Airports (Ownership - Interests in Shares) Amendment Regulations 2002 (No. 1) 2002 No. 82

EXPLANATORY STATEMENT

Statutory Rules 2002 No. 82

Minute No. 2002/13 of 2002 - Minister for Regional Services, Territories and Local Government

Subject: *Airports Act 1996*

Airports (Ownership - Interests in Shares) Amendment Regulations 2002 (No. 1)

Section 252 of the *Airports Act 1996* (the Act) provides that the Governor-General may make regulations prescribing matters that are required or permitted by the Act to be prescribed or that are necessary or convenient to be prescribed for carrying out or giving effect to the Act.

The Act imposes limitations on the ownership of leased Federal airports by airlines and foreign persons, and on the cross-ownership of certain airports. The ownership rules of the Act are set out in Part 3 of the Act and the Schedule to the Act.

Paragraph 9(1)(c) of the Schedule provides that, for the purposes of the ownership provisions, an interest of a prescribed kind in a share, being an interest held by such persons as are prescribed, must be disregarded.

The purpose of the *Airports (Ownership - Interests in Shares) Amendment Regulations 2002* (the Regulations) is to provide for exemptions to be obtained from the foreign ownership provisions, airline ownership provisions and cross ownership provisions of the Act by allowing for certain interests in shares to be prescribed for the purposes of paragraph 9(1)(c).

The Regulations provide for the following exemptions from the ownership provisions:

Foreign-managed Investment funds

The Regulations provide a mechanism whereby the trustee or manager of a partly foreign owned investment fund [Fund A] can seek a declaration that the fund be regarded as a substantially Australian investment fund if foreign persons hold less than 40% of the beneficial interests in the capital and income of the fund. If this occurs, the interest of the trustee or manager is disregarded for the purposes of the foreign ownership provisions of the Act. The amendment allows a similar test to be applied to a trustee of another investment fund [Fund B] which has invested in Fund A before applying the test to Fund A. In other words, in determining the percentage interest which foreign persons have in Fund A, the trustee of Fund B could be treated as not being a foreign person if foreign persons have beneficial interests of less than 40% in Fund B.

This rule can only be applied once - in other words, if there is a foreign trustee who has an interest in Fund B, 100% of their interest will be regarded as foreign.

Agents

The Regulations seek to ensure that interests in shares held by depositories, custodians and nominees are disregarded, so that if a foreign nominee holds a stake in an Airport Operator Company (AOC) on behalf of an Australian investor, these shares are not counted as "foreign".

Indirect interest-holder

The Regulations disregard an interest existing as a result of the interest-holder being a shareholder in a company (other than the AOC or a holding company) which is not a foreign person within the meaning of the *Foreign Acquisitions and Takeovers Act 1975.* This limits the application of the multiplier in clause 12(5) of the Schedule to the Act.

Holding companies holding the interest in an AOC on behalf of a consortium of investors

The Regulations provide for the use of a double holding company structure to hold the underlying interest in an AOC where the sole purpose of the double holding company is to hold 100% direct control interests in a first holding company which in turn is being used to hold 100% direct control interests in the AOC. This is a direct extension of the rules for a single holding company contained in Clause 14 of the Schedule to the Act.

Australian associate of a foreign person - avoidance of double counting

The Regulations seek to disregard an Australian's interest in the AOC, for the purposes of calculating the total interest of a group of foreign associates, to the extent that the Australian's interest would be counted more than once as part of the interests of the group of foreign associates. This provision complements clause 11(3) of the Schedule.

Australian associate of a foreign person - no action in concert

The Regulations disregard the interests of foreign associates of an Australian person provided the Australian person is not directly or indirectly controlled by a foreign person, acting in concert with a foreign person or accustomed or under an obligation to act in accordance with the wishes of a foreign person.

Associate of an airline - no action in concert

The Regulations allow parties to be treated as irrelevant associates for the airline ownership provisions [ie so that their respective direct control interests are not taken into account in each other's stakes] if they are not related entities, acting in concert or accustomed or under an obligation to act in accordance with each other's wishes.

Associate for the cross ownership limits - no action in concert

The Regulations allow parties to be treated as irrelevant associates for the cross ownership provisions [ie so that their respective direct control interests are not taken into account in each other's stakes], if they are not related entities, acting in concert or accustomed or under an obligation to act in accordance with each other's wishes and they are not both airport operator entities.

