

立法會
Legislative Council

LC Paper No. CB(1)1061/04-05
(These minutes have been seen
by the Administration)

Ref: CB1/PL/ES/1

Panel on Economic Services

**Minutes of special meeting held on
Monday, 31 January 2005, at 10:45 am
in the Chamber of the Legislative Council Building**

- Members present** : Hon James TIEN Pei-chun, GBS, JP (Chairman)
Hon Abraham SHEK Lai-him, JP (Deputy Chairman)
Ir Dr Hon Raymond HO Chung-tai, S.B.St.J., JP
Dr Hon David LI Kwok-po, GBS, JP
Hon Fred LI Wah-ming, JP
Hon CHAN Kam-lam, JP
Hon Howard YOUNG, SBS, JP
Hon Miriam LAU Kin-ye, GBS, JP
Hon Jeffrey LAM Kin-fung, SBS, JP
Hon WONG Ting-kwong, BBS
Hon Ronny TONG Ka-wah, SC
Hon KWONG Chi-kin
Hon TAM Heung-man
- Members attending** : Hon Mrs Selina CHOW LIANG Shuk-ye, GBS, JP
Hon Emily LAU Wai-hing, JP
Hon LI Fung-ying, BBS, JP
Hon Albert CHAN Wai-yip
Hon WONG Kwok-hing, MH
Hon LEUNG Kwok-hung
- Members absent** : Dr Hon LUI Ming-wah, JP
Hon SIN Chung-kai, JP
Hon LAU Chin-shek, JP
Hon Andrew LEUNG Kwan-yuen, SBS, JP
Hon CHIM Pui-chung

Public Officers attending : Mr Stephen IP
Secretary for Economic Development and Labour

Ms Sandra LEE
Permanent Secretary for Economic Development and Labour (Economic Development)

Mr Wilson FUNG
Deputy Secretary for Economic Development and Labour (Economic Development)

Mr Howard LEE
Principal Assistant Secretary for Economic Development and Labour (Economic Development)

Attendance by invitation : UBS Investment Bank

Ms Melanie GEE
Managing Director
Joint Global Head of Transport

Ms Mary LEUNG
Director, Investment Banking

Mr Elmahdi TAHRI
Associate, Investment Banking

Airport Authority Hong Kong

Dr David J PANG
Chief Executive Officer

Mr Raymond LAI
Finance Director

Mr Howard ENG
Airport Management Director

Board of Airline Representatives Hong Kong

Mr Gilbert CHOW
Deputy Chairman

The Staffs & Workers Union of Hong Kong & Civil
Airlines

Mr CHAN Po-choi
General Secretary

Mr IP Wai-ming
Deputy General Secretary

Hong Kong Airline Service Providers Association

Mr Jonathan D K CONWAY
Chairman

Mr WONG Tin-sek
Member

International Air Transport Association

Mr Peter BYSOUTH
Assistant Director, User Charges

Aerospace Forum Asia

Mr Martin CRAIGS
President

Mrs Liz BOSHER
Director General

Travel Industry Council of Hong Kong

Mr Ronnie HO
Chairman

Airport Air Freight Employees Association

Mr CHEUNG Siu-ming
副理事長

Mr YEUNG Chi-kwong
理事

Clerk in attendance : Mr Andy LAU
Chief Council Secretary (1)2

Staff in attendance : Miss Anita HO
Assistant Legal Adviser 2

Ms Anita SIT
Senior Council Secretary (1)9

Miss Winnie CHENG
Legislative Assistant (1)5

Action

I Privatization of Airport Authority

- | | |
|---|---|
| (LC Paper No. CB(1)773/04-05(01) | - Submission from Board of Airlines Representative |
| LC Paper No. CB(1)773/04-05(02) | - Submission from The Staff and Workers Union of Hong Kong Civil Airlines |
| LC Paper No. CB(1)773/04-05(03) | - Submission dated 31 January 2005 from Hong Kong Airline Service Providers Association |
| LC Paper Nos. CB(1)773/04-05(04) and (05) | - Submission from International Air Transport Association |
| LC Paper Nos. CB(1)818/04-05(01) | - Submission dated 28 January 2005 from The Real Estate Developers Association of Hong Kong |
| LC Paper No. CB(1)773/04-05(06) | - Information paper provided by the Administration |
| LC Paper No. CB(1)230/04-05(03) | - Information paper provided by the Administration for the meeting on 22 November 2004 |
| LC Paper No. CB(1)497/04-05 | - Minutes of meeting held on 22 November 2004 |
| LC Paper No. CB(1)1154/03-04(01) | - Information paper provided by the Administration for the meeting on 2 March 2004 |
| LC Paper No. CB(1)1749/03-04(01) | - Supplementary information provided by the Administration for the meeting on 2 March 2004 |
| LC Paper No. CB(1)1685/03-04 | - Minutes of special meeting held on 2 March 2004 |
| LC Paper No. CB(1)1017/03-04(05) | - Information paper provided by the Administration for the meeting on 23 February 2004 |
| LC Paper No. CB(1)1321/03-04 | - Minutes of meeting held on 23 February 2004) |

Members noted the following papers tabled at the meeting –

Action

- LC Paper No. CB(1)839/04-05(01) - Submission dated 27 January 2005 from Airports Council International (in English only);
- LC Paper No. CB(1)839/04-05(02) - Presentation notes provided by the Airport Authority Hong Kong;
- LC Paper No. CB(1)839/04-05(03) - Speaking note of the Board of Airline Representatives Hong Kong (in English only);
- LC Paper No. CB(1)839/04-05(04) - Submission dated 25 January 2005 from The Staffs & Workers Union of Hong Kong Civil Airlines (in Chinese only); and
- LC Paper No. CB(1)839/04-05(05) - Submission dated 29 January 2005 from Airport Air Freight Employees' Association (in Chinese only).

