Legislative Council

of the

Hong Kong Special Administrative Region

Panel on Economic Services

Report of the delegation of the Panel to study overseas experience in port and airport management, airport privatization and theme park management in April 2004

June 2004

Table of contents

Chapter 1 - Introduction

1.1 Tourism and logistics are two of the core engines of growth for Hong Kong's economy. Despite the impact of the SARS crisis, the tourism industry has staged a rapid V-shaped recovery and recorded 15.5 million visitor arrivals in 2003. This was just a modest drop of 6.2% year-on-year and was the second highest number of arrivals on record. Overall visitor arrivals increased by 14.7% in the first quarter of 2004 to 4.94 million. A boom in the tourism industry will improve overall market sentiment, stimulate local consumption, boost growth in related sectors and contribute to the creation of employment opportunities.

1.2 Likewise, the logistics industry can bring our existing advantages into full play and also provide many employment opportunities. Hong Kong is a major centre of international and regional aviation served by over 70 airlines. The Hong Kong International Airport (HKIA) is one of the world's busiest. In the 12 month period ending May 2003, a total of 29.2 million passengers (not including 760,000 in transit) passed through the HKIA. The HKIA also handled some 2.6 million tonnes of air cargo. The port is also the key factor in the prosperity and economic growth of Hong Kong, handling about 80 per cent of Hong Kong's total cargo throughput. The container port is vital, not only for Hong Kong, but also for Southern China - one of the fastest industrializing areas in the world, as some 78 per cent of container traffic handled in Hong Kong is related to Southern China. The port of Hong Kong is also a major hub port in the global supply chain and is served by some 80 international shipping lines with over 400 container liner services per week to over 500 destinations worldwide.

1.3 Notwithstanding the above, we cannot be complacent. Competition for visitors throughout the region is fierce. In support of tourism development, we have to further increase our appeal to tourists by upgrading our tourism products and enhancing our service quality to meet future challenges. On the logistics side, we must bear in mind that in neighbouring areas the logistics industry is developing very fast and competition is ever intensifying. As such, there has always been wide public interest in the planning and development of Hong Kong's tourism and logistics infrastructure, services and facilities, as well as the operation and management of port and airport.

1.4 To maintain its position as the preferred international and regional transportation and logistics hub, Hong Kong should look beyond its own confines to acquire first-hand understanding of overseas experience in logistics development. The information is particularly important for examining ways to maximize the scope of cooperation and coordination with other parts of the

Pearl River Delta in developing inter-modal transportation links to achieve synergy. Given the task to monitor and examine Government policies and issues of public concern relating to economic infrastructure and services, including air and sea transport facilities and services, the Panel on Economic services (the Panel) of the Legislative Council (LegCo) has found it necessary to examine the development strategies and operation of other international transportation and logistics hubs.

1.5 In November 2003, the Panel decided that it should consider conducting an overseas duty visit to study overseas experience in port and airport management, and logistics development. The Panel also considered it an opportune time to learn about overseas experience in the privatization of airports and in the operation of Disney Parks. Since the Government's announcement of its plan to privatize the Hong Kong Airport Authority in August 2003, the Panel had engaged itself in discussion with the Administration on issues related to the privatization of the Hong Kong Airport Authority. At the same time, with the imminent opening of the Hong Kong Disneyland in 2005, there are growing concern about the difficulties likely to be faced during the initial period of operation of the theme park. In December 2003, the Panel decided to conduct an overseas duty visit to London, Disneyland Resort Paris, Amsterdam and Rotterdam from 3 to 9 April 2004 to study overseas experience in the following aspects:

(a) port and airport management, and logistics development;

(b) privatization of airports; and

(c) management of theme parks.

1.6 The proposed overseas duty visit was endorsed by the House Committee at its meeting on 9 January 2004.

The delegation

1.7 As findings of the visit would serve as useful references for Members in their consideration of future airport privatization proposal, and measures and plans on logistics/tourism development in Hong Kong, the Panel considers that the visit should be open to non-Panel Members. The delegation comprises seven Panel members, one non-Panel member and one staff member of the LegCo Secretariat. The membership list is in **Appendix I**.

Programme of the Overseas Duty Visit

1.8 During our stay in London, Paris and the Netherlands, we met with legislators and senior government officials responsible for logistics development, planners for airport terminal facilities, and regulator of airports. We also visited the Disneyland Resort Paris, the Amsterdam Airport Schiphol, and the port of Rotterdam to exchange views with their management on various issues. We also took the opportunity to visit the Second Chamber of Parliament in the Netherlands, and meet with a group of top political and business leaders in London to exchange views on matters of mutual concern. The programme of the visit is in **Appendix II**.

Report of the delegation

1.9 This report summarizes the background, findings, observations and conclusions of the visit. The Research and Library Services Division of the LegCo Secretariat has conducted a background research on selected airports, ports and theme parks for members' information. Where appropriate, the findings of the background research have been included in this report. A list of references for preparing this report is in **Appendix III**.

1.10 This report will be presented to the House Committee on 25 June 2004.

Chapter 2 - Airports

2.1 In this duty visit, the Panel visited the Amsterdam Airport Schiphol and met with the UK's aviation regulator, the designing team of the Heathrow's Terminal 5, senior government officials of the Netherlands and other logistics service providers. The Panel has given particular attention to overseas experiences in the privatization of airports and its impact on the level of aviation regulation and the standard of air traffic services. The historical development of airport regulation and operation in the UK over the past 40 years provides very useful reference as to how a formerly Government-owned airport authority transformed into a market-driven listed corporation yet subject to the same, if not higher, level of public accountability. The Amsterdam Airport Schiphol, on the other hand, demonstrates how the Schiphol Group creates and develops AirportCities and turns them into dynamic hubs with multi-transport modes, integrating people and businesses, logistics and shops, information and entertainment. The construction of Heathrow's T5 is also a vital investment to consolidate the UK's position at the centre of world aviation. It also provides much needed state-of-the-art facilities to help meet the future demand to fly.

Development of airport regulation and operation in the United Kingdom

Civil Aviation Authority

2.2 In the UK, the regulation of aviation is vested with the Civil Aviation Authority (CAA), which is a public corporation established by the Parliament in 1972. It was at first an independent specialist aviation regulator and provider of air traffic services. Following the separation of National Air Traffic Services from the CAA in 2001, the CAA is now the UK's independent aviation regulator, with all civil aviation regulatory functions (economic regulation, airspace policy, safety regulation and consumer protection). All airports must be licensed by CAA for reasons of safety. The CAA also has the responsibility of undertaking periodic reviews of airport charges, fixing price caps, conducting in-depth inquiries into mergers, markets and the regulation of the major regulated industries, including the British Airports Authority.

2.3 The UK Government requires that the CAA's costs are met entirely from its charges on those whom it regulates. The CAA has a staff establishment of about 1,000 people. The CAA is divided into four Groups:

(a) Economic Regulation Group
(b) Safety Regulation Group

(c) Directorate of Airspace Policy
(d) Consumer Protection Group

Privatization of the British Airport Authority

2.4 The British Airports Authority (BAA), now a public corporation listed on the International Stock Exchange, currently owns seven airports in the UK, namely Heathrow, Gatwick, Stansted and Southampton in England, and Edinburgh, Aberdeen and Glasgow in Scotland. The former British Airports Authority was originally established by the Airports Authority Act 1965, and was a Government-owned body assuming ownership and responsibility for the three London airports (Heathrow, Gatwick, Stansted) as well as Prestwick airport in Scotland, in April 1966. Later, Edinburgh, Aberdeen, Glasgow and Southampton Airports were added. Prestwick was subsequently sold.

2.5 In 1985, the Government announced its intention to privatize the former British Airports Authority to reduce the size of the public sector and to provide management with greater freedom and access to private capital. In 1986, the Authority was dissolved, and its property, rights and liabilities transferred to BAA, under the Airports Act 1986.

2.6 On 16 July 1987, 500 million shares in BAA were offered for sale and the company was listed on the International Stock Exchange, London, on 28 July 1987. Out of the 500 million shares offered for sale, 260 million shares (including 22 million shares retained for bonus issue) were offered to the general public (including BAA employees and pensioners) at a fixed price of 245 pence per share, 115 million shares were placed at the fixed price with institutions and 125 million shares were sold by tender at or above the fixed price. The fixed price shares to the general public were nearly 10 times subscribed and the tender offer was six times subscribed. Deducting the £20.8 million fees and commission for flotation, the net proceeds from the sale of shares amounted to £1,182.9 million. The Government at first retained a residual 2.9 per cent stake in BAA, but it sold this stake in 1996.

Regulatory framework for BAA's charges and future development

2.7 At the time of privatization, there was concern about the sale of BAA as a single company, rather than selling off its seven airports separately or as two separate groups of London and Scottish airports, would result in a monopoly. There was also concern that any abuse of BAA's power of monopoly would result in predatory pricing. The UK Government believed that the regulation of BAA's airport charges by the regulatory bodies would be effective in avoiding monopoly abuses such as predatory pricing.

