

**For discussion
on 29 March 2010**

Legislative Council Panel on Economic Development

**Proposals arising from Review of Air Transport
(Licensing of Air Services) Regulations (Cap 448 sub. leg. A)**

Purpose

This paper seeks Members' views on the proposals arising from a review of the Air Transport (Licensing of Air Services) Regulations (Cap 448 sub. leg. A) ("the Regulations").

Justifications

2. The Air Transport Licensing Authority (ATLA), established under the Regulations, is responsible for granting licences to local airlines to operate scheduled air services between Hong Kong and any point in the world. ATLA's existing regulatory regime emphasises co-ordination of air services and makes it an object of ensuring, among other things, the avoidance of uneconomical overlapping of air services. It does not distinguish first-time applications and renewal applications for licences, nor impose notification requirements on licence holders, nor does it provide the power for ATLA to intervene when there are signs of any licence holder getting into financial difficulty. To better regulate local airlines, we consider it necessary to improve ATLA's regulatory regime in a number of areas.

General Policy

3. ATLA's general policy¹, when it comes to considering whether to grant (or refuse) licences and deciding on the licence conditions, with its

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

reference to the coordination of air services and the need to avoid uneconomical overlapping, is not in line with the global liberalisation of air services in recent years, nor with Hong Kong's progressive liberalisation policy on air services².

4. ATLA no longer needs to concern itself with the coordination of air services nor with uneconomic overlapping, as these matters should be addressed through market competition. It is more important for ATLA to satisfy itself that a licence applicant or an existing licence holder is capable of operating air services, primarily with regard to its financial capability.

5. We **propose** to update ATLA's general policy to read "ATLA shall have regard to the development of air services generally with the object of ensuring the most effective service to the public and generally to the interests of the public".

6. Neither does ATLA need to require an endorsement from the Civil Aviation Department (CAD)³ (as at present) certifying that the applicant's operational procedures, maintenance manual and schedule, traffic handling, adequacy and competence of the staff to be employed are satisfactory, provided that the granting and validity at any time of a licence shall depend on the possession of a valid Air Operator's Certificate (AOC) granted under Article 6(2) of the Air Navigation (Hong Kong) Order 1995 (Cap 448 sub. leg. C). That said, the applicant should be allowed to apply for a licence from ATLA and an AOC from CAD in parallel.

7. On the transitional arrangements for the existing licences, such licences would be deemed to have been issued under the new regime and would continue to be valid until their original expiring dates.

First-time Applicants

8. To ensure that airlines are capable of operating air services, we **propose** that an airline applying for an ATLA licence for the first time (i.e. the airline does not have any ATLA licence at the time of application) should be required to demonstrate to the reasonable satisfaction of ATLA that –

² Our progressive liberalisation policy emphasises more liberal market access and promotes competition in the interest of the public and Hong Kong's aviation industry.

³ CAD's role is to ensure that Hong Kong's airlines are competent in operating their air services safely and their aircraft are air-worthy.

- (a) it can meet at any time its actual and potential obligations, established under realistic assumptions, for a period of 24 months from the start of operations; and
- (b) it can meet its fixed and operational costs incurred from operations according to its business plan and established under realistic assumptions, for a period of 3 months from the start of operations, without taking into account any income from its operations.

Detailed requirements are set out in **Annex A**.

Licence Holders

9. We **propose** that for the renewal of a licence upon expiry, or for new licence applications, the licence holder should be required to demonstrate to the reasonable satisfaction of ATLA that it can meet its actual and potential obligations for a 12-month period. For this purpose, the licence holder should be required to provide a business plan covering, at least, a period of 12 months, 2 months in advance of the period to which it relates to.

Notification Requirements

10. To ensure that ATLA is in a position to assess the continuing capability of licence holders, we consider it necessary for licence holders to notify ATLA of specific events, in particular, the changes in capital structure, and provide ATLA with the audited financial statements and a business plan every year. The licence holder should also be required to inform ATLA in the first instance of a licence holder's financial difficulties or intention to cease to operate air services or such cessation. Detailed requirements are set out in **Annex B**.

ATLA's General Powers

11. We **propose** that ATLA should be empowered such that –
- (a) it may at any time assess the financial performance of a licence holder and require the licence holder to provide relevant information;
 - (b) it may suspend or revoke the licence or attach or vary any new or existing licence conditions if ATLA is no longer satisfied that the

licence holder can meet its actual and potential obligations for a 12-month period;

- (c) it may, upon revocation of a licence, grant a temporary licence, not exceeding 12 months, pending financial reorganisation of the licence holder, provided that there is a realistic prospect of a satisfactory financial reconstruction within that time period;
- (d) when insolvency or similar proceedings are commenced against a licence holder, it may make an assessment of the financial situation and on the basis of its findings review the status of the licence; and
- (e) it may suspend or revoke a licence if the licence holder knowingly or recklessly furnishes ATLA with false or misleading information on an important point.

Other Matters

12. Regulation 3 of the Regulations provides that no person shall use Hong Kong-registered aircraft to operate air services between Hong Kong and another place without a licence from ATLA. In other words, an airline other than a local airline⁴ would have to obtain a licence from ATLA first before leasing Hong Kong-registered aircraft to operate air services between Hong Kong and another place. This is not consistent with ATLA's role in regulating Hong Kong-based airlines. We **propose** to address this anomaly by exempting this scenario from the requirement for applying for an ATLA licence.