Presentation by the Airport Authority

2. At the invitation of the Chairman, Dr David J PANG, Chief Executive Officer of the Airport Authority (AA), made the following points-

- (a) The mission of AA was to enhance Hong Kong International Airport (HKIA) as a centre of international and regional aviation. There would be no change to this mission before and after the proposed privatization. To achieve this mission, AA worked in collaboration with 243 companies and some 50 000 people operating at HKIA to continuously enhance the flows of people and cargo through HKIA. HKIA's interest and Hong Kong people's interest were actually in total alignment.
- (b) HKIA faced strong competition from the airports in neighbouring places, and thus needed to continuously enhance HKIA's competitiveness. For the past six years, AA had been working hard and closely with its partners to enhance the airport's competitiveness which was a total package of time, money and reliability. Through productivity enhancement, AA had been able to achieve a 2.5% reduction in cash operating expenditure per annum amid increasing traffic. Since the opening of HKIA, AA had not ever increased the airport charges. In year 2000, AA reduced the aircraft landing and parking charges by 15%.
- (c) Through privatization, market discipline and market transparency would be institutionalized into HKIA's day-to-day operation. In addition, privatization would enhance AA's access to the capital market for funding to facilitate its future expansion. Privatization was a world trend and some 195 airports around the world had already been privatized.
- (d) In privatization, valuation was determined by the market, which focused on two factors, namely track record and growth prospects. Since its

Action

opening in 1998-99, HKIA had been profitable for four consecutive years and in four consecutive years, HKIA was elected the best airport in the world. It could thus be said that HKIA had a pretty solid track record. Over the years, AA had worked hard to enhance the flows of passengers and cargo at the airport and to improve its software and hardware. Thus, AA had set a very good foundation for the airport's future growth and the airport indeed had very good growth prospects.

Presentation by deputations

*Board of Airline Representatives Hong Kong
(LC Papers No. CB(1)773/04-05(01) and CB(1)839/04-05(03))*

3. Mr Gilbert CHOW, Deputy Chairman of Board of Airline Representatives Hong Kong (BAR), made the following points-

- (a) Airlines observed that the objectives of the proposed privatization of AA as stated in paragraph 2 of the Administration's consultation paper was not convincing. Firstly, the airport was already winning accolades for its efficiency. Secondly, airlines were concerned that the stated objective of strengthening the airport's market discipline could be used as justification for raising airport charges in order to improve stock market valuation and return.
- (b) Airlines believed that the overriding policy objective was to ensure that HKIA was competitive so that it retained its hub status for the benefit of Hong Kong. If privatization entailed increasing airport charges thereby reducing HKIA's competitiveness, airlines would seriously question the need for the proposed privatization.
- (c) Airlines disagreed with the proposal to adopt the dual-till approach for setting airport charges. This was contrary to the policy and principles laid down by the International Civil Aviation Organization and contrary to the accepted practices elsewhere around the world. Airlines believed that the proven and successful experience of the British Airport Authority (BAA) model should be drawn on. Under this model, all aeronautical and commercial revenues and costs were accounted for in a single till and airlines believed that this model was simpler, uncomplicated and overtly more equitable for all.
- (d) The regulatory scheme for post-privatization airport charges must take account of the contribution airlines made to the growth of commercial revenues. The scheme must also contain a mechanism to ensure continuous productivity improvement of HKIA.
- (e) Airlines considered that the low rate of return of AA in 2002 (less than 2%) was entirely irrelevant in relation to the privatization issue, as HKIA

Action

was barely four years old then and even now it was operating well below capacity.

- (f) Airlines considered that land vested with AA should not be considered as AA's assets for calculating the rate of return on investment.
- (g) Airlines did not agree with the Administration's claim that in order to improve HKIA's rate of return so as to enhance the market value of AA prior to IPO, increases in airport charges would be inevitable. Conversely, if airport charges were raised, it would certainly undermine the competitiveness of HKIA.