2.8 The Airport Act 1986 prohibits the levying of airport charges at an airport unless permission is given by CAA. Under the Airport Act, both CAA and the Competition Commission (CC) play the role of regulators and reset price caps on airport charges on designated airports every five years. CAA and CC do not directly set out how much BAA can charge. The price cap controls the total income from all the airport charges divided by the number of passengers. In other words, it is through the setting of the maximum average revenue per passenger per annum that CAA and CC indirectly regulate the airport charges.

2.9 CAA, through its Economic Regulation Group (ERG), discharges its statutory duties with respect to the economic regulation of aviation in the UK. ERG aims to benefit users of air transport services and facilities through, among others, the regulation of airports and air traffic services to encourage efficiency, service quality and timely investment in capacity. Under the Airports Act 1986 the CAA has to set price caps on airport charges at airports designated by the Secretary of State. The airports currently designated are Heathrow, Gatwick, Stansted and Manchester. Before it can set a price cap the CAA must, consistently with the Airports Act, make a reference to the CC unless the Secretary of State directs otherwise. The reference asks the CC to report on what the maximum limit on airport charges for the following period of five years should be, and whether, since the date of the previous reference, the airport has pursued a course of conduct contrary to the public interest. The CAA has to impose conditions if the CC finds that an airport has been acting against the public interest but it takes the final decision on the price cap.

2.10 On the side of the Government, the Department for Transport sets out the long-term framework for development of air transport, against which the airport operators can plan ahead, as well as providing a guide for decisions on future planning applications. In December 2003, the Department for Transport published its White Paper "The Future of Air Transport", setting out a strategic framework for the development of airport capacity in the UK over the next 30 years. The White Paper has given government support for two new runways to be built in South East of England by 2030, the first at Stansted and the second at Heathrow, provided that BAA meets strict environmental conditions. The Government has invited airport operators to bring forward plans for increased airport capacity in the light of the policies and conclusions set out in the White Paper.

2.11 The Transport Committee of the House of Commons, which is responsible for examining policy proposals from the Department of Transport, has undertaken a major inquiry on the Government's White Paper. The Transport Committee blames the dominant position of the BAA for the

shortage of capacity, and finds it more appropriate to break up the monopoly of BAA. Some airline operators have also called for the break up of BAA. Some believe that separate ownership or financing of BAA's seven airports will make the airports more efficient, while some believe that building of a new runway at Stansted, patronized mainly by low-fare airlines, would require cross-subsidy from Heathrow, resulting in higher charges for airlines using Heathrow.

2.12 At the time of privatization, i.e. mid 80s, the Government considered separation of airports undesirable because of the lack of spare capacity to provide a basis for competing for extra business and in view of the risk of reducing operational efficiency. However, CC, as one of the regulators of BAA, has not ruled out the reconsideration of the possibility of a break up in the future on grounds of consumer interest.

Corporate governance of BAA

2.13 As a listed company, BAA is committed to a high standard of corporate governance. The BAA board comprises a part-time chairman, five non-executive directors and seven executive directors. The role of chairman and chief executive are separate. The company has also identified a senior independent non-executive director. The role of the board is to, inter alia, determine the long-term direction and strategy, monitor the achievement of business objectives, and ensure it meets its responsibilities to shareholders, local communities, staff and other stakeholders, including its regulator, the CAA.

2.14 The board uses a nomination committee, which comprises a majority of non-executive directors, to identify and recommend to the board candidates for executive and non-executive appointments. One third of the directors are required to retire by rotation each year. Directors appointed by the board in the course of the year must retire and offer themselves for reappointment at the next Annual general meeting of the company. All directors are subject to re-appointment by shareholders at the annual general meeting at least once every three years.

2.15 Director's remuneration and service contracts are determined according to the remuneration policies approved by the remuneration committee. The ongoing level of executive director's remuneration is benchmarked against the median practice in a comparable group of companies. Remuneration of non-executive directors is reviewed on an annual basis, within the limit set by the company's articles of association, against the median market trends gathered from an independent market survey. In accordance with the directors' remuneration report regulations 2002, which introduced new

statutory requirements for the disclosure of directors' remuneration, details of directors' remuneration are provided in the annual reports of the company.

2.16 In enhancing transparency on its performance and activities, BAA each year in its annual report gives a full account of the operating and financial review of each of its seven airports in UK, its international airports business, and its airport retail management.

Relationship between CAA and BAA in the system of economic regulation

Quinquennial Reviews

2.17 BAA, despite being a listed company with due responsibility to its shareholders, is subject to the regulation of CAA which has a duty to safeguard the interests of the public. Once every five years, the CAA, through the ERG, conducts the Quinquennial Review, which covers two major aspects of BAA's business:

(a) annual increases in revenue from airport charges per passenger; and; and

(b) BAA's conduct in relation to customers, business partners and suppliers.

2.18 Using the Fourth Quinquennial Review (2003-2008) as an example, new price caps were set for Heathrow, Gatwick, Stansted and Manchester for the period from 1 April 2003 to 31 March 2008[1] (i.e. Q4). The CAA reviewed the BAA London airports (i.e. Heathrow, Gatwick and Stansted) and Manchester airport in parallel. It followed a programme of work which led up to the decisions on the new price caps in early 2003. The first stage of the process should be for airlines and BAA to talk to one another about it and set out the nature of any agreements that they can reach, and present their findings

[1] Different regulatory periods are set out below:

First quinquennium	(Q1)	1987/88-1991/92
Second quinquennium	(Q2)	1992/93-1996/97
Third quinquennium	(Q3)	1997/98-2002/03
Fourth quinquennium	(Q4)	2003/04-2007/08

Following a decision by the CAA in May 1999 to extend the price caps at the BAA London airports into a sixth year, the expiry date of the price caps for Q3 was extended from 31 March 2002 to 31 March 2003.

to CAA for further consideration. For the purpose of illustration, the review of the BAA London airports is used.

2.19 Although price caps are reviewed and set every five years, the X factor in the Retail Price Index (RPI) *minus* X formula can be different for each of the five years and different for each of the three BAA London airports. However, once the X factor is determined, it cannot be changed during the five-year period. In setting the price caps for the period 2003-08, a number of factors have been taken into consideration, including future projections of passengers, operating costs and capital investments, quality of service, security costs per passenger, and the capacity of handling arrivals and departures.

CAA's initial proposal

2.20 Prior to the reference to CC, the CAA undertook a substantial review of the appropriate basis on which to set the maximum level of airport charges. The CAA summarized the basis of its recommendations, which it believed would best meet its statutory objectives, as follows:

(a) regulation should focus on the monopoly services provided by the airport to users;

(b) increased contracting and competition, recognizing the strategic and operational interdependency between users and airports, assisted by improved information disclosure, could allow less intrusive economic regulation;

(c) congestion on Heathrow and Gatwick runways meant that increases in permitted airport charges were likely to result in better use of those airports with consequent benefits for passengers;

(d) users' high valuation of additional capacity, particularly at Heathrow, indicated that incentives to invest in new capacity were essential;

(e) major investments had long lead times and long pay-back periods, both of which could be well beyond the statutory five yearly reviews emphasizing the importance of long-term regulatory commitment;

(f) a greater focus on service quality was a core part of the regulatory framework at Heathrow and Gatwick; and

(g) Stansted would have more limited market power than Heathrow and Gatwick over the 2003 to 2008 period and would remain dependent

on the success of low-fare carriers, pointing to a continuation of light-handed regulation.

2.21 CAA recommended the following, among other things, for the three London airports:

- price caps would be set in relation to the assets and costs of each airport on a stand-alone basis; and

- a revised regulatory cost base (RRCB), which would only focus on the core "aeronautical" activities, and therefore would not consider an airport's performance in its other "commercial" activities when setting a price cap for airport charges. This is also referred to as a dual-till approach as opposed to the single-till approach which takes account of the costs and revenues of both aeronautical and commercial activities of an airport when determining the price cap for the airport charges.

2.22 Underlying the CAA's approach is about the maximization of net gains to users and airports combined to enhance economic efficiency. These mean:

- encouraging the best use of scarce airport capacity;

- enhancing the incentives to expand capacity to meet demand and upkeep service quality; and

- restricting the scope of regulation to monopoly activities.

2.23 The CAA is of the view that widening the scope of regulation to commercial activities carries a range of dangers. It extends the scope for regulatory failure to activities and facilities which would not normally be considered candidates for full economic regulation, thereby dampening incentives to develop those businesses fully and efficiently. It results in aeronautical charges being driven, and increasingly so, by the fortunes of the commercial businesses, and as commercial businesses have grown, this gearing effect has increased. It extends the arena for regulatory influence into important areas of investment, such as surface transport and access, and extends the scope for regulatory failure to these investments (either by encouraging socially unprofitable investments which can be offset through higher airport charges, by dampening the returns on those investments, or by influencing both investment selection and efficiency).

