Commonwealth
Competitive Neutrality
Complaints Office

PRODUCTIVITY COMMISSION

Sydney and Camden Airports

Investigation No. 8

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The Commonwealth Competitive Neutrality Complaints Office

The Commonwealth Competitive Neutrality Complaints Office is an autonomous unit within the Productivity Commission. It was established under the Productivity Commission Act 1998 to receive complaints, undertake complaint investigations and advise the Minister for Financial Services and Regulation on the application of competitive neutrality to Commonwealth Government business activities.

Information on the Office and its publications can be found on the World Wide Web at www.ccnco.gov.au or by contacting Media and Publications on (03) 9653 2244.

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26 November 2001

The Hon Peter Costello, MP
Treasurer
Parliament House
Canberra ACT 2600

Dear Treasurer

In accordance with section 21 of the *Productivity Commission Act 1998* and the Commonwealth Competitive Neutrality Policy Statement, I have pleasure in submitting the results of the Commonwealth Competitive Neutrality Complaints Office's investigation into Sydney (Kingsford-Smith) and Camden Airports.

Yours sincerely

Mike Woods
Commissioner

Competitive neutrality policy

Competitive neutrality is a policy which aims to promote efficient competition between public and private businesses. It seeks to ensure that significant government businesses do not have net competitive advantages over their competitors simply by virtue of their government ownership. The Commonwealth, State and Territory Governments have agreed to implement this policy as part of their commitment to the National Competition Policy Reform Package.

The Commonwealth's approach is outlined in its 1996 *Competitive Neutrality Policy Statement* (CoA 1996). Competitive neutrality requirements automatically apply to Commonwealth Government Business Enterprises, designated business units of budget sector agencies and all in-house units that tender for competitive contracts. It may apply to other businesses if the benefits outweigh the costs.

The Commonwealth Government's competitive neutrality arrangements require that its designated government business activities:

- charge prices that fully reflect costs;
- pay, or include an allowance for, government taxes and charges such as payroll tax, the goods and services tax and local government rates;
- pay commercial rates of interest on borrowings;
- generate commercially acceptable profits; and
- comply with the same regulations that apply to private businesses (such as the Trade Practices Act and planning and environmental laws).

The Commonwealth Competitive Neutrality Complaints Office is located within the Productivity Commission and is responsible for administering the Commonwealth's competitive neutrality complaint mechanism. The Office can receive complaints from individuals, private businesses and other interested parties that:

- an exposed government business is not applying competitive neutrality requirements;
- those arrangements are ineffective in removing competitive advantages arising from government ownership; or
- a particular government activity which has not been exposed to competitive neutrality should be.

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1 The complaint

1.1 Nature of the complaint

On 16 April 2001 and 27 April 2001, the Commonwealth Competitive Neutrality Complaints Office (CCNCO) received separate complaints regarding Sydney (Kingsford-Smith) Airport and Essendon Airport, respectively. On 10 May 2001, the CCNCO received an addendum to the Sydney Airport complaint regarding Camden Airport — then operated by a subsidiary of Sydney Airports Corporation Limited (SACL) — to ensure its inclusion in the CCNCO's investigation.

These complaints were lodged by a private consultancy firm on behalf of the Council of the City of Rockdale and Marrickville Council, the Council of the City of Moonee Valley and the Camden Council (within whose jurisdictions lie Sydney, Essendon and Camden Airports, respectively).

The complaints relate to the ownership, current lease, occupation and use of the Sydney, Camden and Essendon Airports, and the consequences of their proposed privatisation. In particular, the complaints allege that:

- the activity of leasing the Commonwealth-owned land upon which Sydney, Essendon and Camden Airports operate should be considered a 'business' activity and subject to competitive neutrality principles;
- SACL, Essendon Airport Limited (EAL) and Camden Airport Limited (CAL) — the Commonwealth Government owned enterprises that operate airports at those sites — are not meeting their full obligation for taxes due to local governments, as required under competitive neutrality; and
- SACL, EAL and CAL are not subject to regulations to which private sector businesses are normally subject (such as those relating to environment, planning and approval processes) and, as such, are operating in breach of their competitive neutrality obligations.