The Regulations commenced on gazettal.

Authority: Section 252 of the *Airports Act 1996*

ATTACHMENT

Airports (Ownership - Interest in Shares) Amendment Regulations 2002 (No. 1)

Item 1 - Name of Regulations

Item 1 provides for the name of the Regulations.

Item 2- Commencement

Item 2 provides that the Regulations commence on gazettal.

Item 3 - Amendment of Airports (Ownership - Interests in Shares) Regulations

Item 3 (1) provides that Schedule 1 of the Regulations amends the *Airports (Ownership - Interests in Shares) Regulations 1996* and item 3 (2) provides that Schedule 2 of the Regulations amends those regulations as amended by Schedule 1.

Proposed Schedule 1 - Amendments

Item [1] - Subregulation 3(1), definition of *investment fund,* paragraph (b)

Item 1 corrects a spelling error in the subregulation.

Item [2] - Part 2, heading

Item 2 amends the heading of Part 2 to read "Foreign Ownership".

Item [3] - Regulation 5, heading

Item 3 amends the heading of regulation 5 to read "Purpose of Part 2".

Item [4] - Regulation 5

Item 4 amends regulation 5 to make reference to the Schedule to the Act.

Item [5] - After regulation 5

Item 5 inserts proposed regulation 5A, 5B, 5C and 5D.

Proposed regulation 5A

The regulation extends the rules for a single holding company contained in Clause 14 of the Schedule to the Act to a double holding company structure.

Proposed regulation 5B

The regulation disregards an interest existing as a result of the interest-holder being a shareholder in a company (other than the Airport Operator Company or a holding company) which is not a foreign person within the meaning of the *Foreign Acquisitions and Takeovers Act 1975.* This limits the application of the multiplier provision in clause 12(5) of the Schedule to the Act.

Proposed Regulation 5C

The regulation disregards the interests of foreign associates of an Australian person provided the Australian person is not directly or indirectly controlled by a foreign person, acting in concert with a foreign person or accustomed or under an obligation to act in accordance with the wishes of a foreign person.

Proposed Regulation 5D

The regulation disregards an Australian's interest in the AOC, for the purposes of calculating the total interest of a group of foreign associates, to the extent that the Australian's interest would be counted more than once as part of the interests of the group of foreign associates. This provision complements clause 11(3) of the Schedule to the Act.

Item [6] - Regulation 6

Item 6 amends the regulation for drafting consistency.

Item [7] - Subregulation 7 (1)

Item 7(1) amends the subregulation for drafting consistency.

Item [8] - After subregulation 7(3)

Item 8 inserts subregulation 3A.

The Regulations currently provide a mechanism whereby the trustee or manager of a partly foreign owned investment fund [Fund A] can seek a declaration that the fund be regarded as a substantially Australian investment fund if foreign persons hold less than 40% of the beneficial interests in the capital and income of the fund. If this occurs, the interest of the trustee or manager is disregarded for the purposes of the foreign ownership provisions of the Act.

The amendment allows a similar test to be applied to a trustee of another investment fund [Fund B] which has invested in Fund A before applying the test to Fund A. In other words, in determining the percentage interest which foreign persons have in Fund A, the trustee of Fund B could be treated as not being a foreign person if foreign persons have beneficial interests of less than 40% in Fund B.

This rule can only be applied once - in other words, if there is a foreign trustee who has an interest in Fund B, 100% of their interest will be regarded as foreign.

Item [9] - After Part 2

Item 9 inserts Part 2A to deal with "Agents".

Regulation 7A describes the purpose of the part.

Regulation 7B seeks to ensure that interests in shares held by depositories, custodians and nominees are disregarded, so that if a foreign nominee holds a stake in an Airport Operator Company on behalf of an Australian investor, these shares are not counted as "foreign".

Item [10] - Part 3, heading

Item 10 substitutes the heading with the heading "Airline Ownership".

Item [11] - Regulation 8

Item 8 inserts a purpose provision for Part 3.

Item [12] - Regulation 9
Item 12 amends the regulation for drafting consistency.

Item [13] - Subregulation 10 (1)

Item 13 amends the subregulation for drafting consistency.

Item [14] - Subregulation 10AA (1)

Item 14 amends the subregulation for drafting consistency.