2.24 The CAA is also of the view that most of the economic rents accruing from commercial activities relate directly to passengers, not to airlines. Retailing, food and drink, and surface access are obvious examples. But the single till does not have the effect of reducing prices in the shops, for food, or for surface access. Instead it uses those rents to reduce aeronautical charges. At congested airports this is unlikely to be passed back to passengers through lower ticket prices, but will primarily generate rents for airlines and may comprise economic efficiency. This is because airfares are determined by available airline capacity, which is restricted by capacity constraints not airports. Even at non-congested airports, the degree of complementarity between commercial activities and aeronautical activities is unlikely to be close enough that using rents from commercial activities to reduce aeronautical charges is an effective way of protecting passengers.

Views of airlines

2.25 Airlines are of the view that higher airport charges would lead to higher fares, hence affect passengers. They also regard commercial activities as an inseparable part of the aeronautical business. Further, concerns have been raised over the dual-till approach which gives BAA the incentive to favour commercial development at the expense of aeronautical development.

Views of CC

2.26 CC is of the view that other things being equal, the dual-till would lead to significantly higher airport charges over the longer term. CC finds no evidence that the single-till had led to any general under-investment in the past. On the other hand, it is still uncertain whether the dual till would lead to better aeronautical investment in future. Whilst the dual till could improve the efficient utilization of capacity, the benefits are unlikely to be more than marginal, even at Heathrow, where there is significant excess demand. The case for the dual till is, indeed, even weaker in Q4, where the CAA proposed to apply it only to the less congested airports: Gatwick and Stansted.

2.27 CC also does not see significant benefits from any deregulation of BAA's commercial activities, most of which relates to the leasing of space for retail and other commercial activities. In so far as airport charges affect fares, BAA's current relatively high profits from its commercial activities are mitigated by the fact that they are applied to the benefit of passengers. The dual-till approach would break this link and may therefore require increased regulation of such activities. The dual till could also risk unduly benefiting commercial activities at the expense of aeronautical activities, which may not attract sufficient funds or management priority.

2.28 Against those, at most, limited benefits, CC sees significant disadvantages from the dual-till approach. CC believes it is difficult sensibly to separate commercial and aeronautical activities. BAA's rental and other commercial revenues at the three London airports would not be generated without aeronautical facilities—commercial and aeronautical facilities are better, therefore, in CC's view, and more realistically regarded as one business. Since the successful development of commercial revenues requires airlines to attract passengers to the airport, the benefits of commercial activities should also in CC's view be shared with airlines and airline users. It is also difficult, in practice, to allocate either investments or operating costs between aeronautical and commercial activities. To the extent that some of the judgements that have to be made are arbitrary, future disputes about cost allocation could also harm relations between the airport and its users.

2.29 CC does not believe average fares would be unaffected after adopting the dual-till approach. CC recognizes that the current level of prices particularly at Heathrow are very substantially below market-clearing prices or the long-run incremental cost (LRIC) associated with new capacity. But setting market-clearing prices is not consistent with international obligations, and the net effect of setting charges equal to LRIC would be very detrimental to users.

2.30 In brief, CC does not share the view of the CAA that the dual till is best calculated to meet the objectives of the Airports Act 1986. In its view, the single-till approach should be retained for Q4.

CAA's decision after making reference to CC

2.31 According to CAA, all users responding to the CAA's November 2002 proposals, supported the CAA's proposal to set the price caps for Q4 consistent with a single till approach. BAA said that it continued to believe that a dual till approach would provide for improved investment incentives, but did not wish to re-open the debate during the Q4 review stage.

2.32 The CAA takes the view that regulation is likely to be most effective when it is founded upon credible incentives. Establishing such incentives can be difficult in an environment where assets are long lived, but price caps are set for five years and where regulators are not able to bind their successors. Within the regulatory framework established under the Act, the CAA believes that incentives are likely to be most effective where there is a considerable degree of agreement between the two regulatory bodies (the CAA and the CC) and between users and the airports. Where there are major divisions, the risk that future regulatory decisions will diverge from previous commitments increases, the credibility of the incentives suffers, and a framework that may have

potentially strong incentive properties may not be the most effective in practice.

2.33 The fact that CC did not accept the CAA's view on the dual till, and the fact that airline users were universally opposed to its introduction, are likely to undermine the potentially desirable incentive properties that a move to dual till as part of an overall regulatory policy package at the review stage could otherwise have provided. The CAA therefore concluded that it was best able to meet its statutory objectives, given the forgoing, by setting the price caps for Q4 consistent with a single till approach.

2.34 The current price caps, which run from 1 April 2003 to 31 March 2008, are:

(a) Heathrow : RPI + 6.5% per annum

(b) Gatwick : RPI + 0%

(c) Stansted : RPI + 0%

Scheme of service standards and rebates in Heathrow and Gatwick Airports

2.35 Although the findings of the CC are not binding on CAA, reference is always made to CC's study reports when CAA takes on board any new initiatives to enhance market competition and protect users' interests. In October 2002, when the CC reported on Heathrow and Gatwick airports, it found that the airports had acted against the public interest as charges at the airports did not sufficiently reflect the level of service provided. After consulting with BAA, airlines and other interested parties (including representatives of passengers at both airports), the CAA introduced a scheme where airlines receive monthly rebates if service standards fail to meet specified standards. The scheme is designed to introduce some relationship of price paid to service received and to incentivize the airports to maintain or improve service quality. The scheme came into effect on 1 July 2003.

Elements of service covered

2.36 The service standards initially cover both objective measures (which mainly cover the availability and serviceability of certain equipment) and passenger perception of certain aspects of service (measured by surveys). The CAA has set up a working group to consider the introduction of an aerodrome

congestion term, which would cover delays to flights attributable to BAA.

2.37 The objective elements of service and standards are:

- stands (to be available 98% of time);
- jetties (to be available 97% of time);
- pier service (90% of passengers to be pier served);
- fixed electrical ground power (to be available 98% of time);
- people movers (i.e. escalators, passenger lifts, goods lifts and travelators) (to be available 98% of time);
- security queues (waiting time to be less than 10 minutes on 95% of the occasions checked, checks at least every 30 minutes);
- arrivals reclaim (baggage carousels to be available 98% of time);
- inter-terminal transit at Gatwick (at least 1 car to be available 99% of time, 2 cars to be available 97% of peak time);
- South Terminal satellite transit system (at least 1 car to be available 99% of time, 2 cars to be available 97% of peak time).

2.38 The standards do not apply for all 24 hours at the airports but for shorter core periods, usually agreed between the airport and airlines at particular terminals. For certain facilities that require periodic maintenance there is a deadband of one month where rebates will not be paid if the standard is not reached. This month has to be off-peak and have been specified to airlines in advance. There are some other exclusions which mainly relate to service failure in circumstances relating to safety and security and damage caused by airlines or their agents.

2.39 The elements of service which are covered by surveys of passenger perception are:

- availability of departure lounge seating;
- cleanliness;
- wayfinding;
- flight information.

2.40 Passenger perception is measured by a BAA survey which had been established for many years before the scheme of standards and rebates was introduced. The survey will be subject to periodic independent audit on behalf of the CAA. The standards were based on existing performance at the airports, so for some elements covered by the surveys the standards at Gatwick are higher than those at Heathrow.

Rebates

2.41 Rebates are based on performance at individual terminals against common standards for the airport as a whole. Therefore rebates are higher for airlines at the worst performing terminals. Rebates are paid to the airlines operating at a terminal on a pro-rata basis, based on the proportion of airport charges paid by an airline in connection with its flights at the terminal.

2.42 Overall rebates are capped at a level of 2% of revenue from airport charges at the airport for 2003/4 and 2004/5. This limit will rise to 3% of airport charges revenue thereafter. The mechanics of the scheme result in rebates for individual elements of service in a terminal also being capped within a year. This means that if a particular element in a terminal fails to meet the target for six months in a year, no further rebates will be paid in that year for further failures for that element.

Financing new infrastructure -- Heathrow's Terminal 5

2.43 The CAA has taken the view that "BAA is best placed in deciding on its appropriate financial structure" and "the adoption of particular financing arrangement is the responsibility of BAA airports".

2.44 The BAA has embarked on an ambitious investment programme on the construction of new infrastructure and refurbishment of existing facilities. The most significant single project is Heathrow's Terminal 5 (T5), announced by the Government on 20 November 2001. An estimated total capital investment of about £3.2 billion will be made on T5 by BAA. To avoid under investment in aviation as was the case for the rail industry, BAA points out that it stands ready to invest billions of pounds of private sector funds in UK's national transport infrastructure, without the need for any public fund. T5 and other capital programmes of BAA in the next 10 years will be funded by debt and retained earnings for the foreseeable future. Financing will be done primarily through the issue of Euro and Sterling bonds.