The complaints arose mainly from concerns that an inappropriate application of competitive neutrality to airport land and to SACL and CAL has led to a loss of tax revenue to local councils and the potential erosion of their rate base. An additional motivation was the concern that businesses outside the airports are disadvantaged in

competing with businesses within the airport sites by virtue of the latter being 'subsidised' by the failure to appropriately apply competitive neutrality principles.

In late July 2001, the CCNCO received a separate complaint regarding Essendon Airport from CEAC Incorporated (CEAC) — a group representing the interests of persons opposed to the sale of Essendon Airport. The central concern of this complaint was that any development on Essendon Airport — which is on Commonwealth Government-owned land — would not be subject to State planning processes and laws covering similar development on land outside the airport. Those represented by CEAC considered they could be disadvantaged by any subsequent development at the airport that was not consistent with requirements applying to development adjacent to the airport.

As the complaints covered similar issues and the activities involved have the same government 'owners', the CCNCO combined the investigation and reporting of these complaints.

However, on 10 August 2001 the Commonwealth Government announced the sale of EAL to private interests (CoA 2001b). As EAL is now owned privately, it is no longer a 'government' business activity to which competitive neutrality policy or the competitive neutrality complaint mechanism applies.

Accordingly, the following report confines its attention solely to Sydney and Camden Airports.

1.2 Background

SACL — an unlisted public company wholly owned by the Commonwealth Government — is the operator of Sydney Airport on land it leases from the Commonwealth Government. The lease agreement began in 1998 and is for 50 years with an option to renew for a further 49 years.

Until June 2001, CAL was a wholly owned subsidiary of SACL (as were the entities operating Bankstown and Hoxton Park Airports) which operated Camden airport under similar lease arrangements to those for the Sydney Airport. However, on 28 June 2001 — and in line with a Government decision announced in December 2000 (CoA 2000) — these entities were divested from SACL. CAL now operates under a separate company structure, albeit under the same lease agreement as previously.

The Department of Transport and Regional Services (DOTRS) has responsibility for administering the lease agreements with SACL and CAL. The Department of

Finance and Administration has responsibility for shareholder oversight in respect of the Commonwealth Government's equity in SACL and CAL.

The Commonwealth Government has designated SACL and its subsidiaries as significant government business activities subject to competitive neutrality. It has not, however, designated the leasing activity managed by DOTRS as a significant business activity to which competitive neutrality arrangements should apply.

All Sydney basin airports — Sydney, Bankstown, Camden and Hoxton Park — operate on Commonwealth Government land, and all the entities operating those airports are scheduled for sale under the Government's airports privatisation program. As part of that program, the Government separated the ownership of the land on which these airports operate and the business of operating the airports. Following the sale of its equity in those entities, the Government will, however, retain ownership of that land. The sale process for SACL is underway, although the Minister for Finance and Administration announced on 24 September 2001 (CoA 2001c) that the Government has deferred the sale until early 2002. The sale of CAL is expected to begin in 2002, and to be completed in that year.

The primary source of regulation for the Sydney and Camden airports is the *Airports Act 1996* and *Airports Regulations 1997*. The Airports Act regulates, among other things, land use planning, building and the environment on the airport site. Further, Sydney Airport is defined under the Airports Act as a core regulated airport. This classification means that SACL is required to meet other more stringent regulatory requirements, including various obligations under the *Trade Practices Act 1974* and the *Prices Surveillance Act 1983*.

1.3 Conduct of the investigation

In the course of its investigations, the CCNCO held discussions with the complainant, SACL, the DOTRS, the Department of Finance and Administration and the then Office of Asset Sales and IT Outsourcing (the agency charged with responsibility for managing the sale of SACL and CAL).

2 Assessment of issues

2.1 The issues

The complaint regarding Sydney and Camden Airports raised two main issues:

- whether the DOTRS activity of leasing Commonwealth Government owned land to SACL and CAL should be deemed a business activity for the purposes of competitive neutrality; and,
- whether the current operations of SACL and CAL breach the tax and regulatory neutrality components of competitive neutrality arrangements applying to them.

