

**For discussion
on 19 April 2011**

Legislative Council Panel on Economic Development

**Review of the Regulatory Regime of the
Air Transport Licensing Authority**

Purpose

This paper briefs Members on the outcome of our consultation exercise on the proposals to improve the regulatory regime of the Air Transport Licensing Authority (ATLA) and the proposed changes to the proposals in the light of the comments received during the consultation exercise.

Review

2. ATLA, established under the Air Transport (Licensing of Air Services) Regulations (Cap 448 sub. leg. A) (“the Regulations”), is responsible for granting licences to local airlines to operate scheduled air services between Hong Kong and any point in the world. After reviewing ATLA’s regulatory regime, we have consulted the relevant parties on the proposals (see paragraph 11 below). The respondents generally support the need to improve ATLA’s regulatory regime, as follows –

- (a) updating ATLA’s general policy by removing the reference to the coordination of air services and avoidance of uneconomic overlapping;
- (b) allowing an applicant to apply for a licence from ATLA and an Air Operator’s Certificate (“AOC”) from the Civil Aviation Department (“CAD”) in parallel;
- (c) distinguishing first-time applications and renewal applications for licences;

- (d) requiring a licence holder to notify ATLA of certain events having a bearing on the financial status of the holder; and
- (e) providing ATLA with the power to intervene when there are signs of any licence holder getting into financial difficulty.

3. There are no adverse comments on the proposal to exempt a non-local airline from obtaining a licence from ATLA before leasing Hong Kong-registered aircraft to operate air services between Hong Kong and another place, and on the proposed updated penalties provisions. That said, some respondents have raised certain issues and put forward changes to the proposals.

4. In the light of the comments received, we would like to propose a number of changes to the proposals.

A. *ATLA's general policy*

5. We originally proposed to amend ATLA's general policy¹ to read “ATLA shall have regard to the development of air services generally with the object of ensuring the most effective service to the public and generally to the interests of the public, including those of persons requiring or likely to require facilities for air transport, as well as those of persons providing such facilities” as ATLA no longer needs to concern itself with the coordination of air services nor with uneconomic overlapping as these matters should be addressed through market competition.

6. We now propose to refine the wording of ATLA's general policy to read “ATLA shall have regard to the development of air services with the object of providing effective service to the public and the interests of the public, including those of persons requiring or likely to require facilities for air transport, as well as those of persons providing such facilities.”

¹ ATLA's current general policy is that ATLA shall have regard to the coordination and development of air services generally with the object of ensuring the most effective service to the public while avoiding uneconomical overlapping and generally to the interests of the public, including those persons requiring or likely to require facilities for air transport, as well as those persons providing such facilities.

B. Basis for granting licences

7. Under the Regulations, licences are granted on a specific route basis with individual expiry dates. We now propose to adopt an airline-based approach under which each airline would only be granted one licence the conditions of which specify the routes to be operated or the regions/countries to be served. Airlines wishing to operate new routes or serve new regions/countries will need to apply to vary the licence conditions². The licence should be valid for at most five years as at present, subject to renewal upon application. This change seeks to minimise the administrative burden on the airlines and ATLA.

8. As a transitional arrangement, the existing licences held by each airline would be replaced by a single licence which specifies the routes which the licence holder is now allowed to operate³. The fee structure also needs to be amended to cater for the proposed airline-based approach, and the user-pays principle will be followed in the setting of the fee levels.

C. Submission of business plans

9. We originally proposed to require a licence holder to submit an annual business plan to ATLA every year covering at least a period of 12 months. We now propose that a business plan be required only if ATLA considers necessary, e.g. when there is doubt about the licence holder's capacity in meeting its actual and potential obligations for a 12-month period, in exercise of its proposed general power for ATLA to assess at any time the financial performance of a licence holder and require the licence holder to provide relevant information. This is mainly in response to the concern that the original proposal would place an unduly onerous burden on the licence holder.

² Such applications need to be published in the Gazette and be subject to statutory representations or objections in the same way as new or renewal licence applications.

³ The expiry date of the replacement licence will be fixed having regard to the expiry dates of all the existing licences held by the airline concerned to ensure that its rights under the existing licences would not be curtailed.