2.45 T5 is constructed to allow Heathrow to maintain its position as Europe's leading international hub airport and provide much needed state-of-the-art facilities to help meet the future demand to fly. It will accommodate more than 30 million passengers each year by 2016. Given Heathrow's importance to London, the South East and the UK, BAA is of the view that this vital investment will give a major boost to the local economy, to the UK aviation industry and to the general prosperity of the region. T5 will consolidate the UK's position at the centre of world aviation, securing jobs,

attracting inward investment and generating economic prosperity for many years to come. Tourism in the UK is worth £10 billion a year and depends on Heathrow as the country's principal gateway. T5 is therefore essential if the airport is to remain the cornerstone of tourism in the UK.

2.46 The plans for T5 were subject to the UK's longest ever planning inquiry (three years and 10 months) in which many interested parties were able to give evidence and express their views. Ten topics were examined in detail: Economic/Aviation case, Development pressures/regional planning, Land Use Policy, Surface Access, Noise, Air Quality, Public Safety, Construction, Associated Applications and Mitigation and Conditions. The Public Inquiry also considered 21 related planning applications, 6 Highways Orders and 2 Transport & Works Acts. Never before has a UK construction project been subject to such a comprehensive examination.

2.47 According to BAA, T5 is designed and built in accordance with the principle of sustainable development. This means:

- Consultation with stakeholders on environmental, social and economic issues
- High and stable levels of economic growth and employment
- Social progress which recognizes the needs of everyone
- Effective protection of the environment and prudent use of natural resources

Design of T5

2.48 Enhancing the passenger experience has been at the forefront of the design concept - which is to create an airport terminal characterized by open space, natural light, simplified passenger circulation, shorter walking distances and spectacular airfield views. The massing design of the campus has been similarly designed to integrate harmoniously with the surrounding landscape.

2.49 The terminal building consists of four principal passenger levels providing complete segregation of arriving and departing passengers and simplified wayfinding and passenger circulation. These include:

- the departures concourse at the top level leading to the check in area, security points and departures lounges

- the departures gate level for boarding the aircraft

- the arrivals gate level for access from aircraft

- the arrivals concourse at ground level leading to the baggage reclaim hall, customs and arrivals concourse to onward travel facilities

2.50 The main terminal building envelope is 384 metres long, 165 metres wide and 43 metres high. It is supported by 11 pairs of giant steel support arches, which rise 39 metres from the ground. This design offers a vast, completely free and flexible internal space. Each facade is predominantly glazed allowing greater transparency through the building and clear views of the airfield and surrounding countryside. Maximizing the use of natural light also contributes to the energy efficiency of the building.

2.51 Two further sub-ground levels include a basement for the baggage systems and track transit system which connects to the satellite buildings and below that, the rail station for the Heathrow Express and London Underground Piccadilly Line.

2.52 According to BAA, T5 is not the beginning or end of a journey, but a point of transit in a longer journey. For this reason, the terminal design incorporates a fully integrated multi-modal public transport interchange. The departures and arrivals concourses connect seamlessly to the various modes of public transport via glazed link bridges which span the interchange plaza. This allows direct and convenient access to and from the terminal to the bus, coach and taxi facilities which are integrated into the forecourts of the multi-storey car park.

Amsterdam Airport Schiphol

2.53 Amsterdam Airport Schiphol is the 4th largest European airport in passengers and the 3rd largest European airport in cargo in 2003. Schiphol Group owns and operates Amsterdam Airport Schiphol, Rotterdam Airport and Lelystad Airport and has a 51.5% share in Eindhoven Airport. Outside the Netherlands, Schiphol USA Inc. has a share in JFK IAT, which operates Terminal 4 at John F. Kennedy Airport, New York and Schiphol Australia has a share in Brisbane Airport Corporation, the operator of Brisbane Airport. The shareholders of Schiphol Group are :

- State of the Netherlands : 75.8%

- City of Amsterdam : 21.8%
- City of Rotterdam : 2.4%

2.54 Despite this shareholding structure, Schiphol Group is a financially independent, commercial enterprise. It services its financial obligations from cash flows generated by its services without any guarantee from the Dutch government.

AirportCity

2.55 Schiphol Group aims at creating and developing AirportCities and by positioning Amsterdam Airport Schiphol as the leading AirportCity. An AirportCity is an efficient, multimodal hub for air, rail and road transport, integrating people and businesses, logistics and shops, information and entertainment. It is also a location that offers its users all required services 24-hours a day, whether they are passengers, staff or just people meeting and seeing off passengers or locally-based international businesses, such as airlines, handling agents, logistics companies and business service providers.

2.56 On the cargo side, Amsterdam Airport Schiphol is focussing on two approaches to strengthen the hub. First, it further develops the relationship it has with its current customers. Where possible, it will support them with their activities at Schiphol, as well as in the region. Airport Schiphol achieves that by providing market statistics, organizing commercial meetings, and by joining forces in promotion. It is also actively going into dialogue with its customers about their future requirements to improve current services and provide new ones. Secondly, in order to strengthen its current network by stimulating existing cargo flows to move from other European airports to Amsterdam, Airport Schiphol will identify opportunities in new markets, with the goal of attracting new carriers to expand their cargo operation by using Schiphol as their European hub. It is currently focussed on the large markets in the Asia Pacific and Middle East regions. Many of the airlines are also looking for possibilities to position their flights to China, which continues attracting higher loads.

2.57 The availability of a dense and highly flexible European trucking network coupled with good ports nearby and facilities to serve a wide range of the industry remain to be a competitive feature for the Schiphol cargo industry. The catchment area covers Scandinavia, UK, Western and Central Europe.

Future Growth

2.58 The airport development plan, or Masterplan for Amsterdam Airport Schiphol, has been created to enable Amsterdam Airport Schiphol to handle about 85 million passengers as well as three million tonnes of cargo by 2020; twice the volume it is currently doing. In order to accommodate the anticipated growth, a number of infrastructural development projects would be carried out in phases. Development of new business parks and major office complexes would continue to strengthen the region as a major European hub and a nerve centre for European logistics and office activities. The Schiphol Group believes that a key factor to success hinges on good accessibility by road and rail. Vital projects, including the construction of the high-speed eastern rail link into Germany, increasing the capacity of motorways, continued development of Amsterdam's Zuidas District, a second area of reclaimed land at the entrance to the Port of Rotterdam - Maasvlakte II, and the Rotterdam high-speed rail junction and the construction of the Zuiderzee railway line to Almere are being carried out. In addition to these infrastructure projects, there is a need to work on the development of Amsterdam Airport Schiphol as a destination, on improving the housing situation and the quality of life in the region.

Air France/KLM merger

2.59 The Panel also had the opportunity of looking into the merger of Air France and KLM. The merger, which marks an essential step forward in the process of sector consolidation in Europe, will create a new entity which will be the world's largest airline group with a turnover of 19.2 billion euros.

2.60 As of 1 June this year, Air France and KLM passengers could gain benefit from coordinated schedules throughout their entire short, medium and long-haul networks.

2.61 Air France and KLM are to step up services between Amsterdam and French regional airports and between Paris and Dutch regional airports with the launch of three new services: Amsterdam-Bordeaux, Amsterdam-Marseille and CDG-Rotterdam. Air France and KLM are also seeking to maximize the complementary nature of their medium-haul networks.

2.62 Air France has a strong presence in southern Europe, while KLM has developed an extensive network in northern Europe. The long-haul routes on which Air France and KLM do not have a daily flight or do not have a non-stop point-to-point flight are to be rationalized and improved.

2.63 The two airlines' world networks can be combined, forming a vast network organized around the two major hubs of Amsterdam-Schiphol and Paris-CDG. This initiative will be very attractive for passengers who need to travel via a hub to reach their final destination. When they organize their trip to a distant destination served by Air France and KLM, they can benefit from two different schedules on the same day, on both the outgoing and return legs, and will be able to combine a trip via Amsterdam with one via Paris.

2.64 By pooling their strengths in the cargo sector, Air France and KLM are of the view that they will become the biggest non-integrator operator, with a combined turnover of 2.5 billion euros.

2.65 In the field of aircraft maintenance, the merger is to give rise to one of the world's leading suppliers of maintenance services, with a combined turnover of 2.6 billion euros.

2.66 The Schiphol Group holds a positive view towards the merger of KLM and Air France. The Group believes that the merger is in line with the further consolidation of the global aviation industry and will reinforce KLM's position. With the planned multi-hub system of the Skyteam alliance – with Paris CDG and Amsterdam Airport Schiphol as the principal European hubs – the new combined airline offers good growth prospects for the Group. For that growth to be achieved, however, it is important that the airport continues to offer quality services and facilities at competitive rates. The visit costs in particular – the total cost to an airline for a visit by one of its aircraft to Schiphol – is an important criterion in this context. It is vital to keep these costs down if Amsterdam Airport Schiphol is to compete successfully with the other major hubs in Europe.