Item [15] - Subregulation 10AA (2)

Item 15 amends the subregulation for drafting consistency.

Item [16] - After regulation 10AA

Item 16 inserts a proposed regulation 10AAA in Part 3.

The regulation allows parties to be treated as irrelevant associates for the airline ownership provisions [ie so that their respective direct control interests are not taken into account in each other's stakes] if they are not related entities, acting in concert or accustomed or under an obligation to act in accordance with each other's wishes.

Item [17] - Part 3A, heading

Item 17 substitutes the heading with the heading "Cross-ownership".

Item [18] - Regulation 10A, heading

Item 10 inserts a purpose provision for Part 3A.

Item [19] - Regulation 10A

Item 4 amends regulation 10A to make reference to the Schedule to the Act.

Item [20] - After regulation 10A

Item 20 inserts proposed regulation 10AB.

The regulation allows parties to be treated as irrelevant associates for the cross ownership provisions [ie so that their respective direct control interests are not taken into account in each other's stakes], if they are not related entities, acting in concert or accustomed or under an obligation to act in accordance with each other's wishes and they are not both airport operator entities.

Item [21] - Regulation 10B

Item 21 amends the regulation for drafting consistency.

Item [22] - Regulation 10C

Item 22 amends the regulation for drafting consistency.

Proposed Schedule 2 - Amendments

Item [1]

Item 1 renumbers the existing parts as set out in the table.

Item [2]

Item 2 renumbers each regulation as set out in the table.

Item [3]

Item 3 amends references contained in headings and provisions, which may have been effected by the Schedule 1 amendments, to part numbers.

Item [4]

Item 4 amends references in provisions, which may have been effected by the Schedule 1 amendments, to regulations.

REGULATION IMPACT STATEMENT

Airports (Ownership - Interest in Shares) Amendment Regulations 2002 (No. 1)

BACKGROUND

The *Airports Act 1996* (the Act) specifies restrictions on the ownership of Airport Operator Companies which includes both Airport Lessee Companies and Airport Management Companies.

Foreign Ownership

Pursuant to s.40 of the Act, an unacceptable foreign ownership situation will exist in relation to an AOC where the total **stakes** of **foreign persons** in the company exceeds 49%.

For the purposes of the 49% restriction, a foreign person is defined in the Schedule to the Act to include, inter alia, a foreign citizen not ordinarily resident in Australia as well as a company in which foreign stakes exceed 15% for individual foreign citizens or companies, or 40% for the aggregate of the stakes of foreign interests and companies.

Unlike the Foreign Acquisitions and Takeovers Act, all foreign shareholdings (including those below the 15% / 40% thresholds) are counted towards the foreign ownership limit.

Policy intention of the Foreign Ownership limits

Quite simply, the foreign ownership restrictions operate to ensure majority Australian ownership of Federal Airports.

Cross Ownership

Pursuant to s.50 of the Act, an unacceptable cross ownership situation will exist in relation to a pair of airport operator companies (the ALC or AMC for the first company [ie either Brisbane, Melbourne or Perth] and the ALC or AMC for the second company [ie Sydney]) and in relation to a particular person if the person holds:

(a) a particular type of stake in the first company of more than 15%; and

(b) any type of stake in the second company of more than 15%.

Policy intention of the Cross Ownership limits

The cross-ownership restrictions of the Act ensure separate ownership and control of Sydney Airport from the other major airports (Melbourne, Brisbane and Perth).

The policy underpinning this requirement of diversity of ownership is to ensure that airport operator companies continue to facilitate innovative management and greater local involvement in the operation and development of their airport. Through encouraging competition between airports in a strongly growing market, the Government can expect airport users and the economy more broadly to benefit from the productivity gains achieved from the separate ownership of Sydney Airport from Melbourne, Brisbane and Perth Airports.

Airline Ownership

Section 44 of the Act states that an unacceptable airline ownership situation exists if an airline holds a particular type of stake in an AOC of more than 5%.

Policy intention of the Airline Ownership limits

The airline ownership restrictions are designed to ensure that major airlines are not able to wield significant influence on airports of related ownership to influence the airport's future directions in ways which reduce, or have the capacity to reduce competition in the aviation industry. This is particularly important at Sydney Airport for example where, due to physical constraints associated with the limited size of the site, options for future facilities development may conceivably have different impacts on individual airline users.