D. Other notification requirements

10. We originally proposed various notification requirements for licence holders. We now propose to update them as set out in **Annex A**. The main changes are as follows –

- (a) we do not pursue the original proposal that a licence holder should notify ATLA in advance of any intended mergers or acquisitions. That said, mergers and acquisitions almost always involve significant changes in shareholding, of which ATLA needs to be alerted; and
- (b) in relation to share pledge agreements or similar arrangements, we require a person having a control in the licence holder to notify ATLA when that person has entered into such agreements or arrangements.

Consultation

11. Our first round of consultation took place in the first half of 2010. A list of the relevant stakeholders is at **Annex B**. We also consulted the Legislative Council Panel on Economic Development and the Technical Subcommittee of the Aviation Development Advisory Committee. We conducted a second round of consultation in early 2011 on the proposed changes to the proposals. In general, the stakeholders are supportive of the proposals to improve ATLA's regulatory regime. A summary of the comments and our responses is at **Annex C**.

Way Forward

12. We intend to table the relevant legislative amendments at the Legislative Council in the third quarter of 2011.

**Transport and Housing Bureau
April 2011**

Annex A

Detailed Notification Requirements for Licence Holders

A licence holder should have the onus to notify ATLA –

- (a) within 14 days of any change in the ownership of any single shareholding which represents 10% or more of the total shareholding of the licence holder or a holding company⁴ of the licence holder;
- (b) within 14 days of any change in the voting rights of any person who either alone or with any associated person⁵ is entitled to exercise or control the exercise of 10% or more of the voting rights at the general meetings of the licence holder or a holding company of the licence holder; and
- (c) within 14 days of any change in the control of the licence holder;

whereas a person having a control in the licence holder should have the onus to notify ATLA –

- (d) within 14 days after it has entered into any share pledge agreement or similar arrangement, which, as a consequence of an event of default or occurrence of certain circumstances as set out in the agreement or arrangement, is capable of leading to any change referred to in (a), (b) or (c) above⁶.

⁴ “Holding company” has the meaning ascribed to it in section 2 of the Companies Ordinance, Cap.32.

⁵ “Associated person” has the meaning ascribed to it in section 18 (1) para (a) of the Securities and Futures Ordinance, Cap. 571.

⁶ A persons who does not comply with the requirement commits an offence and is liable –

- (a) in the case of summary conviction, a fine not exceeding \$100,000 or imprisonment for a term not exceeding 3 months or both such fine and such imprisonment; and
- (b) in the case of conviction on indictment, a fine not exceeding \$1,000,000 or imprisonment for a term not exceeding 1 year or both such fine and such imprisonment.

2. For the purposes of paragraph 1 above,
- (a) “control” in a licence holder means –
- (i) to have the capacity to control the composition of the board of directors of the licence holder or a holding company of the licence holder; or
 - (ii) to be entitled to exercise, or control the exercise of, 30% or more of the voting rights at the general meetings of the licence holder or a holding company of the licence holder.
- “Control” includes control by a person alone or with any associated person.
- (b) “a change in the control of a licence holder” occurs if a person or body incorporate who as at the relevant date does not have the ability to do paragraph 2(a)(i) or (ii) above but subsequent to that date that person or body incorporate has the ability to do so by reason of transfer (or issue) of shares or voting rights in the licence holder or in the holding company of the licence holder to that person or body incorporate.
- (c) For the purposes of paragraph (2)(a)(i), a person or a person together with any associated persons (“first person”) has control of the composition of the board of directors of a licence holder or a holding company of the licence holder (“second person”) if the first person has the power to appoint or remove all or a majority of the directors of the second person without the consent of any other person.

The first person is regarded to have power to make the appointment if –

- (i) a person cannot be appointed as a director of the second person without the exercise in his favour by the first person of the power of appointment; or
- (ii) it necessarily follows from a person being a director or other officer of the first person that the person is appointed as a director of the second person.

3. A licence holder should be required to provide to ATLA every financial year the audited financial statements relating to the previous financial year no later than six months following the last day of the respective financial year.