*The Staffs & Workers Union of Hong Kong & Civil Airlines
(LC Papers No. CB(1)773/04-05(02) and CB(1)839/04-05(04))*

4. Mr IP Wai-ming, Deputy General Secretary of the Staffs & Workers Union of Hong Kong & Civil Airlines, presented the views of the Union. The salient points were as follows-

- (a) The Administration should give priority consideration to the rights and welfare of some 50 000 employees of the contractors and franchisees of AA, in addition to the staff of AA, in the privatization exercise.
- (b) A transparent contracting-out mechanism should be established for the privatized company with a view to safeguarding the interests of all staff working for AA's franchisees and contractors, and to promulgate a policy statement to this effect (*The Union's proposed details of the policy statement are set out in LC Paper No. CB(1)839/04-05(04)*).
- (c) It was necessary to include an employee representative in the management board of the privatized AA.
- (d) The Administration should substantiate how the efficiency and competitiveness of HKIA could be enhanced after privatization given the possibility of the need to increase airport charges to achieve reasonable returns for the privatized AA.
- (e) The Administration had yet to address the potential conflicts arising from the Government's dual roles of being the majority shareholder of the privatized AA and the regulator.
- (f) In this connection with (e) above, the Administration should elaborate on the proposal that the Government should be empowered to give directions to the privatized AA in the public interest, with compensation to it under specified circumstances.

Action

*Hong Kong Airline Service Providers Association
(LC Paper No. CB(1)773/04-05(03))*

5. Mr Jonathan D K CONWAY, Chairman of Hong Kong Airline Service Providers Association (HASPA), presented the views of HASPA. The salient points were as follows-

- (a) HASPA represented 22 companies operating at HKIA, directly employing about 15 000 staff at HKIA.
- (b) As a matter of principle, member companies of HASPA had no objection to the privatization or partial privatization of HKIA.
- (c) For member companies of HASPA, HKIA was already an extremely expensive place to do business. The various charges payable to AA at present, were (as a percentage of overall business costs) higher than industry norms. Some charges such as annual licensing and inspection of non-mechanized equipment were unique to HKIA. Many of HASPA's members had struggled to achieve acceptable returns since the airport opening in 1998. HASPA was concerned that the various fees and charges levied on franchisees and other airport companies, might be increased arbitrarily and excessively after privatization.
- (d) HASPA supported the airlines' view that revenues earned by AA from retail related activities should be factored into any economic equation involving the financial performance of the airport (i.e. the single till model). HASPA did not agree that organizations that supported the airport operation and had no ability to trade elsewhere should be regarded as primary revenue streams of AA.
- (e) HASPA considered that the Administration's proposal for privatization of HKIA, outlined thus far, could not provide a strategy that would promote the long term and sustainable growth and profitability of the aviation sector in Hong Kong.
- (f) In the event the privatization exercise went ahead, HASPA urged the Administration to conduct a full review of AA's relationship with the airline service providers.

*International Air Transport Association
(LC Paper Nos. CB(1)773/04-05(04)-(05) and CB(1)794/04-05(01))*

6. Mr Peter BYSOUTH, Assistant Director of the International Air Transport Association (IATA), presented the views of IATA. The salient points were as follows-

- (a) IATA had 280 member airlines of which some 60 flew to HKIA.

Action

- (b) IATA supported any Government's right to decide airport ownership but as long as it was done for the *right*, and not for the *wrong* reasons. IATA would not support privatization of the airport if the privatization-
 - (i) was just to raise money;
 - (ii) could not set and achieve extra efficiencies;
 - (iii) could not protect ALL stakeholders;
 - (iv) did not stimulate long term economic benefit for the whole Hong Kong community; or
 - (v) did not bring overall cost reductions and bring more passengers to Hong Kong, keeping Hong Kong viable and competitive in the region.

- (c) There are five main stakeholders vitally concerned with the HKIA. They were the people using the airport, the Government, the Airport Authority and staff, the Airlines and the Investors. Each had rights and privileges but each must also share responsibilities and moderate their outright claims if there was to be a continuing and long-term benefit for all.

- (d) The Economic Development and Labour Bureau (EDLB) had tasked the Airport Authority, IATA and BAR to examine eight guidelines and prepare an industry solution on the way forward - should the Government decide to go ahead with the IPO of the Airport Authority. The time frame given by EDLB was extremely tight.

- (e) A pricing agreement involved considerable discussion and time. This was a first time exercise for Hong Kong and in the short time allotted, IATA members were trying to achieve agreement on-
 - (i) specifications for services and standards;
 - (ii) capital expenditure plan so that upgrades and new developments were optimally timed to meet growth;
 - (iii) estimated operational, maintenance and depreciation costs;
 - (iv) pricing policy for new regulations and any unforeseen or unplanned expenditure; and
 - (v) forecast activity levels and risk sharing.

- (f) IATA strongly suggested the following-
 - (i) the need for incentive regulation to drive efficiencies;
 - (ii) the need for lowering airport charges to remain competitive;
 - (iii) the requirement to balance the needs of all stakeholders; and
 - (iv) the need for requiring all suppliers of monopoly services, the Government as well as AA to be subject to performance and cost review.

Action

Aerospace Forum Asia

7. Mr Martin CRAIGS, President of the Aerospace Forum Asia (AFA), said that AFA was a non-profitable organization dedicated to encouraging discussion and awareness of the positive aspects that civil aviation brought to communities. He then shared with the Panel some observations of AFA on the recent developments in the civil aviation sector. He said that recently, both Boeing and Airbus announced huge orders. The first big order was from China South Airlines for five new A380, the new super jumbo. This indicated that China South was very optimistic about the development of Guangzhou into a much bigger hub than it was today, operating major international services. The second order was from the central purchasing bureau of Civil Aviation Administration of China (CAAC) on behalf of six Mainland airlines for 60 Boeing 787. These multi-billion decisions were being made and creating much greater competition for Hong Kong and its airlines. It was well known that Singapore passionately supported its aviation infrastructure and fiercely defended and built its hub status. The Minister of Transport of Singapore in a recent conference stated that last year, the government donated to airlines a major supplement of S\$150 million to encourage them to continue to fly to Singapore. Presently, aviation accounted for nearly 10% of Singapore's GDP.

