and APAX in London to discuss Airways reward under consortium agreement. Agreement reached; meets expectations of NATS subcommittee. No discussion of management incentives.

18 November 1999 (UK time)

Meeting between General Counsel, APAX and various lawyers. Management incentives are discussed.

19 November 1999

Minister responds to Airways letter of 5 November 1999; indicates that Ministers would like to be given the opportunity to consider the Consortium Agreement prior to its execution.

20 November 1999(NZ time)

E-mail from General Counsel to Chairman updating the Chairman on the discussions on 17 and 18 November 1999.

22 November 1999 (NZ time)

Telephone conversation between former General Counsel and Chairman.

22 November 1999 (UK time)

Former General Counsel receives a written draft of a proposal from APAX about management incentives.

23 November 1999 (NZ time)

Further e-mail from General Counsel to Chairman, including written draft of APAX proposal on management incentives.

27 November 1999

General Election takes place.

30 November 1999

Presentation by the three executives to the Board of the terms of Airways' reward. On the basis of the data provided, the Board agrees with the scheme proposed subject to a further paper being prepared by the executive containing further details of the proposal – and, in particular, the different financial scenarios for Airways. At the meeting the Chairman also calls a further meeting of the Board to be held by teleconference, with the purpose of the meeting to discuss various issues concerning Airways participation in NATS.

30 November 1999

Board briefs CCMAU and Treasury officials on NATS project. An informal meeting of the NATS sub-committee then takes place (without executives present); issue of management fees discussed. The sub-committee instructs the Chairman to reject the APAX proposal.

1 December 1999

General Counsel prepares a legal opinion for the Chairman and Deputy Chairman concerning conflicts of interest.

2 December 1999

Chairman sends a fax to APAX rejecting management incentive proposal and suggests that the management incentive clause in the consortium agreement be reworded to state that incentives would be agreed by all parties and their respective shareholders, subject to the bid being successful.

3 December 1999

Board meeting held by teleconference (in absence of executives), which discussed further advice provided by the executive on the Airways' reward, the General Counsel's memo to the Chairman and Deputy Chairman on conflicts of interest, and management incentives.

6 December 1999

Airways officials meet with CCMAU and the Treasury to discuss draft consortium agreement. Copy of draft, described in draft minutes as “basically agreed”, is provided.

6 December 1999

Chairman and Deputy Chairman seek further external legal advice on governance issues and conflicts of interest. Meeting with former General Counsel follows.

9 December 1999

New Shareholding Ministers take office.

13 December 1999

CCMAU advised the Shareholding Ministers on whether they ought to approve Airways’ involvement in the consortium.

16 December 1999

Deputy Chairman prepares memorandum for the Board on corporate governance issues.

21 December 1999

Board meeting, at which the corporate governance recommendations set out in memorandum prepared by the Deputy Chairman are adopted.

23 December 1999

Airways receives a letter from the Minister for SOEs requesting Airways to withdraw from the NATS project as soon as possible.

14 January 2000

Former General Counsel resigns from position at Airways.

19 January 2000

Meeting between the Minister for SOEs and the Deputy Chairman and Chief Executive Officer, to discuss a revised proposal for Airways’ involvement in the NATS consortium.

25 January 2000

Letter from the Minister for SOEs to Airways confirming that provided Airways involvement in the Consortium is confined to a genuine consultancy basis, then the decision on whether to participate is a matter for the Board. This is subject to the Board only proceeding with offshore ventures if it is satisfied that resources will not be diverted to such an extent that Airways’ New Zealand business could be compromised.

29 February 2000

Consortium agreement signed by Airways, Lockheed Martin, and APAX.