4. Where considered necessary by ATLA in exercise of its general power to assess at any time the financial performance of a licence holder, a licence holder may be required to submit to ATLA a business plan covering, at least, a period of 12 months. The business plan should include the relevant information, including the following data –

- (a) the most recent internal management statement of financial position;
- (b) precise details of all proposed changes, e.g. change of type of service, modifications in share capital, changes in shareholders, etc;
- (c) a projected statement of financial position, with a statement of comprehensive income, for the current financial year, including all proposed changes in structure or activities with a significant bearing on finances;
- (d) past and projected expenditure and income figures on such items as fuel, fares and rates, salaries, maintenance, depreciation, exchange rate fluctuations, airport charges, air navigation charges, ground handling costs, insurance, etc., traffic/revenue forecasts;
- (e) statement of cash flows and cash flows forecasts and requirements for the following year, including all proposed changes in structure or activities with a significant bearing on finances; and
- (f) details of the financing of aircraft purchase/leasing including, in the case of leasing, the terms and conditions of contract.

5. If a licence holder is likely to become unable to meet its obligations to such an extent as to cause material adverse effect on its operations, it should be required to forthwith report in writing all relevant facts, circumstances and information to ATLA.

6. If a licence holder intends to cease or ceases to operate air services, it should be required to forthwith notify ATLA in writing of that intention or fact.

Annex B

List of Stakeholders

1. AHK Air Hong Kong Ltd.*
2. Cathay Pacific Airways Ltd.*
3. Hong Kong Dragon Airlines Ltd.*
4. Hong Kong Airlines Ltd.*
5. Hong Kong Express Airways Ltd.*
6. Sky Shuttle Helicopters Ltd.*
7. HeliServices (Hong Kong) Ltd.
8. Metrojet Ltd.
9. TAG Aviation Asia Ltd.
10. Airport Authority Hong Kong*
11. Hongkong Association of Freight Forwarding and Logistics Limited
12. Hong Kong Shippers' Council
13. Consumer Council*
14. Travel Industry Council of Hong Kong
15. Hong Kong Tourism Board*
16. The Chinese General Chamber of Commerce
17. The Federation of Hong Kong Industries*
18. The Hong Kong General Chamber of Commerce
19. The Chinese Manufacturers' Association of Hong Kong
20. The Hong Kong Chinese Importers' and Exporters' Association
21. Aviation Policy and Research Center of the Chinese University of Hong Kong*

* Denotes stakeholders that have made written submissions. In the cases of Hong Kong Airlines Ltd. and Hong Kong Express Airways Ltd., a joint submission was made by the two companies.

Summary of Comments and Responses

<i>Comments</i>	<i>Responses</i>
(a) There is concern about whether the updated general policy of ATLA would viciously exacerbate the already intense competition in the air services market and undermine the development of the industry.	The existing reference in ATLA's general policy to the coordination of air services and the need to avoid uneconomical overlapping is not in line with the global liberalisation of air services in recent years, nor with Hong Kong's progressive liberalisation policy on air services. There is a need to improve the regulatory regime while liberalising the market.
(b) ATLA would not need to require an endorsement from CAD (as at present) certifying that, <i>inter alia</i> , the adequacy and competency of the staff to be employed by the applicant are satisfactory. There is concern about how ATLA can exercise oversight in this regard as the applicant would not be required to provide the relevant staff information in the application for a licence.	The granting and validity at any time of a licence would depend on the possession of a valid AOC, and we do not intend to amend section 11(h) of the Regulations, which requires ATLA to have regard to, <i>inter alia</i> , the remuneration and general conditions of employment of aircrew and other personnel employed by the applicant when considering to grant or refuse a licence.
(c) ATLA should promulgate clear guidelines to facilitate airlines to prepare submissions to ATLA. Criteria should be devised to guide ATLA in gauging the financial performance of the licence holders and to decide at which point it should intervene.	The basic principle is whether the licence holder can meet its actual and potential obligations for the relevant period of time. As the situation of each licence holder is different, ATLA would need to consider each case, having regard to the specific circumstances of the case.