The policy intent of all the ownership provisions of the Act was to give broad operation to the ownership definitions. In an effort to minimise the opportunity for avoidance, the definitions and explanations for the terms used in the ownership provisions such as "associate", "foreign person", "entitled to acquire", "interest in a share" and "direct control interests" have been widely cast.

OWNERSHIP DEFINITIONS

Stakes

A "stake" is defined in the schedule to the Act as the aggregate of the direct control interests the person has in the AOC plus the direct control interests "associates" of the person have in the AOC.

Direct Control Interests

There are four types of **direct control interests** namely, total paid-up share capital, voting power, rights to distribution on a winding-up and rights to distributions otherwise than on winding-up.

Multiplier provisions

There are also multiplier provisions in the Schedule to the Act for calculating stakes where interests are traced back through higher tiers of the shareholding chains.

Associates

A person's stake of any type is the aggregate of its interests and those of its **associates**. Therefore, a person will have a stake which includes any direct control interests held by its **associates** even if it holds no shares itself.

Associates of a person are very broadly defined to include, inter alia, officers of a company (and companies of which the person is an officer), employees and employers. It also includes a company in which the person has a stake of at least 15% (and if the person is a company, any person having a stake of at least 15% in it) and persons who are acting together in relation to particular types of voting and board control. Associates of associates are also deemed to be associated. For example, if company A and company B both have stakes of at least 15% in company C, not only will companies A and B be associates of company C, the will also be associates of each other.

Foreign persons

The Act defines a foreign person as a foreign citizen not ordinarily resident in Australia or a company where one foreign citizen/company owns more than 15% or a number of foreign citizens/companies own more than 40%.

The tenor of the ownership policy is that if you touch upon one aspect of a definition/concept, however lightly or remotely, the definition/concept will apply.

Clause 9(1)(c) of the Schedule to the Act however provides that, for the purposes of the ownership provisions, an interest of a prescribed kind in a share, being an interest held by such persons as are prescribed, must be disregarded. This paragraph was deliberately included in the Act in recognition that the widely cast definitions of the ownership provisions may give rise to restrictions on Airport ownership beyond that which was intended.

The regulations effectively provide for exemptions to be obtained from the foreign ownership provisions, airline ownership provisions and cross ownership provisions of the Act by allowing, pursuant to Clause 9(1)(c), for certain interests in shares, to be disregarded for the purposes of the ownership provisions.

ISSUES

In the 2001 sale process for Sydney Airport, bidders raised various issues about the interaction between their proposed ownership structures and the ownership provisions of the Act. The Department of Transport and Regional Services considered these matters in the light of Government policy and the original intention of the ownership provisions. The Department formed the view that some of the proposed structures were consistent with the policy objectives of the Act but that it was desirable to make regulations to ensure they could not be argued to technically breach one or more of the ownership provisions.

Accordingly regulations were drafted to clarify some of these issues.

OBJECTIVES

The Regulations are designed to address a number of technical issues associated with the ownership provisions of the Act.

These include:

- Ensuring that certain groups are not unintentionally caught by the foreign ownership provisions such as nominee companies and agents, and foreign-owned fund managers of Australian investment funds; and

- Facilitating the administration of all the ownership limits such as refining the effect of the definition of an associate.

The ownership provisions should not restrict investment by persons who are not in a substantive sense "associated" with a foreign person, an airline or a "paired" airport.

THE REGULATIONS AND ALTERNATIVE OPTIONS

The following describes each regulation, provides information on the rationale for each regulation and discusses alternative options.

Foreign managers/trustees of upstream investment funds in two tiered funds structures where foreign persons hold a beneficial interest in less than 40% of the capital and income of the upstream funds.

Regulation 7 of the *Airports (Ownership - Interest in Shares) Regulations 1996* allows a foreign fund manager where less than 40% of the beneficial interest in the fund is held by foreign persons effectively to be treated as an Australian rather than a foreigner. This is consistent with foreign ownership policy which requires majority Australian ownership of airports. Without

regulation 7 the definition of foreign person would mean that shares held for many large Australian Superannuation and investment funds would be classified as foreign because the manager or trustee is either partly or wholly owned by a foreign person.