Travel Industry Council of Hong Kong

8. Mr Ronnie HO, Chairman of the Travel Industry Council of Hong Kong, said that at this stage, the travel industry had taken a neutral stance on the privatization proposal. However, the industry was very concerned about the likely escalating airport charges affecting the position of HK as the centre of aviation in the region. After privatization, the airport management would have to be accountable to its stakeholders, i.e. the investors. The travel industry and the aviation industry were closely related. Any policy or situation diluting Hong Kong's air services would have serious effects on the travel industry as well as other industries. HKIA's status as an aviation hub in the region was being heavily competed by other major cities in the region, including the major cities in south China and Shanghai and Dai Lin in the north. Maintaining the competitiveness of the airport was of paramount importance to the business development in Hong Kong. The travel industry urged that when considering privatization, the Government should consider seriously how the airport, being a strategic infrastructure, should be applied to support the economy, and served the best interest of the public.

Airport Air Freight Employees Association
LC Paper No. CB(1)839/04-05(05)

9. Mr CHEUNG Siu-ming, Vice-Chairman of the Airport Air Freight Employees Association, presented the views of the Association. He highlighted that the employees working at HKIA had the following concerns-

Action

- (a) The increase in airport charges would directly or indirectly cause increases in the operating costs of airlines and the franchisees and contractors of AA. Given the prevailing conditions of the labour market, part of the cost increases would have to be shouldered by the employees working at HKIA through pay cuts etc.
- (b) As the pursuit of maximum profits and the interests of HKIA's shareholders would be the primary concerns of AA after privatization, it was unlikely that the privatized AA would pay much attention to safeguarding the rights and welfare of the employees working at the airport.
- (c) Likewise, the privatized AA would lack the incentive to exercise strict supervision over its contractors in regard to industrial safety, and hence less safeguards for the safety of the employees working at HKIA.
- (d) The Association strongly demanded that in pursuing the privatization exercise, the Government should incorporate provisions aimed at safeguarding the rights and welfare of the employees working at HKIA into the relevant legislation to ensure that the employees' rights and welfare would not be jeopardized after privatization of the airport.

Discussion with deputations/the Administration

Airport charges

10. Noting that the issue of airport charges had been raised by nearly all the deputations present, the Secretary for Economic Development and Labour (SEDL) affirmed that the Government's objective was to promote the further development of Hong Kong as a centre of international and regional aviation, and hence would continue to work closely with all parties concerned to attract more airlines and passengers to use HKIA. He stressed that privatization of AA did not necessarily mean higher airport charges. The Administration appreciated the deputations' concern and would continue to discuss with various concerned parties to come up with an objective and transparent mechanism for the determination of airport charges.

11. SEDL further said that in view of the numerous concerns raised by various interested parties and the view of some parties that the public consultation period was too short for them to sort out the related issues with their industry/association members, the Administration had decided to extend the consultation period by three months up to 31 May 2005.

12. Mr LAM Kin-fung said that the business sector basically supported the proposed privatization of AA, on the condition that upon privatization, the charges and costs of the airport could be reduced. He considered that it was of paramount importance to maintain the competitiveness of HKIA. At present, the services provided at HKIA were of high standard and the airport was generally well managed.

Action

However, there was strong and growing competition between HKIA and the airports in neighbouring places. He sought assurance from the Administration that airport charges could be reduced after privatization such that the competitiveness of the airport could be maintained. On the timing of privatization, he noted that HKIA had not yet achieved a commercial return, and it was only operating at about 50% capacity. He therefore asked whether it would be more desirable to defer the privatization to allow more time for the airport to develop and achieve a higher return.

13. SEDL stressed that all along, the Administration and AA had been doing a lot to reinforce Hong Kong's aviation hub status. In 2004, the passenger throughput of HKIA was 37 million and the cargo throughput was 3.1 million tonnes. Both were the highest among the airports worldwide. In the consultation process, the Administration considered it important for the concerned parties to agree on the mechanism for determination of airport charges before the IPO of AA as well as the mechanism for variation of airport charges after the IPO. The extension of the consultation period would allow more time for the airline industry to discuss the matter among themselves and with the Administration and AA.

14. On the timing of IPO, SEDL said that the Administration did not have a fixed timetable at this stage and would like to gather the views of Members and other interested parties first before deciding on the timetable. He remarked that the Administration did not seek to rush through the IPO within 2005.

15. Ms Miriam LAU said that there had been much controversy about the airport charges of AA, especially the question of how AA's airport charges were compared to those of other airports. She considered it necessary to make an objective and fair comparison. She noted that airlines were opposed to the dual-till approach for calculation of the target return and proposed the adoption of the single-till approach. She said that since under the single-till approach, profits from both aeronautical and non-aeronautical activities would be taken together in calculation of the target return, adoption of this approach might give rise to the concern that revenue from the non-aeronautical activities of AA was indirectly subsidizing the airlines, benefiting only the airline industry. She sought the response of BAR to this concern. She also sought AA's response to the question that from the general public's viewpoint, which model would serve the public better.