<i>Comments</i>	<i>Responses</i>
(d) There is concern that as the new regulatory regime would still be route-based, there would be heavy and repetitive administrative workload on the airlines to provide, and on ATLA to assess, the information.	We now propose to adopt an airline-based approach.
(e) There are suggestions of refining the wording of ATLA's general policy.	We now propose to refine the wording to read "ATLA shall have regard to the development of air services with the object of providing effective service to the public and the interests of the public, including those of persons requiring or likely to require facilities for air transport, as well as those of persons providing such facilities."
(f) There is a suggestion that ATLA should grant licences with no expiry dates and flexibility on the routes to be operated by the airlines concerned. Another suggestion is that under the route-based approach, ATLA should allow a licence holder to update its existing licences by adding additional points of destination.	We now propose to adopt an airline-based approach.

<i>Comments</i>	<i>Responses</i>
(g) There is concern that in the past, objections to licence applications were often lodged by parties with vested interest, resulting in lengthy public hearings. The current public hearing might not be the best system to resolve the conflicting interests among different local airlines. The appeal mechanisms used by other jurisdictions should be examined for their merits.	We have looked at overseas practices. In the UK, operating licence applications are processed by the Civil Aviation Authority with no statutory provisions for the lodging and disposal of objections and representations. We have not been able to find similar provisions in the airline licensing regimes in Singapore, the US, Canada and Australia. We propose to keep the existing arrangements so that representations can be made and dealt with in a fair, open and transparent manner.
(h) There is concern that the annual business plan requirement would place an unduly onerous burden on the licence holder and, coupled with the proposal to empower ATLA to hire consultants or advisors to assist ATLA in discharging its duties, could raise issues of commercial confidentiality.	<p>We now propose that the business plan be required only if ATLA considers necessary, e.g. when there is doubt about the licence holder's capability in meeting its actual and potential obligations for a 12-month period, in exercise of its proposed general power for ATLA to assess at any time the financial performance of a licence holder and require the licence holder to provide relevant information.</p> <p>We propose no change to our original proposal to empower ATLA to hire consultants or advisors to assist ATLA in discharging its duties and to pass the information submitted by the licence applicants and holders to the consultants or advisors. We will put in place suitable arrangements to ensure that such information is treated in confidence.</p>

<i>Comments</i>	<i>Responses</i>
(i) There is concern about the requirement for a licence holder to notify ATLA in advance of any intended mergers or acquisitions.	We now propose not to pursue the proposed requirement.
(j) There is concern about the requirement for a licence holder to notify ATLA should any of its shareholder(s) have entered into any share pledge agreement(s) or similar arrangement(s). This would be too onerous and difficult to comply where the licence holder is a listed company.	In relation to share pledge agreements or similar arrangements, we now propose to require a person having a control in the licence holder to notify ATLA when that person has entered into such agreements or arrangements.
(k) There is a suggestion of extending the period within which the audited financial statements relating to the previous financial year would need to be submitted to ATLA from six months (as originally proposed) to 12 months.	We propose to maintain the original deadline of six months following the last day of the respective financial year, which is considered as a reasonable period for the submission of the audited financial statements.

<i>Comments</i>	<i>Responses</i>
<p>(l) ATLA should adopt a pragmatic approach to ensure that the information gathering and explanation burden placed on the first-time applicant does not end up becoming a formidable deterrent to new entrants. In judging whether the requirement of “demonstration to the reasonable satisfaction of ATLA” has been met or not, ATLA should appreciate that it takes time for new airlines to develop the expertise and experience.</p> <p>Whilst whether or not an airline is financially sustainable is always open to debate, what is really of concern to the government authorities/ATLA should be whether or not public interest will be served. A new operator wishing to provide more choices to consumers is regarded as in public interest, and it should be encouraged and facilitated.</p>	<p>Noted. The proposals seek to strike a balance between facilitating new entrants’ entry into the aviation market and ensuring that a licence holder is capable of operating services. The requirements for first-time applicants facilitate the making and processing of licence applications.</p>
<p>(m) Following the revamp of ATLA regulations, aviation policy related matters such as designation criteria, consultation with airlines for route rights, charter policy, attendance of licence holders at air services talks etc. will also have to be reviewed to ensure compatibility with the new revamped ATLA regulations.</p>	<p>Noted. It is our policy to review the relevant areas from time to time.</p>