2.2 Is the DOTRS activity of leasing land a 'business' activity?

The activity of leasing land for use as an airport (an activity managed by DOTRS on behalf of the Government) is not a specified significant 'business' activity for the purposes of competitive neutrality. As such, there is no automatic requirement that the competitive neutrality arrangements outlined in the box on p. iv of this report should apply to the activity. The complainant asked the CCNCO to examine if the activity should be deemed a 'business' activity and, if it was, whether the application of competitive neutrality was warranted (ie if the benefits of doing so were greater than the costs).

The Commonwealth Competitive Neutrality Policy Statement of June 1996 states that, for the purposes of competitive neutrality in the Commonwealth sector, a 'business' activity must meet three criteria:

- there must be user charging;
- there must be an actual or potential competitor (ie users are not restricted by law or policy from choosing alternative sources of supply); and
- managers of the activity have a degree of independence in relation to the production or supply of the good or service and the price at which it is provided.

User charging

SACL and CAL do not pay an ongoing lease payment to DOTRS for the use of the leased land upon which the Sydney and Camden airports operate. However, the original agreement transferring the Sydney basin airports from the Federal Airports Corporation (FAC) to SACL obligated the Commonwealth to transfer assets of the Commission along with the lease of the airport to SACL in exchange for $1.4 billion in cash and shares.

The CCNCO is satisfied that part of the consideration paid by SACL for the purchase of the airport operating lease represented a user charge for the leased land on which the airport facilities are located. Accordingly, the CCNCO considers this meets the user-charging criterion of the business test.

An actual or potential competitor

Under this criterion, the CCNCO is required to consider whether the DOTRS faces competition, or potential competition, from an alternative supplier of airport land.

Sydney Airport is the sole major domestic and international airport hub in the Sydney basin. The power to approve another site for a major domestic and international airport (such as that operated by SACL) in the Sydney basin resides with the Commonwealth Government. On this matter, the Commonwealth Government recently stated that:

> Sydney Airport is comfortably handling its growing level of air traffic and the Federal Government, after lengthy and careful consideration, has concluded that it would be premature to build a second major airport in the city.
>
> … The Government has concluded that Sydney Airport will be able to handle the air traffic demand over the next ten years. (CoA 2000)

In a more recent statement on the sale of Sydney (Kingsford-Smith) Airport, the Government reaffirmed its position, stating that:

> The Federal Government does not believe that a second [major] airport will be necessary within the next ten years, and will review Sydney's airport needs again in 2005. (CoA 2001a)

Although the Government has announced measures to facilitate the upgrading of Bankstown Airport (CoA 2001a), this is only intended to allow Bankstown to operate as an overflow airport for Sydney Airport.

In the CCNCO's view, there is no actual or potential parcel of land that could be developed in the foreseeable future as a major airport in competition with Sydney Airport.

Other major airports such as Melbourne and Brisbane, or minor local airports such as Camden, currently compete with Sydney Airport for part of its passenger and airfreight traffic. However, those airports cannot realistically be considered to offer a comprehensive substitute for Sydney Airport's core functions and, as such, the land on which they operate cannot be considered as competing with the land on which Sydney Airport operates. (Those airports also operate on Commonwealth land under lease arrangements with DOTRS, in the same manner as SACL).

This view is consistent with the recent Productivity Commission draft report on *Price Regulation of Airport Services*, which noted, for example:

> It does not appear that the other core-regulated airports face strong competition from other airports for domestic passenger traffic. … although there is more than one airport in some of these cities, such as Melbourne, the preference of users for using one hub airport means that the others do not present significant competition. (PC 2001, p. 112)

In view of the above considerations, the CCNCO finds that the DOTRS activity of leasing the land on which SACL operates its airport business does not face an actual or potential competitor. Hence, this activity does not meet the second criterion of the business test.

The situation for that parcel of land on which CAL operates an airport is, however, somewhat different. That land does face an actual competitor in that it 'competes' with those parcels of land on which the general aviation airports of Bankstown and Hoxton Park operate. However, as land used for these airports is also leased from DOTRS, the Department does not, at the present time, face competition from another supplier of airport land. Indeed, there is no indication that it is likely to do so in the foreseeable future.

Accordingly, the CCNCO finds that the DOTRS activity of leasing the Commonwealth owned land on which CAL operates its airport business similarly does not meet the second criterion of the business test.