16. Mr Gilbert CHOW of BAR replied that under the dual-till approach, the vast majority of the costs of the infrastructure in the airport, i.e. the runways, the taxi ways, the parking aprons and the terminal buildings etc., would be shouldered by airlines but airlines would be excluded from the commercial revenue which to some extent was generated by their efforts. Airlines considered this unfair. It should be reckoned that the customers/passengers of HKIA were brought in by airlines. Airlines invested a lot of money in developing air routes and marketing Hong Kong as an international hub and destination. Airlines also set their ticket fares at levels as attractive and competitive as possible to get people into Hong Kong. Also, in the dual-till situation, the apportionment of the costs and revenue between the aeronautical part and non-aeronautical part of AA's business would ultimately be arbitrary and would not be

Action

as equitable as under the single-till situation whereby all the costs and revenues were put into one single account. There was no question of the non-aeronautical activities of the airport subsidizing the airlines under a single-till situation, as recognition must be given to the efforts made by airlines in developing the airport as a major destination and international hub by generating the traffic and activities in the airport.

17. Dr David PANG said that the aeronautical assets of the airport accounted for only about 50% of the total airport assets, and brought about 45% of AA's total revenue. As to the question of who brought passenger traffic to HKIA, he considered that, to put it more correctly, the traffic was brought by Hong Kong; the passengers did not come to the airport but to Hong Kong to take part in the economic activities in Hong Kong. He suggested that the issue of the choice between the single-till or dual-till approach should be looked at in conjunction with the proposal that certain business of AA should be regulated and certain business should not. The single-till approach implied that all the business of AA should be regulated. AA agreed that the aeronautical business, i.e. the core airport activities, which were necessary for the operation of the airport and which could not be economically duplicated or produced outside the airport perimeter, should be regulated. The other part of AA's business should be left entirely to the market.

18. In reply to Mr Ronny TONG's query on how AA would ensure competitiveness and efficiency of AA's operations after privatization, Dr David PANG said that for the past six years, AA had been working very hard to continually strengthen the competitiveness of the HKIA. In fact, AA alone could not maintain or enhance the airport's competitiveness. It was really the 243 companies with some 50 000 people working together to serve HKIA's customers, who contributed to the success of HKIA. The market dynamics were changing all the time, and more and more players were joining the market thus providing customers with more and more choices. This development drove AA and its partners to continuously work hard to be competitive.

19. On the view of some deputations that HKIA was a very expensive place to do business, Dr David PANG said that based on the level of total airport charges, i.e. landing, parking and terminal building charges taken together, levied by individual airport operators, HKIA ranked 46th among the top 50 airports worldwide. Singapore collected only landing and parking charges from airlines and collected terminal building charges from passengers. Taking all the three charges into account, the level of airport charges at HKIA was lower than that at Changi Airport. (*Relevant figures are set out in paragraph 31 of the Administration's paper.*)

20. Ms Emily LAU supported extension of the consultation period and said that having listened to the views of deputations, she found that there were many issues yet to be adequately addressed in respect of the privatization proposal. She would not support the privatization of AA if the major concerns raised by the deputations and other concerned parties could not be satisfactorily addressed. As the level of airport charges between HKIA and other airports in the world was a major issue raised, members agreed that the comparative information on the airport charges of HKIA and

Action

other airports should be compiled for members' reference.

Labour issues

21. On the concerns raised by employee associations, the Deputy Secretary for Economic Development and Labour (DS/EDL) said that as highlighted in the consultation paper, AA was required by statute to conduct its business according to prudent commercial principles. Privatization would not affect this existing mode of operation. Likewise, privatization of AA would not affect AA's existing arrangements with regard to the award of contracts and franchises. AA would pay heed to the employee associations' views on these arrangements and would make necessary improvements irrespective of whether AA would be privatized.

22. Mr Ronny TONG said that since AA was required to conduct its business according to prudent commercial principles irrespective of whether it would be privatized, AA had to set a right level of airport charges to maintain the competitiveness of HKIA, and must address the concerns of the employees working at the airport, as employees' co-operation was essential to ensure smooth operation of the airport. He was perplexed to note the grave concerns expressed by some deputations about the privatization proposal. He asked how AA saw these concerns and how it would respond to the concerns.

23. Dr David PANG said that privatization would not change how AA managed the airport. The interests of airport employees would continue to be well protected. However, there might be a need for AA to have more communications with all its partners and their staff.

24. Ms LI Fung-ying said that all along, the Administration emphasized that one of the objectives in pursuing the privatization of AA was to enhance AA's efficiency. After privatization, AA would seek to lower costs and increase efficiency. It was thus inevitable that AA's contractors and franchisees and their employees would express grave concern about the effects of the privatization on them. Moreover, at present, AA, being a statutory body, provided guidelines to its contractors on industrial safety and took measures to safeguard the interests of the contractors' employees. It was doubtful whether AA would continue to exercise strict supervision over its contractors on their compliance with the guidelines after privatization. She asked what safeguards would be in place to prevent contractors from transferring the financial burden, arising from AA's efforts to raise revenue and cut costs, to their employees.