This regulation does not currently treat a foreign managed fund within a tiered fund structure, where the upstream fund(s) are also foreign managed (and with other foreign investors hold more than 40% of the downstream fund), as `substantially Australian'. This will be the case even if all the upstream funds held or were eligible to hold `substantially Australian' declarations in their own right. This is because the foreign fund manager of the upstream fund(s) will be taken to hold a beneficial interest in the downstream fund and the substantially Australian declaration does not remove the `foreign' character of the fund manager [as opposed to its interests in shares].

The amended regulation intends to provide a level of flexibility in determining the ultimate beneficiaries in the case of a tiered trust structure. However it operates only once - ie if there are more than 2 funds in the structure it only operates in respect of the second fund and would not apply to subsequent upstream funds.

The only alternative option is to not make the regulation. However, this has the following implications:

Ø Excluding certain foreign managers/trustees of Australian sourced funds the opportunity effectively to be treated as an Australian investor may prevent many small Australian investors having an indirect shareholding in Federal Airports. For example it will be much harder for these funds to obtain allocation as part of the foreign component of the shareholdings compared with the Australian component of the shareholdings because they will be competing against a large number of very big foreign investors for a limited volume of stock (constrained by the foreign ownership limit of 49%.

Ø Proceeds from the sale of Sydney Airport may be much lower by excluding certain foreign managers of Australian funds from the domestic component of the offer. The sale of Telstra estimated that 43% of the domestic institutional market (including 3 of the top 5 fund managers) would be classified as foreign persons as defined in the Act*.* Many of these managers would manage within a tiered fund structure and without the regulation would be ineligible to partake in the domestic component of the sale.

A depository, custodian or nominee holding an interest in shares on behalf of investors.

The regulation disregards the interests of custodians, depositories and nominees for the purposes of all the ownership provisions (ie the airline-, foreign- and cross-ownership restrictions) provided they do not have any rights in respect of the share beyond that which is usually attached to such a position.

This treatment of custodians, depositories and nominees is consistent with Corporations Law and the *Telstra (Ownership - Interest in Shares) Regulations 1997.*

Depositories, custodians and nominees hold legal title to property for and at the direction of their beneficial owners. They have no substantive interest in the property but, because an interest in a share is defined in the Act to include, inter alia, any legal or equitable interest in the share (and various powers which nominees are likely to have such as exercising votes on behalf of beneficiaries), they may technically have an interest in shares held by them in their capacity as custodian, depository or nominee.

The regulation is being made for all the ownership limits. So if an airline, a foreign person, a "paired airport" or an associate of any one of them are custodians or depositories for, or nominees of another person, their interest in the share will be disregarded provided the

custodian or depository or nominee does not hold any beneficial interest in the shares or have any authority, by proxy or any other arrangement with the holder of the beneficial interest, to exercise in a discretionary way the voting rights attached to the share.

The alternative option is not to make the regulation. Failure to make the regulation may mean that many Australian investors could have their shares classified as "foreign" in the event they hold shares in a name of a nominee who is a foreign person.

Interests held in companies except those regarded as foreign under the Foreign Acquisitions and Takeovers Act 1975.

This regulation, based on regulations 11 and 20 of the *Telstra Corporation (Ownership - Interest in Shares) Regulations 1997* deals with disregarding interests held in companies except those regarded as foreign under the *Foreign Acquisitions and Takeovers Act 1975 (FAT Act).* Under the *FAT Act,* a company in which the interest of foreign persons is at least 15% individually or at least 40% in aggregate is considered to be a foreign person.

The regulation provides that a person's interest in a share is disregarded if the interest exists solely as a result of the person being a shareholder in a company which is a) upstream from an Airport Operator Company (AOC) or a holding company, and b) not a foreign person within the meaning of the *FAT Act.*

Subclause 12(5) of the schedule to the Act contains a "multiplier" provision. This provision says that if any foreign person has any interest in any company that has a stake in an AOC, that foreign person has a stake in the AOC equal to the multiple of the foreign person's percentage interest in the company times the company's percentage in the AOC.