Managerial independence in relation to the supply of the leased land or the price at which it is provided

The *Airports Act 1996* and the lease agreements governing the land used for Sydney and Camden Airports effectively require that the entire parcel of land be used as an airport. As noted, the lease agreements, which began in 1998, are for 50 years (with

the option of a further 49 years). Thus, for that 50 year period, at least, DOTRS effectively has no independence in relation to the supply of that land.

Moreover, DOTRS is not in a position to control the supply of that land with respect to its end use — for example, the mix of aeronautical and commercial/trading activities. That ability — albeit subject to various regulatory controls applying to Sydney and Camden airports — rests with the lessee operating the airport, in this case SACL or CAL.

In the light of these restrictions on the supply of the land and the degree of control regarding end use, the CCNCO considers DOTRS has virtually no managerial independence in relation to the supply of those parcels of land. Additionally, the CCNCO considers that the initial single payment in consideration of the lease agreement has removed any scope for ongoing managerial independence by DOTRS with regard to the price at which that land is provided.

Accordingly, the CCNCO finds that the DOTRS activity of leasing the land in question does not meet this criterion of the business test.

In sum, the DOTRS activity of leasing the land on which SACL and CAL operate their airport activities does not meet all of the criteria specified in the Commonwealth Competitive Neutrality Policy Statement as necessary for an activity to be deemed a 'business activity'.

The CCNCO has, therefore, concluded that this activity is not a 'business activity' for the purposes of competitive neutrality and is therefore not subject to competitive neutrality policy. This, in turn, means that competitive neutrality arrangements do not apply to that activity and rules out the need for any investigation into whether DOTRS is complying with such arrangements.

2.3 Are SACL or CAL breaching tax and regulatory neutrality?

SACL (and its then subsidiary, CAL) is designated in the *Commonwealth National Competition Policy Annual Report 1998-99* (Commonwealth Treasury 2000) as a Government Business Enterprise subject to competitive neutrality policy.

The competitive neutrality obligations applying to SACL and CAL are specified in the *Commonwealth Competitive Neutrality Policy Statement* (CoA 1996) and elaborated on in *Commonwealth Competitive Neutrality Guidelines for Managers 1996-97* (Commonwealth Treasury 1998). These obligations require that, among other things, designated government business activities pay all Commonwealth

direct and indirect taxes and State indirect taxes or tax equivalents that would normally apply to their private sector competitors, and that they are subject to the same or equivalent regulatory requirements as their competitors.

Tax neutrality

Although the Commonwealth has constitutional immunity from State and local government taxes, for airports formerly owned and operated by the FAC it had a policy of making *ex gratia* payments to local governments in lieu of rates on part of the land on which those airports operated. Documents provided by DOTRS to the CCNCO indicate those *ex gratia* payments applied in respect of the airport sites, but excluded those parts of the sites that could be broadly categorised as land used in the provision of aeronautical services.

As part of the Commonwealth Government's privatisation program for FAC airports, it separated the ownership of the land on which those airports operated and the business of operating the airports. The Government retained ownership of those lands and entered into lease agreements governing the operation of the airports with government business entities. The sale of the various airports under the program was (and will be) achieved through the sale of those government business entities.

The leases for all the airports subject to the privatisation program — including those already sold, such as Brisbane and Melbourne, and those still to be sold, such as Sydney and Camden — contain essentially the same provisions. Examples of those leases provided to the Office by DOTRS and SACL indicate that one of those provisions effectively continues the Government's former policy of *ex gratia* payments in lieu of rates to local councils, but passes the cost of doing so to the lessee. The lease provision dealing with the *ex gratia* payment to local councils specifically excludes payment in respect of those parts of the airport site used for runways, taxiways, aprons, roads, vacant land, buffer zones and grass verges, and land identified in the airport Master Plan for these purposes.

The complaint alleges that the *ex gratia* payments that SACL and CAL are required by their leases to make to local councils in lieu of local government rates (taxes) have not been paid in accordance with the tax neutrality provisions of competitive neutrality policy. This aspect of the complaint encompassed a number of areas where the complainant believed SACL and CAL are treated differently to other businesses subject to local government rates — with the effect of reducing tax payments to local councils. These include the exclusion of parts of their land from rate assessment, the terms on which payments in lieu of rates are made and the ability of SACL or CAL to influence what parcels of airport land are excluded from

their *ex gratia* payment obligations. SACL and CAL's compliance with respect to other taxes was not an issue.