Privatization of the Amsterdam Airport Schiphol

2.67 During the visit, we met with the Ministry of Transport, Public Works and Water Management of the Netherlands Government. We were given a briefing on how the Netherlands Government planned to privatize the Amsterdam Airport Schiphol.

2.68 The Netherlands Government has a tradition of favouring industry development through private enterprise, and intervention will only be performed when the national interest or many jobs are at stake. In this connection, policies tend to emphasize improving competition and protecting consumer rights. The government has been actively liberalizing sectors such

as gas and electricity, telecommunications and public transport.

2.69 The Netherlands Government announced its intention of selling a minority stake in Schiphol Group in 2002. The government expected that the size of flotation (49% of the existing shares) together with the airport's investment and expansion strategy would receive favourable feedback from investors. However, due to a change in government in 2002/03 and the negative privatization experiences in both the Netherlands and overseas places in the above period, there is still no formal decision made on the flotation exercise.

Views on privatization

2.70 We note that there are divergent views over the proposed privatization of the Amsterdam Airport Schiphol. It is believed that public float enables Schiphol Group to expand both its aviation and non-aviation activities and to participate in airport alliances abroad. In general, a privatized airport allows a more efficient decision making process, a reduction in excess staff and the lowering of operating costs, leading to reductions in user fees and a modernization of air traffic control. A clear delineation of responsibilities between the privatized company and the State could be achieved upon privatization.

2.71 For those who object to the proposed privatization, they are worried that privatization may lead to a decline in services, bearing in mind the negative privatization experiences of the national train company in the Netherlands. Some people consider that privatization is not desirable unless there is a proper functioning market with several providers of services. In Amsterdam, however, there is only one airport for all air traffic movements. There is also a fear of an abuse of the monopoly position by Schiphol Group after privatization. Schiphol Group may exploit its market power and reap off its customers as there is no close substitute for the Amsterdam Airport Schiphol. It may increase tariffs for airlines and decrease investments in infrastructure of Amsterdam Airport Schiphol in order to maintain satisfactory profit level and dividend payments. Privatization may not increase the opportunities for capitalization nor reduce the cost of capital. In the event that the financial performance of the privatized Amsterdam Airport Schiphol or Schiphol Group cannot meet the requirements of some credit rating agencies, the credit rating agencies may downgrade the credit ratings of Schiphol Group, resulting in an increase in the cost of capital.

2.72 The Netherlands Government would continue to plan ahead for the proposed privatization of Amsterdam Airport Schiphol, taking into account the views expressed by various parties and the need to formulate a proper economic regulatory regime to balance the interests of various stakeholders and the long term growth of the airport.

Chapter 3 - Port

3.1 To study the development and management of major port facilities, the Panel visited the Rotterdam port of the Netherlands, which, together with its industrial complex, fulfils an important role as a hub for international goods flows and as a business location for industry and logistic services. The port and industrial complex of the Rotterdam port is of great significance to the European, national and regional economies. During the visit, the Panel met with the Ministry of Transport, Public Works and Water Management, which gave a presentation on, among other things, the main port policy and hinterland connections. The Panel also met with the management of the port authority.

Port of Rotterdam - Introduction

3.2 The port of Rotterdam is situated at the mouth of River Maas, a river which rises in France and flows through Belgium into the Netherlands. The port and industrial area, comprising an area of about 10,000 hectares, spans forty kilometers and runs from the city center to the North Sea. The accessibility for ships with a very deep draught (24 meters) and the excellent hinterland connections by water, road, rail and pipeline make Rotterdam an outstanding logistic hub. The port offers employment to more than 60,000 people in Rotterdam as well as to an additional 255,000 people in the rest of the country. The direct gross added value of the port and industrial area amounts to 7.7 billion Euro. This is 1.9 % of the Dutch Gross National Product.

3.3 In terms of cargo throughput, port of Rotterdam is the world's busiest port in 2002, handling some 322 million tons of cargoes. Regarding container throughput, it handled 6.5 million TEUs in 2002. Large global container carriers are handled at Maasvlakte, a port complex with an annual capacity of handling 8.7 million TEUs.

Ownership and management

3.4 The Port of Rotterdam (P of R), previously known as the Rotterdam Municipal Port Management, is responsible for the development, construction, management and operation of the port and the nearby industrial zone. With effect from 1 January 2004, P of R has been converted by the Rotterdam City Council from a municipal service branch into a government corporation, with the municipality being the shareholder of the company. P of R receives revenue from harbour dues, quay rental and the income from ground rents and rents. About 1,300 people work for the P of R. Its core

activities can be divided into two categories: commercial and nautical services.

Commercial services

3.5 P of R is responsible for the exploitation of the numerous sites that make up the 10,000-hectare port and industrial complex. The Commercial Division focuses on attracting new businesses and cargo flows and on strengthening existing cargo flows in the port of Rotterdam. Together with its clients, the Commercial Division develops new logistic and industrial concepts and makes sure these concepts are implemented, and maintains commercial contacts with existing lessees and shipping companies. Furthermore, the Division is also responsible for all rental and leasehold contracts and for offering information on and the collection of harbour dues.

Nautical services

3.6 P of R is responsible for the efficient and safe handling of shipping traffic in a clean and sustainable port. In the port, roughly 80,000 ship's movements of sea-going vessels and 300,000 ship's movements of inland navigation vessels take place. The traffic management system of the port comprises the Port and Coordination Center (PCC) and a network of 33 radar stations, four of which are manned. This network offers an overview of the management area, which has a total length of 100 kilometers. The PCC has a large central overview of the port at its disposal on large video walls, with up-to-date information about ship's movements, detailed ship's and hydrometeorological information.

3.7 Leading in the combating of large-scale incidents is the crisis control plan of the Municipality of Rotterdam, which has been drawn up by all the core services together. Formerly, this plan would only be put into action in the case of an incident. Nowadays, the threat of, for example, terrorism is already enough to implement the plan. This results in a higher state of alertness of all the parties involved. Patrols are intensified and, in certain cases, it can even result in certain ships being denied access to the port.

3.8 In addition to security, the subject of 'safety' is also gaining importance. An organization has been formed to secure the port and industrial complex. Consultation between the various parties involved plays a leading role in this respect. The multidisciplinary Port Security Board offers the municipality univocal advice about policy matters. In the Security Integration Board, consultation regularly takes place at the managerial level between the business community and the P of R, the Seaport Police and Customs. The Port

Security Development Group develops concrete measures to implement safety measures. The P of R sees to it that these measures cause as little disruption to the logistics process as possible.

Strategic development of the port

3.9 We note that the port of Rotterdam is easily accessible and well connected with the outside world through an efficient inter-modal transport system.

Sea transport

3.10 Rotterdam has a huge number of regular short sea and feeder services to and from more than 200 European ports. Transit times to destinations can be as little as 24 hours. Short-sea and feeder services can handle practically all types of cargo and tend to focus on European destinations. Most vessels combine short-sea and feeder services. This results in a high number of departures – sometimes several per day - to various major destinations. Feeder services are integrated with intercontinental deep sea traffic. The quality and quantity of feeder services allow large global carriers to call at only a few European ports, thus saving time. As the mainport of Europe, Rotterdam is one of these central hubs. Cargo from the Far East, the US and further afield is first shipped to Rotterdam. From there, feeder services carry the cargo to smaller European ports and vice versa in smaller volumes. Shortsea services focus on transport over sea between European ports and those on neighboring continents. Both liner services and charters offer various daily departures from Rotterdam for any type of cargo.

3.11 Some 50 percent of all cargo is transported by inland vessels. With an extensive network of rivers and inland waterways that link Rotterdam to destinations in Germany, Belgium, France, Switzerland, Austria and beyond, inland shipping is a reliable and inexpensive mode of transport. The Rhine-Main-Danube Canal even makes Central and Eastern Europe accessible for inland shipping from Rotterdam. Transit times vary from less than 1 day for destinations in Germany and Belgium to 4 days for destinations in Switzerland. Inland shipping from Rotterdam has traditionally been the major means of transport for bulk such coal, iron ore, grains and scrap. Tankers and parcel vessels provide safe and cost-efficient transport of chemicals and liquid bulk. Inland shipping also plays a prominent role when it comes to container transport.