The effect of this multiplier provision can be illustrated in the following example. Suppose foreigners own 10% of Domestic Company A and Domestic Company A has a 50% direct control interest in Sydney Airport Corporation Limited (SACL) as indicated in the following diagram, foreigners would be taken to have a 5% stake in SACL for the purpose of determining the level of foreign ownership of SACL. This will be the case even though Domestic Company A is not a foreign person within the meaning of the *FAT Act.*

10%

50%

Moreover this process not only occurs at one level above an AOC but potentially at multiple levels (so if Domestic Company C owns shares in Domestic Company B which owns shares in Domestic Company A which owns shares in SACL and Domestic Company C has foreign shareholders, a multiplied foreign interest in SACL would result).

The regulation disregards an interest existing as a result of the interest-holder being a shareholder in a company other then an AOC or holding company that is not a foreign person within the meaning of the *FAT Act.* As noted above, the regulation is consistent with the approach to foreign ownership adopted in the *Telstra Corporation (Ownership - Interest in Shares) Regulations.* The regulation streamlines the administration of the foreign ownership limits that apply to AOCs because companies routinely consider whether they are foreign for *FAT Act* purposes.

Note that the interest will still be taken into account to determine whether or not the relevant upstream company is a foreign person for the purposes of the *FAT Act.*

The alternative option is to not make the regulation. In practice it is difficult to trace foreign interests back to their origins where an Australian company exists in the ownership chain. Not

making the regulation will continue to make the administration of the foreign ownership limits that apply to Airport Operator Companies difficult. This is because it is difficult for AOCs to identify foreign ownership of upstream companies which are not considered foreign under the *FAT Act.*

Holding companies holding the interest in an AOC on behalf of a consortium of investors.

The regulation provides for the use of double holding company structures to hold the underlying interest in an AOC. This is to ensure that the second holding company will be taken not to be a foreign person or an associate of a foreign person if the proposed ownership structure is characteristically similar to a single holding company structure to which Clause 14 of the Schedule to the Act applies.

Clause 14 provides for the existence of a holding company which exists solely for the purpose of holding all the shares in an AOC.

Clause 14 is necessary in any situation where a single foreign person has a 15% or more stake or if foreign stakes in aggregate exceed 40% in the holding company. This is because the holding company itself would be regarded as a foreign person (in accordance with the definition of foreign persons in the Act) and foreign persons would be deemed to hold a stake in the AOC equivalent to that held by the holding company [i.e. 100%].

Similarly, if a single foreign person holds a 15% or greater stake in the holding company, the holding company will be regarded as an *associate* of the holding company (in accordance with the definition of associates in the Act) and the foreign person will be deemed to have a stake in the AOC equivalent to that held by the holding company.

Bidders for SACL have raised the question of whether Clause 14 will work where a double holding company structure is used.

The regulation puts this matter beyond doubt. The regulation is being implemented to give certainty to bidders where a double holding company structure is proposed. It is common practice for companies to use such a structure.

As noted above, the regulation provides that the second holding company will be taken not to be a foreign person or an associate of a foreign person only if it is characteristically similar to a single holding company structure to which Clause 14 applies. That is, it is being used simply to hold 100% of direct control interests in the first holding company which in turn is being used to hold 100% direct control interests in the AOC.

It should be noted that while the regulation disregards the interest of foreign persons for determining the "foreigness" of the holding companies, foreign interests in the second holding company or any other upstream companies will still be taken into account for the purposes of determining foreign stakes in an AOC. For example, if a foreign investor has a 20% interest in the second holding company, they will be taken to have a 20% interest in the AOC but not a 100% interest in the AOC.

The alternative is to not make the regulation. Failure to make the regulation may mean that second holding companies in a double holding company structure may be regarded as a foreign person or an associate of a foreign person. This has significant implications. Bidders for Sydney Airport proposing such a structure may take the view that their bid does not comply with the foreign ownership provisions and spend significant time and expense on restructuring. Alternatively they may pull out of the sales process altogether, potentially jeopardising the commercial success of the sale despite their proposed structures meeting the intention of the ownership policy.

Double counting the interests of foreign associates of an Australian.

The regulation is a technical amendment being made to ensure that Subclause 11(3) of the Schedule operates effectively for the purposes of determining foreign ownership levels of an AOC. It is being made to put the Government's position on "double counting" of shares beyond doubt.