SACL's latest annual report to the Commonwealth Treasury on its compliance with competitive neutrality — for 1999-2000 — states that the Corporation (and its then subsidiary, CAL) has paid all appropriate Commonwealth direct and indirect taxes and State indirect taxes or tax equivalents. In discussions with the CCNCO during the course of this investigation, SACL maintained that its performance since 1999-2000 is also fully compliant with its competitive neutrality obligations.

When this complaint was first brought to the CCNCO, and in the initial discussions with the complainant, SACL, DOTRS and the shareholder unit of DOFA, the assumption was that the local government taxes (rates) involved were relevant taxes for the purpose of competitive neutrality.

However, local government rates are levied against the value of land, and it is the owner of that land who bears the liability to pay them. Local government rates are not taxes that apply to business activities operating on land they do not own. They cannot, therefore, be considered taxes that SACL and CAL are required to pay to maintain tax neutrality with their competitors in the private sector. In a comparable position, a private sector business operating on land it did not own would not be liable for such taxes. (Although its lease could transfer the cost of such rates — or any other costs of owning the land — in a similar vein to the *ex gratia* payments).

Moreover, as the lease provision regarding *ex gratia* payments applying to SACL and CAL also applies to former FAC airports that are now privately owned businesses (eg Brisbane and Melbourne), this cannot be viewed as an issue arising purely from government ownership.

Accordingly, the CCNCO considers that the conduct of SACL and CAL with respect to such *ex gratia* payments is not a competitive neutrality matter but, rather, is a lease compliance matter. In this regard, the Office has informed representatives of DOTRS responsible for administering the lease agreements and the DOFA shareholder unit responsible for SACL and CAL of the issues involved. These agencies are currently examining the matter with the view to resolving the areas of concern raised by the complainant regarding these payments.

The CCNCO further observes that the concern raised by the complaint that the current situation might confer advantages on businesses located on the airport sites does not appear to be a likely scenario. The land excluded from *ex gratia* payments approximates land used for aeronautical purposes. The lease agreements specify that those parts of the airport site that SACL or CAL sub-lease to tenants, or on which trading or financial operations are undertaken, are subject to *ex gratia* rate

payments. This implies that provided *ex gratia* payments are made in accordance with the lease, the costs associated with such land are not being artificially reduced and, accordingly, businesses located on the airport would not be artificially advantaged relative to businesses outside the airport site.

However, even if there were no provision for *ex gratia* payments, input prices — including land rentals — for businesses located on the Sydney Airport site are more likely to reflect what the market can bear rather than being set on a cost-plus basis.

Regulatory neutrality

The complaint against SACL and CAL questioned whether they are subject to regulations relating to the protection of the environment, and planning and approval processes on an equivalent basis to private sector competitors, and thus whether their current operations breach the regulatory neutrality requirements of competitive neutrality policy.

This raises the question of what activities should be considered to be in competition with SACL and CAL as far as regulatory neutrality is concerned.

Competitors could be taken to mean other airports such as the privately owned major airports at Brisbane, Melbourne and Adelaide in the case of SACL, and the Government owned general aviation airports at Bankstown and Hoxton Park in the case of CAL. However, as all these airports operate under similar regulatory arrangements, there is no question that regulatory neutrality prevails.

The complainant held that a broader interpretation should apply, with competitors covering, for example, retail and commercial businesses located outside the airports operated by SACL and CAL, which compete with similar activities located on the airport premises.

Competitors outside the airport site are subject to State Government environmental, planning and development regulations. As the complainant pointed out, Commonwealth owned airport land is exempt from such State Government regulation and thus those businesses located on the Sydney and Camden airport sites are not subject to the same regulations as their off-site competitors.

However, planning, development and environmental regulations do apply at Sydney and Camden airports. The Commonwealth *Airports Act 1996* and Commonwealth environmental legislation establishes a national framework for the regulation of such matters at leased federal airports (see box 2.1).

Box 2.1: The environmental, planning and building regulatory regime applying to SACL and CAL

Among other things, the Airports Act requires SACL and CAL to have:

- an airport master plan;
- major development plans in respect of certain activities including alterations to runways and various building development;
- building approvals and building certification; and
- an environmental strategy.