25. DS/EDL responded that at present, AA employed less than 1 000 employees, representing only 2% of workers on the airport island. Most of AA's services were contracted out through open tenders. The employment conditions of staff working for AA's franchisees and contractors were determined by the companies concerned. Any improvement to the contracting-out arrangements could be followed up by AA irrespective of whether AA would be privatized. AA would be willing to further discuss with the employee associations on the possible improvements to the

Action

contracting-out arrangements.

26. SEDL said that the Administration appreciated the employees' concerns. AA would consider increasing the transparency of the contracting-out system, and the need to put in place measures to safeguard employees' interests. He assured members that the Administration and AA would follow up these concerns.

27. Mr KWONG Chi-kin said that privatization would give rise to greater pressure on AA to increase charges, cut costs and increase yield. He was thus concerned that after privatization, AA would tend to award its service contracts to contractors submitting the lowest price bids, and this would lead to a trend of pay cuts by contractors. He asked what specific measures would be put in place by AA to ensure that the interests of contractors' employees were duly safeguarded after privatization.

28. Dr David PANG said that it was AA's established policy to select service contractors taking into account their experience and service quality instead of price alone. Bidders were required to make separate submissions of technical and financial specifications for independent assessment. For some contracts, AA might separately specify the management and frontline staff requirements. Those who failed in technical submissions would not be selected, regardless of their financial bids.

29. Mr LEUNG Kwok-hung considered that the privatization of AA would have the effect of transferring wealth. Based on market economy principles, the privatized AA would definitely lay off staff and/or reduce their wages to cut costs. He asked whether the Administration could assure members that the privatized AA would not lay off the existing staff of AA or reduce their wages. He further said that other airports might have an interest to buy AA's shares. As the airport was a strategic asset of Hong Kong, it would be to the detriment of Hong Kong's interests if the ownership of the airport was transferred to HKIA's competitor(s).

30. SEDL responded that the Administration had proposed that exercise of voting rights by any single shareholder (including associates), other than the Government, should be limited to not more than 10% of the total voting rights of all shareholders.

31. Dr David PANG said that AA would continue its efforts to increase revenue sources and reduce costs, and these would be done mainly by raising productivity of AA's resources including staff. So far, AA had been effective in creating additional value for its employees and would continue to do so. AA had no plan to reduce the number of its employees or cut their salaries.

Target rate of return and valuation at IPO

32. Mr CHAN Kam-lam supported the Administration's decision to extend the consultation period by three months. He noted from the Administration's paper that the Administration had not come to a view on the level of target return of the privatized AA. Pointing out that the valuation of AA and the extent of investors' interest at the IPO would be very much affected by the target rate of return, he

Action

suggested that to enable a better valuation of AA's equity at IPO, it might be preferable to defer the IPO to a later time so as to allow more time for AA to further improve the airport's operation and management and thus set a more solid track record of its financial performance.

33. SEDL said that the Administration's proposal did not include a target rate of return for the privatized AA. The Administration had proposed that only the airport's aeronautical operations, i.e. the airport charges, should be subject to economic regulation, while the other commercial activities of the airport not related to its aeronautical operations should be determined by the market. The Administration and AA would continue to discuss with the airline industry with a view to putting in place a mechanism for determination of airport charges and the level of the target return for the airport's aeronautical activities.

34. Mr CHAN Kam-lam opined that the community as a whole would benefit if the IPO was made after AA had attained a higher rate of return.

35. Ms Emily LAU said that the "Link REIT" incident had aroused wide public concern about privatization of public assets. There were important lessons to be learnt from the incident. She asked what the Administration would do to prevent the sale of public assets at an unreasonably low price on this occasion and to ensure that the privatization of AA would not be subject to legal challenge at the court. In this connection, she referred to a press report quoting the comment of an academic that the proposed privatization of AA might be challenged on the basis of Article 129 of the Basic Law. She also asked how the shares to be issued at the IPO would be apportioned between institutional investors and retail investors.

36. In response, SEDL said that the Administration welcomed various sectors and parties to bring out all relevant and potential issues relating to the privatization proposal and would study all these issues very carefully before deciding the way forward. The Administration would seek expert advice on these issues where appropriate. He added that the privatization of AA would be implemented through the enactment of legislation, and assured members that the Administration would allow sufficient time to sort out all relevant issues and proceed with the plan with the greatest care.

37. Miss TAM Heung-man said that she in principle supported privatization of AA. She asked when the Administration would come up with a concrete proposal on the regulatory framework in respect of airport charges, and whether it would put up the proposal to the Legislative Council for consideration. On the valuation of AA at IPO, she asked what measures would be put in place to prevent the assets of AA from being overly undervalued or overvalued. On the target level of return for AA at IPO, she asked whether land value would be taken into account in calculating the target return.

38. SEDL said that AA and airlines were discussing the appropriate level of airport charges and the mechanism for determination of airport charges after privatization. These matters would have been sorted out when the Administration

Action

introduced to LegCo the legislative proposal for privatization of AA. Hence, LegCo would have the opportunity to scrutinize the proposed airport charges and charge determination mechanism. As regards the issues of valuation and target rate of return, the Administration would determine these aspects prudently taking into account the advice of financial experts and the views of the community.