The ownership restrictions are intended to operate in such a way that interests are not "double counted". Because a person's stake in the AOC includes the stake of their associates, if an Australian person holds 10% of the shares in a company and has a foreign associate who does not hold any shares in the company or who has an interest in the same shares as the Australian person, the intention is that foreign persons will be taken to have a 10% stake in the company not a 20% stake. Subclause 11(3) of the Schedule to the Act is intended to have this effect. Subclause 11(3) refers to a group of foreign persons and does not specifically deal with an Australian person who may be an associate of a foreign person. This regulation is intended to put beyond doubt the position of an Australian associate of a foreign person and ensure that they are treated in the same way as a group of foreign persons.

The regulation is based on regulations 15 and 24 of the *Telstra Corporation (Ownership - Interest in Shares) Regulations 1997*. It provides greater administrative certainty to determining the level of foreign ownership of the AOC.

The alternative is to not make the regulation. The implication of this is that there could be double counting of an interest in an AOC flowing from foreigners being associates of an Australian. This may in turn hinder the Government's ability to accurately determine the true level of Australian interest in the AOC.

Associates in the event that their association with an airline, a foreign person or another airport is not substantive.

The associates provisions of the Act are very broadly defined. Read literally they would treat "co-investors" in a company as associates if each co-investor held more than 15% of the company, even in the absence of any substantive associations between them (eg if one controlled the other).

Co-investment of 15% or more in *any* company would create associations between co-investors, leading for example to a need for co-investors to aggregate their SACL holdings for the cross-ownership and airline ownership provisions.

The effect of these provisions raises issues for each of the three ownership limits but the policy issues arising are different for each type of ownership limit. The regulations reduce unintended consequences of the wide associate provisions of the Act by defining more clearly the circumstances in which parties will be regarded as being associated for each of the particular ownership limits.

Foreign Ownership

As noted above the associates provisions of the Act are so broad that they could inadvertently pick up the stakes of irrelevant foreign associates of Australian investors in an AOC for the purposes of determining the foreign ownership level in an AOC.

An example of a situation which may arise in connection with the broad definition of associates is as follows:

Company A is an Australian Company which has an interest in an AOC. However Company A is an associate of Company B, a foreign person, because both companies have a 15% or greater

investment in Company C. Company B's stake in the AOC will be equal to Company A's stake in the AOC. If Company A has 15% stake in the AOC, a foreign persons (Company B) will be taken to have a 15% stake in the AOC. If Company A's stake in the AOC exceeds 49%, an unacceptable foreign ownership situation will result.

This will be the case regardless of any substantive association between the two companies (ie if one company controlled the other).

Another implication of the broad definition of associates for the foreign ownership limits is as follows. Under a literal reading of the definition of foreign person in Clause 2 of the Schedule to the Act, there are unintended consequences which result in a foreign person being taken to have a stake in the Airport Operator Company. This occurs if an Australian company has invested 15% or more in a company incorporated oversees which itself has invested 15% or more in another company. The company incorporated overseas while not a foreign person pursuant to the Act is a foreign company by virtue of it being incorporated overseas. However the company in which the foreign company invests will be taken to be a foreign person because a foreign company has an investment in it of at least 15% (see definition of foreign person under Clause 2 of the Schedule to the Act). Because the interests involved are at least 15% all three companies will be taken to be associates and any investment in the AOC of the Australian Company will result in foreign persons having a stake in the AOC.

Accordingly, for the foreign ownership provisions, the regulation disregards the interests of foreign associates of an Australian person provided the Australian person is not directly or indirectly controlled by a foreign person, acting in concert with a foreign person or accustomed or under an obligation to act in accordance with the wishes of a foreign person.

The alternative is to not make the regulation. It is likely that the proposed structures of the various consortia bidding for SACL may contain members who have 15+% co-investments with foreign persons in irrelevant companies, such that if the co-investing consortium members were for that reason to be treated as associates, they would together be precluded from holding more than 49% of SACL. The real risk is that some Australian companies investing in SACL will not be eligible to make up the domestic equity component of the sale but rather forced to be part of the foreign equity component of the sale and therefore limited in their investment (by the 49% foreign ownership limit).

Airline Ownership

For the airline ownership provisions, the regulation will disregard an interest in a share for the purposes of the airline ownership provisions where, after being counted for the purpose of determining the direct control interests held by the person (the primary interest holder) in an AOC, the interest would, in the absence of this regulation, be counted for the purpose of determining the size and type of stake held by an irrelevant associate (who is an airline).