The master plan is a 20 year forward-looking document and must be renewed at least every five years. Among other things, it is intended to include the lessee's proposals for land use and related development, and assess environmental issues associated with the implementation of the plan. Any proposed change to the master plan must be submitted to the Commonwealth Minister for Transport and Regional Services for approval. Prior to submission, the draft plan must go through a public consultation process.

Major development plans are addressed in Part 5 of the Act. These plans and associated building activities for the airports (including those for tenants and airlines) must be consistent with the approved master plan for the airport.

Building activities at an airport are governed by the regime prescribed in Part 5 of the Airports Act and the *Airports (Building Control) Regulations 1996*. The Building Regulations provide for a specific process for the approval of building and construction activities at airports (for example, for the majority of the work involving buildings, the relevant standards can be found in the Building Code of Australia).

With respect to environmental management, Part 6 of the Airports Act requires the submission to, and approval by, the Commonwealth Minister for Transport and Regional Services of an environmental strategy for each federal airport. That strategy must set out comprehensively how the airport will be operated so that its environmental health is maintained or improved.

In addition, as Commonwealth Government owned companies, SACL and CAL are subject to the *Environmental Protection and Biodiversity Conservation Act 1999*. Under this Act, significant actions undertaken on leased federal airports are exposed to the environmental assessment, public consultation and approval process as required. Additionally, all major development plans must be referred to the Commonwealth Minister for the Environment for advice on the required environmental assessment before they can be adopted or implemented.

Although State and Territory laws in respect of building approvals and planning generally are not applicable at leased federal airports, State and Territory laws on the registration of builders and other construction professionals, builders insurance, occupational health and safety, and protection of persons against fire do apply. Similarly, although State and Territory environmental management laws are not applicable at the leased airports, State laws concerning waste management, occupational health and safety, motor vehicle pollution and the sale of certain chemicals do apply.

The Commonwealth Government has imposed these regulations with the stated intent of putting in place an appropriate regulatory framework to govern the protection of the environment, land use, planning and building controls and to ensure compatibility between on airport and off airport development (PoCA 1996, pp. 2-3).

No evidence was presented to the CCNCO to indicate that these regulations are sufficiently less onerous than those applying elsewhere such as to provide a net advantage to businesses operating within the airport sites.

On this basis, the CCNCO considers that the current operations of SACL and CAL are not in breach of the regulatory neutrality principle of competitive neutrality policy.

2.4 Conclusion

The complaint regarding Sydney and Camden airports raised two main issues — whether, under competitive neutrality policy, the leasing of land to SACL and CAL is a 'business' activity and whether SACL and CAL are operating in breach of the tax and regulatory neutrality principles of competitive neutrality policy.

The CCNCO finds that the DOTRS activity of leasing the land on which SACL and CAL operate their airport activities does not meet all of the criteria required for an activity to be deemed a 'business activity'. Accordingly, the CCNCO has concluded that this activity is not a 'business activity' for the purposes of competitive neutrality.

On the question of tax neutrality, the CCNCO considers that *ex gratia* payments made in lieu of council rates as part of a lease agreement are not taxes that apply to business activities operating on land they do not own. The *ex gratia* payments cannot, therefore, be considered taxes that SACL and CAL are required to pay to maintain tax neutrality with the private sector. Accordingly, the CCNCO has concluded that the concerns raised by the complaint regarding *ex gratia* payments are not matters for the competitive neutrality complaint mechanism to resolve. Rather, they are matters of lease compliance and it is more appropriate they be handled by DOTRS as the leasing agency and the DOFA shareholder unit holding the Government's equity in SACL and CAL.

On the question of regulatory neutrality, SACL and CAL face an equivalent regulatory environment to other airports considered to be competing with them. Allowing for a broader definition of competing activities, the CCNCO considers that SACL and CAL face a regulatory regime governing the protection of the

environment, and planning and approval processes broadly comparable to that applying to businesses located outside their airports. Accordingly, the CCNCO has concluded that the current activities of SACL and CAL are not in breach of the regulatory neutrality principle of competitive neutrality policy.

The CCNCO therefore finds that no action under competitive neutrality policy is required with respect to the land leasing activity of DOTRS or the current activities of SACL and CAL.

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