<i>Comments</i>	<i>Responses</i>
<p>(n) To avoid imposing excessive cost and compliance burdens on first-time applicants and licence holders, the information with which they are required to furnish should be restricted to those that are essential for ensuring effective service delivery and protecting the interests of the public.</p> <p>As the information ATLA may require from first-time applicants and licence holders may involve sensitive operational data including commercial secrets, there should be sufficient safeguards to ensure that the information so submitted will be kept in strict confidence and treated professionally.</p>	<p>Noted. The proposals seek to strike a balance between facilitating new entrants' entry into the aviation market and ensuring that a licence holder is capable of operating services. The requirements for first-time applicants facilitate the making and processing of licence applications.</p> <p>Suitable arrangements will be put in place to ensure that the relevant information is treated in confidence.</p>
<p>(o) The proposed requirement to submit audited financial statements and a detailed business plan on an annual basis should only apply to those licence holders which have mounted and operate air services under the licence(s) held.</p>	<p>Although licence holders may not always put all their licences into active use, to protect the interest of the public and for fairness, there is a need to apply the same notification requirements to all licence holders.</p> <p>We now propose not to pursue the annual business plan requirement.</p>
<p>(p) While the assessment in parallel (for an AOC by CAD and for a licence by ATLA) would speed up the application process hence facilitate market entrance, emphasis should be placed on the importance of safety issue being assessed independently by CAD.</p>	<p>Noted. CAD will continue to ensure that Hong Kong's airlines are competent in operating air services safely and their aircraft are air-worthy.</p>

<i>Comments</i>	<i>Responses</i>
(q) Requirements proposed in respect of renewal or new licence applications by an existing licence holder are rather onerous. There is a suggestion that such requirements be applied only if the past performance of the licensee calls into question its management of the business. Where the licensee is a registered public company, information in the latest annual report should be deemed sufficient.	We now propose to adopt an airline-based approach, which would reduce the administrative burden on both the airlines and ATLA. We now also propose that the business plan be required only if ATLA considers necessary.
(r) It could become extremely costly to pay for the consultants/advisors that ATLA would need to appoint to assist in its scrutiny of financial and business plans. This requirement should apply by exception where ATLA has cause for concern as to the viability of the licence holder's operation.	Noted. The service of consultants/advisors will be engaged on a need basis.
(s) An applicant may apply for licences to facilitate future operations say, 2 years later, but its current financials may look questionable (due to the harsh economic environment). If its application gets rejected because of the present poor financial figures, its future development would be curtailed when the world economy improves.	A key factor affecting ATLA's decision in granting a licence is not whether an airline is making a profit or a loss at the time of application, but whether it has sufficient financial resources to support its proposed operations.

<i>Comments</i>	<i>Responses</i>
<p>(t) The proposal invariably creates a direct correlation between ATLA's suspension or revocation of a licence and the licence holder's ability to meet its financial obligations for a 12-month period based on the financial data submitted. There is concern that –</p> <ul style="list-style-type: none"> i. a 12 month period is far too short to arrange and execute alternative financial arrangements to save the airline; ii. the correlation is self-defeating in that having a licence suspended or substituted with a temporary licence makes it even more difficult to raise finance and/or come up with alternative remedies; and iii. this correlation would drive airlines to extinction prematurely, contrary to Hong Kong's liberalisation policy on air services. 	<p>The ability to meet financial obligations for 12 months is a reasonable requirement. Apart from suspending or revoking the licence, ATLA may also attach new licence conditions or vary existing ones. ATLA would exercise its judgement and take appropriate action, having regard to the circumstances of each case.</p>
<p>(u) New ATLA licences should not be provided nor existing licences renewed for airlines which have or have had in the six months prior to the application or renewal any outstanding material debt beyond 30 days after due date due to the Airport Authority or CAD, including but not limited to those relating to landing, parking or overflying charges.</p>	<p>For the renewal of a licence upon expiry, or for variation of licence conditions to operate new routes or serve new regions/countries, the licence holder will be required to demonstrate to the reasonable satisfaction of ATLA that it can meet its actual and potential obligations for a 12-month period. ATLA will take into account all relevant considerations, including any outstanding liabilities of a licence holder, in making a decision.</p>