Rail transport

3.12 All European destinations can be reached from Rotterdam via the international rail network. Transit times are short and vary from less than 12 hours for destinations in Belgium and Germany to 48 hours for destinations in the Czech Republic, Italy and Poland. Because rail transport is environment-friendly and the capacity of Europe's motorways is close to reaching its maximum, the European Union is actively stimulating the use of rail transportation. Rail constitutes a strategic and commercially attractive alternative. Especially after the Betuwe route, a dedicated freight railway line between Rotterdam and Germany, comes into use in 2007. Rotterdam has also developed special concepts for transporting containers by rail. For quickly and safely transporting chemicals, the port has two dedicated Rail Chemical Centers. All in all, almost anything is possible by rail from Rotterdam: cars, refrigerated cargo, heavy machinery and special shipments.

Road transport

3.13 Road transportation has always been one of the major modes of transportation to and from the European hinterland. All industrial sites, distribution centers and terminals have direct access to the extensive, efficient and growing European motorway network. This network covers all the countries that are important for the port of Rotterdam, from UK to Hungary and from Scandinavia to Italy. Every day, thousands of trucks depart to or arrive from these destinations. Remarkably, approximately 40% of all trans-border European road transportation is carried out by Dutch haulers, who offer door-to-door services for relatively low prices. Road transport is especially efficient for urgent consignments that are too large for air transport, small quantities of cargo and perishables. The transit times are short, ranging from 8 hours for destinations such as Frankfurt to 48 hours for destinations such as Moscow, Rome and Stockholm.

Air transport

3.14 Rotterdam is less than one hour's drive from Amsterdam Schiphol Airport, the country's main international airport. Schiphol is one of Europe's most important freight airports. From Amsterdam, air cargo is moved to all corners of the globe. Rotterdam's own regional airport is some ten kilometers to the north of the city centre and can among other things boast a new transshipment center for airfreight, facilities for veterinarian inspections and customs services that are available round the clock. Passengers can each day fly to cities such as London, Paris, Hamburg, Birmingham, Manchester and Copenhagen.

Pipelines

3.15 In Rotterdam, there are many companies focusing on oil and chemicals. These companies actively use pipelines for large-scale point-to-point transport. Both the companies in the port and companies in the Netherlands, Belgium and Germany are connected to the network: as part of the transit and distribution function of the port. Each year, some 60 million tons of various oil and chemical products pass through the pipeline network. The main products being transported are crude oil and (semi) finished products such as naphtha, kerosene, liquefied petroleum gas and ethylene. A multicore pipeline system, which is an underground transport and distribution system for the chemical and gas industry consisting of a pipeline bundle through the port has been developed. This system is regarded as offering a cost effective transport alternative to truck or barge. Phases 1 and 2 of the system have been under operation since 2003

Other infrastructural development

3.16 In order to enhance its competitiveness, P of R has also taken forward a series of measures, apart from strengthening its inter-modal links, to expand the European axis function of the Rotterdam port. These include:

(a) investing in new terminal capacity. The Delta 2000-8 project will be completed by 2005, which involves the construction of eight dedicated container terminals. The project will result in a 54% increase in the Rotterdam port's capacity for container transshipment. An all-weather terminal and multi-modal logistics centre is under construction in Brittanniehaven. The first phase of a new terminal complex, Euromax, will also be built in the near future;

(b) creating Maasvlakte 2, which is a project of constructing a new port and industrial zone on reclaimed land in the North Sea to attract new clients and move existing businesses from the old port areas. The project is scheduled to start in 2005 and is expected to commence with an initial 700 hectares of a planned reclaimed area of 1 000 hectares. It aims at creating a mix of working, living and recreation in the city port area. Vacated port areas are also expected to be transformed into an integrated modern city area;

(c) launching the FAMAS (First All Modes All Sizes) project, which involves co-operation between authorities, businesses and

knowledge institutes to develop a new generation of container terminals, service centres for hinterland transport and inter-terminal transport system for Maasvlakte 2;

(d) strengthening co-operation with ports in the south-west of the Netherlands such as Vlissingen, Terneuzen, Moerdijk and Dordrecht;

(e) reinforcing the leading position of the Rotterdam port in the transshipment of bulk goods, the storage of oil and chemical products and the refining industry. For example, a 600-metre new quay on Maasvlakte will be ready in mid-2005 for the expansion of coal throughput. Negotiations are ongoing with the business community regarding increasing the capacity of handling liquid bulk;

(f) improving the cluster of supplementary service providers such as insurance, classification, agents, attorneys, forwarding agencies, ship brokers, laboratories, consultants and accountants; and

(g) developing an online vacancy databank to help companies in port, industry and related clusters to search for suitable personnel.

Government support

3.17 We notice that the Department of Transport, Public Works and Water Management is cooperating with the P of R and the Betuwe Route Project Organization to create extra capacity in the transport network to facilitate the shifting of cargos from road to rail and inland shipping. For example, it is preparing a capacity expansion for the Vaanplein-Beneluxplein route on A15, the most important traffic route in the port and industrial area. The Ministry of Housing, Spacial Planning and the Environment is responsible for setting a policy framework for the green environment in the Rotterdam port

Chapter 4 - Disneyland Resort Pairs

4.1 During our trip to Europe, we took the opportunity to visit the Disneyland Resort Paris. We also received a briefing by the management on the latest planning and development of the theme park.

Master Agreement

4.2 On 24 March, 1987 the Walt Disney Company (WDC) entered into an agreement on the creation and operation of Euro Disneyland (EDL) in France (the "Master Agreement") with the Republic of France and certain other French public authorities. The Master Agreement sets out a master plan for the development of the land and a general development program defining the type and size of facilities that the theme park company has the right, subject to certain conditions, to develop over a 30-year period ending in 2017. Two theme parks were initially planned for completion in phases.

Role of the French Government

4.3 The French government granted a number of incentives in order to attract EDL to France. The concessions covered four major areas. First, the government allowed EDL to purchase the land at 1970 prices, a 50% to 90% discount relative to the market price. Second, the government agreed to provide a transportation infrastructure, both road and rail, to connect the theme park to Paris. Third, the government agreed to provide a 20-year FF4.8 billion loan at a fixed annual rate of 7.85%. Finally, the tax authorities agreed that EDL could depreciate its assets over ten years, rather than the twenty years that would be normal for such an asset class.

Financing of the project

4.4 In September 1989, the WDC finalized its plans for an initial public offering (IPO) that would partially finance the development of its first major theme park and resort complex in Europe. Under the IPO, a total of 85.88 million shares were issued at an offer price of FF72 per share, with 50% reserved for French investors and the other 50% for investors from the rest of the European Community. Following the IPO, the issued share capital of EDL was 170 million shares with a nominal value of FF10 each, with WDC owning 49%. The equity ownership of EDL after the IPO was as follows:

Entity	No. of shares (millions)	Ownership (%)	FF Invested (millions)
WDC	83.3	49.0[2]	833
Investment Banks	0.9	0.5	9
Public	85.9	50.5	5730
Total	**170**	**100**	**6572**

4.5 According to the original business plan, Phase I of the theme park would be financed through a combination of market debt (FF4.5 billion at an interest rate of Paris Interbank Offered Rate *plus* a spread of 1/2% to 7/8%), a French government loan (FF4.8 billion at an interest rate of 7.85%) and the equity IPO (FF5.73 billion, net of transaction costs). Phase II would be financed entirely with a new debt issue (FF5.9 billion at an assumed interest rate of 9%). With this historical background, EDL is highly leveraged. Under the Generally Accepted Accounting Principles of the United States, as of 30 September 2003, the company had Euro 2.2 billion of borrowings and Euro 60.4 million of shareholders' equity. In addition, EDL pays significant royalties and management fees to affiliates of WDC. The high level of borrowings renders the theme park company to devote a large portion of its operating cash flow to service debt and limit its operating flexibility. As such, the management is actively working on a restructuring plan to improve the situation.

Returns for Disney

4.6 Under the License Agreement, WDC would receive royalties from admission (10% of revenues), participant[3] (10% of revenues), merchandise (5% of revenues), food and beverage (5% of revenues), and hotel (5% of revenues), receive base management fees of 3% of the park's revenues for the first five years, and 6% of the revenues from the sixth year onwards, and receive variable management fee of 0-50% of pre-tax cash flow above a pre-determined threshold.

4.7 The theme park company is mainly engaged in two types of businesses, viz resort activities and real estate development.

[2] Disney's initial shareholding was 49%. Its share was reduced to 39% by selling its equity to Saudi Prince Alwaleed and public shareholders during a financial restructuring in 1994.

[3] In connection with the Disneyland Park, the Walt Disney Studios Park, and Disney Village, the Company has entered into long term participant agreements with companies that are leaders in their fields. These participant agreements provide such companies with certain rights in the theme parks in exchange for an individually negotiated fee.

Resort activities

4.8 Resort activities include the operation of Disneyland Park (which was opened on 12 April 1992) and Walt Disney Studios Park (which was opened on 16 March 2002). Also included in the Resort Segment are hotels and Disney Village operations. Revenues from these activities include room rental, food and beverage, merchandise, dinner shows, convention revenues and fixed and variable rent received from third-party partners operating within the Resort.