For example, Company A and Company B (an airline) are associates of each other because they both hold more than 15% in Company C. In the absence of the regulation, Company A and Company B would be limited to a 5% in aggregate stake in an AOC. In other words, in determining what stake an airline (Company B) has in the AOC, its direct control interests in the AOC are counted plus the direct control interests of its associate (Company A).

For the airline ownership limits, the regulation allows parties to be treated as irrelevant associates for the airline ownership provisions [ie so that their respective direct control interests are not taken into account in each other's stakes] if they are not related entities, acting in concert or accustomed or under an obligation to act in accordance with each other's wishes.

The alternative is to not make the regulation. It is conceivable that the proposed structures of the various consortia bidding for SACL may contain members who have 15+% co-investments

with airlines in irrelevant companies, such that if the co-investing consortium members were for that reason to be treated as associates, they would together be precluded from holding more than 5% of SACL.

Cross Ownership

For the cross-ownership provisions, the regulation disregards an interest in a share where, after being counted for the purpose of determining the direct control interests held by the person (the primary interest holder) in an AOC (eg Sydney), the interest would in the absence of this regulation be counted for the purpose of determining the size and type of stake held by an irrelevant associate who holds an interest in an AOC which is paired with the AOC in which the primary interest holder has a stake (in this case, Melbourne, Brisbane, or Perth).

For example, Company A and Company B, are associates of each other because they both hold more than 15% in Company C. In the absence of the draft regulation, Company A and Company B would be limited to a 15% in aggregate stake in a Sydney Airport, if one or the other also had a greater than 15% stake in a "paired" Airport to Sydney Airport (ie Melbourne, Brisbane or Perth). In other words, if Company A had greater than 15% stake in Brisbane Airport, because Company A and Company B are associates they will be limited to 15% in aggregate stake in Sydney Airport.

Thus the regulation also allows parties to be treated as irrelevant associates for the cross ownership provisions [ie so that their respective direct control interests are not taken into account in each other's stakes], if they are not related entities, acting in concert or accustomed or under an obligation to act in accordance with each other's wishes and they are not both airport entities.

For the cross-ownership provisions it should be noted that the Regulations still operate to pick up associations where both parties (co-investors) are airport entities.

The alternative is to not make the regulation. The proposed structures of the various consortia bidding for SACL however appear likely to contain members who have 15+% co-investments in non-airport related companies, such that if the co-investing consortium members were for that reason to be treated as associates, they would together be precluded from holding more than 15% of SACL if one or other or both of the co-investors holds more than 15% of a "paired" airport (Melbourne, Brisbane, Perth).

<u>OTHER ISSUES</u>

Impact of Regulations on stakeholders

It is expected that the Regulations will only impact on companies proposing to invest in Airport Operator Companies (ie this may include airlines, but not in any operational sense) and more immediately bidders for Sydney Airport. For most stakeholders, including airlines, air traffic control service providers, businesses operating at the airport, the travelling public and people living around the airport the overall impact will be nil. In the case of potential investors the impact will be positive as the amended regulations will provide additional clarity.

The Regulations will have no impact on:

- pricing,

- operational arrangements at the airport (including for example the curfew, movement cap, slot management scheme or noise sharing arrangements),

- environmental management,

- land use planning and building control,
- quality of service, and
- access management.

All these matters are governed by separate policy instruments.

Consultation

Key stakeholders with a direct interest in the operation of the amended Regulations were consulted during the drafting of the Regulations. The organisations consulted included:

- All leased Federal Airports,
- Major domestic airlines, and
- Bidders for Sydney Airport.

Copies of the draft Regulations were also provided to the Sales Team for the sale of Sydney Airport including:

- Saloman Smith Barney - the Commonwealth's business advisors to the sale,
- the Department of Finance and Administration, and
- Freehills - the Commonwealth's lawyers for the sale.

Due consideration was given to all comments received. Overall reaction by stakeholders to the Regulations was favourable however a number of comments received requested even further flexibility from the Government in the application of the ownership provisions.

The Department is considering these issues and if considered appropriate may draft further regulations at a later stage.

Review

The Regulations do not include a provision indicating that they are to be reviewed some time in the future. However it is Government practice to review existing legislation from time to time. It is expected that the regulations will continue to apply as long as the ownership restrictions apply to leased Federal Airports.