<i>Comments</i>	<i>Responses</i>
(v) The board structure and management control of the airline company should be examined according to Article 134 of the Basic Law, with interpretative guidelines.	Article 134 of the Basic Law merely confers a power, rather than imposes an obligation, for the Government to issue licences to airlines meeting the criteria of incorporated and having their principal place of business in Hong Kong. The issue of licences by ATLA based on aircraft registered in Hong Kong does not conflict with Article 134 of the Basic Law.
(w) Currently, it makes economic sense for airlines to hold as many licences as possible for them to respond quickly to any potential/future business development. ATLA may need to further investigate how best to balance the need for traditional operators to respond to quick changes in market demand versus the safeguarding of the public interest in the application of new routes by new airlines. Airlines should demonstrate their need for the licences they hold but not use.	We now propose to adopt an airline-based approach. Airlines wishing to operate new routes or serve new regions/countries will need to apply to vary the licence conditions, and be required to demonstrate to the reasonable satisfaction of ATLA that it can meet its actual and potential obligations for a 12-month period.
(x) This is a significant change in existing policy and will take time to gain the relevant experience. ATLA will become actively monitoring the operation of airlines. This will require a significant amount of additional budget, staff and expertise as Hong Kong's reputation as an international aviation centre is at stake.	The proposals strike a balance between facilitating the operation of airlines and ensuring that a licence holder is capable of operating services. Care would be exercised to avoid interfering with the normal operations of the licence holders. We will keep under review the resources required to support ATLA's discharge of its duties.

<i>Comments</i>	<i>Responses</i>
(y) Under the new proposed arrangement, precise conditions and procedures for a special review, suspension or revoking, or granting a temporary licence should be documented by ATLA. The share of responsibilities and authorities among ATLA, CAD, Transport and Housing Bureau (THB) and the courts on licensing matters should be clearly defined as well for the benefit of the aviation industry.	The criteria for the grant and renewal of licences will be set out in the Regulations, to be supplemented by relevant guidelines as may be required. ATLA shall satisfy itself that a licence applicant or an existing licence holder is capable of operating air services, primarily with regard to its financial capability. In processing AOC applications, CAD's role is to ensure that Hong Kong's airlines are competent in operating their air services safely and their aircraft are air-worthy. As the lead policy bureau on aviation matters, THB will continue to pursue and implement Hong Kong's progressive liberalisation policy on air services. Licence applicants or holders aggrieved by ATLA's decisions may seek judicial review.
(z) There is a suggestion that more information about the selection and appointment process for ATLA's consultants/advisors should be shared with the stakeholders.	The consultants/advisors will be selected and appointed in accordance with the established Government regulations and guidelines.

<i>Comments</i>	<i>Responses</i>
(aa) The new Administrative Guidelines should be of a high level of granularity, by setting out the level of details that a licence holder will be requested in respect of the submission of a business plan (when required), and the ‘triggers’ for investigation by ATLA and a description of the investigation pathway that ATLA will undertake. Airlines should be consulted on the draft Administrative Guidelines before they are finalised.	The notification requirements for the existing licence holders will be set out in the Regulations, to be supplemented by relevant guidelines as may be required. Airlines would be consulted when the relevant guidelines are drawn up.
(bb) There is a request for details of information that will be required by ATLA of a licence holder that is a wholly-owned subsidiary of another licence holder, as well as on the reporting and notification requirements if the licence holder is a subsidiary and that its holding company stands as its ‘guarantor’.	Each licence holder would be treated separately and be required to comply with the same requirements under the Regulations. A licence holder may provide relevant information relating to its financial resources to facilitate ATLA’s consideration.
(cc) ATLA should have a mechanism in place regularly to collect the up-to-date information and market intelligence for monitoring purposes, and take a more pro-active role.	Under the new regime, the licence holder will be required to inform ATLA in the first instance of its financial difficulties or intention to cease to operate air services. ATLA will also be given the general power so that it may at any time assess the financial performance of a licence holder and require the licence holder to provide relevant information.
(dd) ATLA should be alerted about the future development of the Competition Bill.	Noted.