4.9 We notice that a new hotel district, Val de France, is scheduled for completion by 2004. According to the company, the four new hotels, vacation condominium and timeshare units managed by third party operators will reinforce the growth synergy.

4.9 The following table provides information regarding the key operating indicators of the Disneyland Resort Paris:

	Theme Parks[1]		Hotels	
Fiscal years (year end September 30)	Total guests (in millions)	Spending Per guest[2] (in Euros)	Occupancy Rate[3]	Spending Per room[4] (in Euros)
2002	13.1	44.4	88%	193.3
2001	12.2	43.1	86%	186.3
2000	12.0	42.2	83%	183.0
1999	12.5	40.7	83%	177.3
1998	12.5	39.3	81%	173.8
1997	12.6	38.3	78%	158.9
1996	11.7	37.8	72%	155.2
1995	10.7	37.8	69%	150.5
1994	8.8	42.1	60%	148.6

1. Includes Disneyland Park and, from March 16, 2002, Walt Disney Studios Park.
2. Average daily admission price and spending for food, beverage and merchandise sold in the Theme Parks, including VAT.
3. Average daily rooms sold as a percentage of total room inventory (total room inventory is approximately 5,800 rooms).
4. Average daily room price and spending on food, beverage and merchandise sold in hotels, including VAT.

Real estate segment

4.10 Disneyland Resort Paris has a strength in real estate development, the other facet of the Master Agreement signed in 1987 with the French state and other public parties. Today, the theme park company is near the half-way point in this ambitious 30-year master plan, which consists of the development of both a major tourist destination and a centre of economic activity in the East Parisian region. Of the site area of 1,943 hectares, 900 have already been developed. According to the company, this master plan provides them with unparalleled opportunities for growth over the long-term. Ultimately, there will be 300,000 metre^2 of office space in the town centre and 660,000 metre^2 in the International Business Park developed by Arlington. The town will come alive through the residents of its 5,400 housing units, 2,400 holiday residences and 13,000 hotel rooms. Even more important is the fact that, over the next 15 years, Val d'Europe will have generated a total of 40,000 jobs. It has 15,000 inhabitants, triple the number in 1992, and by 2017, the population will reach 40,00.

Chapter 5 - Observation and conclusion

5.1 The delegation finds the overseas duty visit to Europe very timely. There has been rising concern that the status of Hong Kong as the most important gateway to China is being increasingly impinged upon by the rapid development of container ports in Shenzhen and airports in the region. In 2002, the Shenzhen ports handled a total container throughput of 7.6 million TEUs. Over the past few years, container throughput in Shenzhen grew rapidly. This was mainly attributable to the improvement in quality and capability of freight handling services as well as the streamlined customs procedures in the Pearl River Delta (PRD) region over the recent years. Relatively lower costs for the services in Shenzhen were also highly relevant. These factors are inducing more and more manufactured goods produced in the PRD region being shipped out directly from the ports in Shenzhen rather than indirectly through Hong Kong. On the air side, with the rapid growth of the economy, airports within the region are developing fast. Airports in the South East Asia and those around the world are ever increasing their direct services into the Mainland bypassing Hong Kong. The strategic position of Hong Kong as the international gateway to China is diminishing.

5.2 Facing the above challenges and in recognizing that port and airport development are important engines for economic growth in Hong Kong, we consider it important to keep abreast of the latest development in the international logistics arena and review with the Administration measures and strategies to maintain Hong Kong's status as a logistics hub port for Asia-Pacific Region and a major centre of international and regional aviation. Our visit to London and the Netherlands has provided us an opportunity to acquire first-hand information on overseas experience in port and airport management as well as logistics development. This, no doubt, would facilitate the Panel to consider the related matters in the years ahead.

Characteristics of aviation hub

5.3 Despite the existence of a number of airports in the UK, Heathrow remains the primary hub for Europe. We observe that each London airport has its own characteristics. Heathrow is the fourth largest airport in the world, and the busiest international airport. A greater share of its passengers travel on business than at the other BAA London airports (37%, compared with 19% at Gatwick and 20% at Stansted); and a greater proportion of its passengers also transfer between flights (some 30%, compared with 20% at Gatwick and 6% at Stansted). Heathrow's advantages derive partly from its more convenient location for many of its passengers, but also from the number of

destinations served and the frequency of service, which provide significant benefits both to passengers starting or finishing their journeys at the airport and to passengers transferring between flights. Airlines operating there therefore regard the other two airports as not providing a realistic alternative to Heathrow. We also understand that scheduled services account for almost two-thirds of passengers at Gatwick, but these have developed at Gatwick partly because of the difficulty in increasing scheduled services at Heathrow due to capacity problem. Some 80% of Stansted passengers, on the other hand, use "low-fares" carriers, compared with 2% at Gatwick in 2001 and none at Heathrow.

5.4 We note the development strategy of the Schiphol Group of the Netherlands, which aims at creating and developing AirportCities and by positioning Amsterdam Airport Schiphol as the leading AirportCity. An AirportCity is a dynamic hub integrating people and businesses, logistics and shops, information and entertainment. Apart from providing an efficient, multimodal hub for air, rail and road transport, it offers its users all required services 24-hous a day, whether they are passengers, staff or just people meeting and seeing off passengers or locally-based international businesses. In other words, the task is to create an attractive "total package" for people and for business. Among other things, that requires lasting integration of economic activities into the urban networks.

Enhancing accessibility and connectivity

5.5 The success of Heathrow and Amsterdam Airport Schiphol indicates that by enhancing accessibility and connectivity, Hong Kong International Airport may act as the consolidation point for flows from many modes and directions. Consideration should be given to the provision of efficient inter-modal transport facilities and services. There is also the potential to expand the customer base for southern China so that all five airports in the PRD region can benefit and use their resources in the fullest and most appropriate fashion. Distribution of air traffic among the three BAA London airports may serve as a reference for further examination. We also believe that the evolution of an airport into an aviation hub is tied closely to the future of its domestic airlines and to its global alliance relationships. To this end, the merger of Air France and KLM may, in one way or another, shed some light on how the hub status of Paris CDG airport and the Amsterdam Airport Schiphol may be affected as a result of the future business strategy of the merged company. Whilst the Government should seek diversity of ownership in the interest of competition and the consumer, where external competition becomes too keen, some form of alliances among airlines in the region may help promote the future development of regional hubs.

Just-in-time shipment

5.6 The international air cargo market is much more concentrated than passenger market, as there is a high cost involved in shifting its hub operations. Efficient handling, simple customs procedures, dense route networks, and increasingly inter-modal transportation links are crucial factors in the choice of an air cargo hub. During our stay in the Netherlands, we have had the opportunity to tour around the Aalsmeer flower auction. We note that an average of 19 million flowers and 2 million plants change hands every day within a surface area of 1 million metre^2. The flowers and plants are supplied by around 7,000 growers world-wide, and bought by 1,375 wholesalers and exporters. Within a couple of hours the products are exported to almost every country in the world. The success of the logistics industry in the Netherlands tells us that it is important to create a competitive multi-modal transportation and value added logistics gateways. Sufficient land at reasonable price should be provided to the industry players. To meet the increasing time-sensitive, reliable and information intensive demand for just-in-time shipment, we have to take care of the development of express cargo terminal apart from meeting demand for general cargo. Customers will benefit through more service options, expanded hubbing networks, improved frequencies, and more competitive pricing. It will also stimulate air cargo growth and strengthen Hong Kong's competitiveness.

Sea Transport

5.7 We observe that the port of Rotterdam and its related industrial area spans forty kilometers and runs from the city center to the North Sea. The accessibility for ships with a very deep draught (24 meters) and the excellent hinterland connections by water, road, rail and pipeline make Rotterdam an outstanding logistic hub. To sustain its competitiveness, the port management together with the Government have put in place substantial resources to improve the transport infrastructure and port facilities. The port management also takes a proactive role to assist the business community to develop their business in the vicinity of the port.

5.8 We note that in Hong Kong, cost is the most often cited factor for Hong Kong's declining competitiveness against nearby ports. Apart from reducing the terminal handling charges, service competition (or efficiency) is also crucial. Quick turnaround is the key that carriers treasure, as timeliness of delivery is an essential element in logistics business. We have to uphold the efficiency and competitiveness of Hong Kong's container port, as a pivotal facility in Hong Kong's broader trading and logistics sector. There is a need

for the Government to work hand in hand with the industry players to promote the development of logistics. We also consider it necessary to provide adequate berthing facilities to meet the demand of shippers. Inter-modal transport facilities and services, coupled with efficient cross-boundary clearance capacities, should be provided to minimize transport costs and turnaround time. Logistics parks should be designated to facilitate just-in-time shipment.