Justifications for privatization

39. Referring to paragraph 12 of the Administration's paper about the justifications for privatization, Mr CHAN Kam-lam said that he was yet to be convinced that the scrutiny of investors would be more effective than the scrutiny of the entire community in terms of enhancing the efficiency of AA. He questioned why under the existing mode of governance of AA, additional motivation and enterprising culture could not be brought in to further improve the airport's management and operation.

40. Ir Dr Raymond HO said that it was imperative for the Administration to elucidate how and to what extent privatization of AA could achieve those key objectives referred to in the Administration's paper. He remarked that even under the existing system, those objectives could still be achieved.

41. Mr Abraham SHEK said that in its submission, the Real Estate Developers Association of Hong Kong (REDA) had raised a number of important issues, including the appropriateness of privatizing AA at such an embryonic stage of the airport, the fact that the airport was already one of the best managed, the pressure for increasing airport rents and charges in order to improve returns, and the issue of AA holding a large amount of surplus land. These were issues yet to be answered by the Administration. Mr SHEK asked AA what measures would be available to it to improve competitiveness after privatization and what level of return AA anticipated that it would achieve after privatization.

42. Dr David PANG said that improving competitiveness was a continuous task of AA before and after privatization. However, privatization would bring in more market supervision over AA's management by institutionalizing market discipline and market transparency. This would push AA to do more to make HKIA more competitive. He remarked that the management of AA would change but market supervision would be constantly there when AA became a public listed company. As regards the level of return, Dr PANG said that after privatization, it would be up to the market to decide what a reasonable return for AA should be. Obviously, AA was not satisfied with a 2% return rate. He was confident that AA could achieve a higher return in future.

43. SEDL said that in the privatization exercise, the issue of land would be looked into and the relevant proposal would be subject to LegCo's scrutiny. The Administration would provide all relevant details in the future legislative proposal.

Action

44. As regards the Administration's claim that privatization of AA could enhance AA's access to the capital market, Mr CHAN Kam-lam pointed out that AA could obtain market funding through issuing bonds and not necessarily through public listing. DS/EDL said that the Administration had examined the option of issuing bonds for the privatization of AA, but considered the option not preferable. A major benefit of privatization through IPO was to allow the Hong Kong public to benefit from the growth and success of the airport.

45. Mr Albert CHAN opined that the Administration should not proceed with the privatization plan if there were not adequate justifications. Otherwise, it would only create additional troubles for the Hong Kong community. As stated by the Administration in its paper, HKIA was one of the best managed airports in the world with good potential. As such, there was no good reason to pursue privatization. Whilst the Administration might see that the privatization was concordant with the "small government, big market" principle, he opined that this principle was not always the most important principle. He shared REDA's views on the proposed privatization of AA. He urged that the Administration must present a very clear vision of what specific results/effects it wished to achieve through privatization. He was gravely concerned that the Administration would take forward the privatization based on ambiguous beliefs.

46. SEDL said that apart from enhancing the management of the airport, there were other objectives which the Administration wished to achieve through privatization and the details were already set out in the public consultation paper and the Administration's paper provided to the Panel.

47. Mr Albert CHAN urged the Administration to reconsider the matter taking into account the very strong reservation expressed by various parties over the privatization proposal. He suggested that to end the unnecessary controversies, the Administration should withdraw the privatization proposal.

Issues relating to the Basic Law

48. Taking note of Articles 129 to 130 of the Basic Law, Mr KWONG Chi-kin expressed concern that the privatization of AA might be subject to legal challenge. He urged the Administration to satisfactorily address all the relevant issues at an early stage.

49. SEDL said that well before the issue of whether privatization of AA was in compliance with the Basic Law was raised by some critics and Members, the Administration had started studying the issue and seeking legal advice. He assured members that the Administration would ascertain the legal position thoroughly in pursuing the privatization proposal.

50. Ir Dr Raymond HO asked when the Administration would be able to confirm the legal position on the question of whether privatization of AA was in compliance with the Basic Law. He considered that the Administration should ascertain the legal

Action

position in the first place before taking forward the privatization exercise.

51. SEDL said that the Administration was fully aware that privatization of AA must be concordant with the Basic Law and thus would ensure that any issues relating to the Basic Law as well as other relevant issues and concerns arising from the privatization proposal would be adequately and satisfactorily addressed and resolved in the course of pursuing the privatization.

52. Ir Dr Raymond HO further said that he was not opposed to the privatization of AA. He however considered that to avoid abortive efforts, it was necessary to establish whether the privatization of AA was concordant with the Basic Law in the first place.

53. Mr WONG Kwok-hing sought AA/the Administration's response on the following-

- (a) the suggestion of the Staffs and Workers Union of Hong Kong Civil Airlines that the management board of the privatized AA should include a representative of airport employees;
- (b) whether AA would adopt the sample employment contract being drawn up by the Administration for use by the Government's contractors;
- (c) as Articles 128 to 135 of the Basic Law were on Civil Aviation, whether the Government of HKSAR had consulted the Central People's Government and obtained the latter's blessing on the privatization proposal; and
- (d) as the listing of Link REIT was held in abeyance, whether privatization of AA would be left to the next term of the Government of Hong Kong Special Administrative Region (HKSARG).

54. SEDL reiterated that the Administration did not have a determined timetable for the listing of AA. Such would only be done when all the preparatory work and relevant issues had been satisfactorily completed and addressed. It was up to AA to decide whether it would adopt the sample employment contract that would be used by the Government's contractors. But the Administration would be happy to forward the sample document, when it was available, to AA for its consideration.

55. Under the principle of "one country, two systems", SEDL assured members that all concerns raised about the provisions in the Basic Law would be looked into and addressed in pursuing the privatization of AA.

56. Dr David PANG said that he was not in a position to say how the privatized AA and its management board would be formed. AA would listen very carefully to all concerns about AA's existing tendering arrangements and continue with the improvement process with the consideration that HKIA must maintain its

Action

competitiveness and bring the maximum value for Hong Kong with minimum resources.

57. Mr WONG Kwok-hing considered that the continuity of the policy on the privatization of AA was very important. The Administration should seriously look into this issue, i.e. whether the privatization exercise would be completed within the current tenure of HKSARG.

58. Mr Ronny TONG said that he would very much not wish to see that the HKSARG would seek the approval or blessing from the Central People's Government for the privatization of AA as this would contravene the principle of "one country, two systems". Also, he did not wish to see that the privatization of AA was politicized, as the matter was of a purely economic nature. He was also concerned about the issues surrounding the privatization of AA vis-à-vis the Basic Law. Referring to Article 5 of the Basic Law which stipulated that "The socialist system and policies shall not be practised in the Hong Kong Special Administrative Region, and the previous capitalist system and way of life shall remain unchanged for 50 years.", he said that privatization implied changes towards commercial operations, and thus should be in compliance with Article 5 of the Basic Law. He considered that Article 129 of the Basic Law was concerned with the regulation of the airport rather than the operation of the airport. It was Article 130 which was concerned with the operation of the airport.

59. Mr Albert CHAN said that the Panel might wish to consider whether the Legal Advisor of the Legislative Council Secretariat should be asked to provide his legal opinion on whether the privatization of AA was concordant with the Basic Law in particular Articles 129 and 130.

60. The Chairman said that he might consult Panel members on Mr Albert CHAN's suggestion when appropriate. He however believed that it was incumbent upon the Administration to ensure that the privatization of AA would be pursued only if the Basic Law was fully complied with.

Monitoring of the privatized AA

61. Mr CHAN Kam-lam and Ms LI Fung-ying sought elaboration on the proposal that the Government could give directions to the privatized AA in the public interest, but considering the need to also safeguard shareholders' interest, the Government might need to pay compensation to the privatized AA under specified circumstances.

62. DS/EDL advised that the Government would not pay compensation to the privatized AA under normal circumstances. It would only be in the situation that the Government, on grounds of public interest, gave directions to the privatized AA to act contrary to prudent commercial principles that the Government might need to pay compensation to them. The rationale under this suggested arrangement was that a private company should act according to prudent commercial principles as it was accountable to its shareholders. Investors would lose confidence in the company if there was no such compensation mechanism. DS/EDL further advised that this

Action

arrangement was already laid down in the existing AA Ordinance (Cap. 483). Similar arrangement was also put in place when the then Mass Transit Railway Corporation was privatized. He assured members that when the Administration put up the legislative proposal for the privatization of AA, the Administration would set out in detail the circumstances under which compensation would be made and the conditions such compensation would be subject to.

63. Noting that IATA had suggested that the privatized AA should be subject to an incentive regulation scheme to drive efficiency, Mr Howard YOUNG asked what sort of incentive arrangement was recommended by IATA for AA in the event of privatization, and how far Hong Kong could draw reference from the relevant arrangement adopted for the privatized London Heathrow Airport.

64. Mr Peter BYSOUTH of IATA said that whilst the London Heathrow Airport was most quoted and studied in regard to privatization of airports, it was difficult to draw reference from the Heathrow model for application to the HKIA, since Heathrow was an old and constrained airport at the time of privatization whilst HKIA was only opened in 1998. As to whether the Heathrow model of RPI-X and efficiency parameters acceptable to the airline industry in the proposed privatization of AA, Mr BYSOUTH said that the RPI-X model involved a regulatory regime with a specific regulator. An equivalent of RPI-X was an efficiency dividend. What IATA was working with AA on was some kind of efficiency dividend they would undertake in its pricing agreement. IATA was working towards an agreement with AA for three years at the moment. Three years had been chosen to give a relative amount of stability. IATA was also concerned about the land issue and would like to see the issue fully addressed at an early stage. Mr BYSOUTH further commented that the citation of the less than 2% return in 2002-03 of HKIA in the Administration's consultation paper in discussing AA's business case and valuation had created an expectation unwittingly that there would be increases in airport charges.

65. Ms Emily LAU suggested that the Panel convene another meeting after the consultation period ended and again invite interest parties to take part in the discussion. The Chairman noted Ms LAU's suggestion.

II Any other business

66. There being no other business, the meeting ended at 12:58 pm.