Airport privatization

5.9 During our stay in London, we have met with the Head of the Economic Regulation Group of the Civil Aviation Authority (CAA) and exchanged view with him over the economic regulatory framework for designated UK airports upon privatization. We also received a briefing by the Ministry of Transport, Public Works and Water Management of the Netherlands Government on the proposed privatization of the Amsterdam Airport Schiphol. The meetings are extremely useful in assisting us to scrutinize the proposed privatization of the Hong Kong Airport Authority (AA). We consider that there is a need to devise a form of regulatory mechanism that would address the concern about AA's monopolistic position, whist at the same time providing sufficient commercial flexibility to the privatized AA to engage in airport-related activities. We also accord great importance to maintaining high service standards and efficiency at the airport, and hence, we should incorporate appropriate features in the price regulatory mechanism to help monitor the performance of the airport. The model built up by CAA certainly serves as a useful reference when we consider the future regulatory framework for the privatized AA.

5.10 We note the regulatory debate that took place over the course of the last price reviews of the Manchester and BAA designated airports. Whilst the statutory requirement for the CAA to make a reference to the Competition Commission (CC) adds a layer of complexity to the arrangements for airport regulation, it can help strike a right balance among different interest groups. CAA is not the only one party to the regulatory process. Airports and users also have important roles to play in ensuring that CAA regulation remains proportionate and cost-effective by engaging commercial parties on issues where they are best placed to make decisions. According to CAA, if airports and airlines can demonstrate that they have reached a consensus view and agreed costings on key issues, it could be expected that the CC - like the CAA - would take that seriously into account in reaching its own conclusions, providing that the industry consensus is in user interests overall.

Disney theme parks

5.11 The trip to Disneyland Resort Paris is appealing. We have had the opportunity to tour around one of the most famous theme parks in the world and try out some of the attractions there. With this experience, it will certainly facilitate our consideration of the future theme park development in Hong Kong.

5.12 With the imminent opening of the Hong Kong Disneyland in 2005, a lot of preparatory work would be required. We understand that in the first year of operations, the Euro Disneyland experienced significant difficulties in accommodating all prospective guests during peak days, which resulted in long waiting times for attractions, guest dissatisfaction and lost revenues. We believe that suitable contingency plan for crowd control should be worked out among government departments, transport operators, travel and tourism trade and the theme park management to avoid disruption. Good service manner and availability of Cast Members who can speak the original language of prospective guests are also key to success. To this end, a proper recruitment and training programme would be of paramount importance. On our part, there is a need to promote service quality and a hospitable culture in the industry and the community.

5.13 We note from the management of the Disneyland Resort Paris that the performance of the company could have been better if they could have more on-site hotel capacity. During fiscal year 2002, the occupancy rate of the Disney Hotels had already reached 88.2%, which exceeded its original forecast. Upon the opening of Walt Disney Studios Park, the second theme park within the Disneyland Resort Paris, the Hotel occupancy rate rose to 95%. In summer peak, almost if not all the 5,800 rooms were occupied. The phased opening of the four new hotels, vacation condominium and timeshare units in the new hotel district, Val de France, will undoubtedly reinforce the growth synergy of the theme park.

5.14 Competition in the tourism industry is very fierce. The Disneyland Resort Paris competes for guests throughout the year with theme parks as well as other European and international holiday destinations (including ski and seaside resorts) and with other leisure and entertainment activities (including museums and cultural activities) in the Paris region. The Disney hotels also compete with other hotels in the Paris regions and convention centres all over Europe. Notwithstanding, we note that the theme park market in Europe has grown significantly over the last two decades. According to the publication *Amusement Business*, the ten largest European theme parks attracted approximately 43 million guests in 2001. Guests of the Disney theme park

have fully adopted the concept of Resort. They stay longer and they spend more, both per day and for their entire stay. During the past years, the theme park company therefore put in place investments in new parks and new attractions to boost attendance. The management also reviewed the pricing policy, package offers, taking into account external factors such as the strength of local economies, exchange rates, cultural interests and holiday and vacation timing.

5.15 On our side, along with the classic Disney stories and attractions, Hong Kong Disneyland has the distinction of featuring original attractions designed specifically for Hong Kong, as well as entertainment and parades that will celebrate local culture. With more and more Mainland visitors coming to Hong Kong, the future prospect of the Hong Kong Disneyland should be more on the positive side. Further, unlike the Disneyland Resort Paris which is highly leveraged, the level of borrowings in respect of the Hong Kong Disneyland is much lower. This would provide greater flexibility for the theme park company to make capital investment in new attractions of the parks and hotels, both of which are essential to the theme park business.

5.16 The tourism industry has long been a key driver of our economy. Notwithstanding the impact of SARS, we received more than 15 million visitors in 2003, the second highest on record. The estimated expenditure related to inbound tourism topped $70 billion, and more than 120,000 jobs were associated directly with the tourism industry. The prospect for 2004 is even better. The Hong Kong Tourism Board forecasts that we will receive more than 20 million visitors, a 30% increase over last year. To sustain our growth, we urge the Administration to continue to improve our tourism infrastructure and products. There is also a need to promote service quality and a hospitable culture in the industry and the community.

Chapter 6 - Acknowledgements

6.1 The delegation wishes to thank the organizations which have kindly assisted the delegation in lining up the programmes and helping with the logistic arrangement during the visit. They include the British Consulate General (Hong Kong), the Consulate General of France, the Consulate-General of the Netherlands, the Hong Kong Disneyland, and the Economic and Trade Offices of the Hong Kong Government in London and Brussels.

6.2 The delegation would also like to thank all persons and organizations for the time they have taken to brief the delegation on their work.

6.3 The delegation is grateful to the staff of the Legislative Council Secretariat for their assistance in the visit.

Appendix I

Panel on Economic Services

List of Members who took part
in the overseas duty visit in April 2004

Panel members

Hon James TIEN Pei-chun, GBS, JP (Leader of the Delegation)
Dr Hon LUI Ming-wah, JP
Hon Mrs Selina CHOW LIANG Shuk-yee, GBS, JP
Hon CHAN Kam-lam, JP
Hon Howard YOUNG, SBS, JP
Hon Miriam LAU Kin-yee, JP
Hon Abraham SHEK Lai-him, JP

Non-Panel Member
Hon Emily LAU Wai-hing, JP

Clerk to Panel
Mr LAU Kwok-cheong

Total: 7 Panel members
1 non-Panel Member
1 staff

Appendix II

Legislative Council Panel on Economic Services

Overseas duty visit

Time	**Event**
✣ 5 April 2004 (Monday) ✣	
9:30 am	Meeting with the Civil Aviation Authority
12:30 pm	Lunch hosted by — Mr Andrew K P LEUNG, JP Director-General of the Hong Kong Economic and Trade Office in London
3:00 pm	Meeting with BAA and HOK International Limited on the development of Heathrow Airport's Terminal 5
5:30 pm	End of programme

Legislative Council Panel on Economic Services

Overseas duty visit

Time	**Event**
✣ 6 April 2004 (Tuesday) ✣	
1:30 pm	Arrival of the delegation
2:30 pm -3:00 pm	Presentation of the Parks Operations
3:00 pm - 5:00 pm	Walk through Disneyland Park & Walt Disney Studios
5:00 pm - 5:30 pm	Walk through Disney Village
5:30 pm - 6:00 pm	Walk through Newport Bay Club (Hotel and Convention Center)
6:00 pm - 6:30pm	Walk through Disneyland Hotel
6:30 pm - 7:00 pm	Site tour of the "Hôtels du Val de France"
7:30 pm	Dinner hosted by — André Lacroix, Chairman and Chief Executive Officer Euro Disney
	End of programme

Legislative Council Panel on Economic Services

Overseas duty visit

Programme in the Netherlands

Time	**Event**
✣ 7 April 2004 (Wednesday) ✣	
11:30 am	Arrival at Amsterdam Airport Schiphol
2:00 pm	Presentation by Schiphol Group
4:00 pm	Site tour of logistics facilities at Schiphol
7:00 pm	Dinner hosted by — Mr Andrew WONG Special Representative for Hong Kong Economic and Trade Affairs to the European Communities End of programme
✣ 8 April 2004 (Thursday) ✣	
7:30 am - 9:45 am	Flower Auction Aalsmeer
9:45 am - 10:30 am	Transfer from Amsterdam to Hague
10:30 am - 11:45 am	Meeting with the Ministry of Transport, Public Works and Water Management
12:00 noon - 1:30 pm	Lunch hosted by Parliamentary Committee for Transport, Public Works and Water Management
1:30 pm - 2:00 pm	Transfer from the Hague to Rotterdam
2:00 pm - 4:00 pm	Meeting with the management of Port of Rotterdam
4:00 pm - 6:00 pm	Harbour Tour by M/V Contessa
6:00 pm	End of the visit

Appendix III

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