13. To facilitate ATLA's work, we **propose** that ATLA should be empowered to hire consultants or advisors to assist ATLA in discharging its duties and to pass the information submitted by the licence applicants and holders to the consultants or advisors.

14. We **propose** to update the existing penalties for using any aircraft in contravention of the provisions of the Regulations⁵, to follow those specified in Section 5(2) of the Civil Aviation Ordinance, as follows –

⁴ At present, an airline other than a local airline is regulated by an operating permit issued by the Civil Aviation Department.

⁵ The existing penalties were set in 1950 and 1969, and are inadequate (for example, the maximum penalties for a second offence under regulation 3(2) are \$70,000 and/or imprisonment for 2 years).

- (a) in the case of summary conviction, a fine not exceeding \$100,000 or imprisonment for a term not exceeding 3 months or both such fine and such imprisonment; and
- (b) in the case of conviction on indictment, a fine not exceeding \$5,000,000 or imprisonment for a term not exceeding 2 years or both such fine and such imprisonment.

Consultation

15. We issued a consultation paper to the relevant stakeholders in late February 2010 to seek their comments on the proposals. The stakeholders include the local air services operators, the Airport Authority, Hongkong Association of Freight Forwarding and Logistics Limited, Hong Kong Shippers' Council, Consumer Council, Travel Industry Council of Hong Kong, Hong Kong Tourism Board, the five local Chambers of Commerce⁶, and the Aviation Policy and Research Center of the Chinese University of Hong Kong. We expect them to let us have their comments by end April 2010. We will also consult the Technical Subcommittee of the Aviation Development Advisory Committee in April 2010.

Way Forward

16. Subject to the outcome of such consultation, we will firm up the proposals to be implemented. As the implementation of the proposals requires legislative amendments, we aim to submit the relevant legislative amendments to the Legislative Council in the fourth quarter of 2010.

Transport and Housing Bureau March 2010

⁶ The five Chambers are - The Chinese General Chamber of Commerce, The Federation of Hong Kong Industries, The Hong Kong General Chamber of Commerce, The Chinese Manufacturers' Association of Hong Kong, and The Hong Kong Chinese Importers' and Exporters' Association.

Detailed Requirements for First-time Applicants

The detailed requirements for first-time applicants are as follows –

- (a) each applicant should be required to submit a business plan for, at least, the first 2 years of operation;
- (b) the business plan should be required to also detail the applicant's financial links with any other commercial activities in which the applicant is engaged either directly or through related undertakings;
- (c) the applicant should also be required to provide all relevant information, in particular the following data –
 - (i) the most recent internal management accounts and, audited financial statements for the previous financial year or the latest available financial year;
 - (ii) a projected statement of financial position, including statement of comprehensive income, for the start-up phase and the first 2 years of operation;
 - (iii) the basis for projected expenditure and income figures on such items as fuel, fares and rates, salaries, maintenance, depreciation, exchange rate fluctuations, airport charges, air navigation charges, ground handling costs, insurance, etc., traffic/revenue forecasts;
 - (iv) details of the start-up costs incurred in the period from submission of application to commencement of operations and an explanation of how it is proposed to finance these costs;
 - (v) details of existing and projected sources of finance and supporting documentations;
 - (vi) details of shareholders, including type of shares to be held, any agreement(s) or arrangement(s) that shareholder(s) have entered into which may restrict the future issue or transfer of shares (such as a share pledge

agreement) or require future issue of shares (such as a share option agreement) and the Articles of Association. If part of a group of undertakings, information on the relationship between them;

- (vii) projected statement of cash flows and cash flows forecasts and requirements for the start-up phase and the first 2 years of operation; and
- (viii) details of the financing of aircraft purchase/leasing including, in the case of leasing, the terms and conditions of contract.

Detailed Notification Requirements for Licence Holders

A licence holder should have the onus to notify ATLA –

- (a) in advance of any intended mergers or acquisitions;
- (b) within 14 days of any change in the ownership of any single shareholding which represents 10% or more of the total shareholding of the licence holder or a holding company of the licence holder; or any change in the shareholding of the licence holder or of a holding company of the licence holder which may result in a change in the control of the licence holder; and
- (c) within 14 days should any of its shareholder(s) have entered into any share pledge agreement(s) or similar arrangement(s) which, as a consequence of an event of default or occurrence of certain circumstances as set out in the said agreement(s) or arrangement(s), is/are capable of leading to –
 - (i) a change in the ownership of any single shareholding which represents 10% or more of the total shareholding of the licence holder or of a holding company of the licence holder; or
 - (ii) a change in the control of the licence holder as a result of any change in the shareholding of the licence holder or of a holding company of the licence holder.

2. In relation to paragraphs 1(b) and (c) above, “control” in a licence holder means –

- (a) to have the capacity to control the composition of the board of directors of the licence holder or of a holding company of the licence holder; or
- (b) to be entitled to exercise, or control the exercise of, 50% or more of the voting power at any general meeting of the licence holder or of a holding company of the licence holder;

whereas “a change in the control” of a licence holder occurs if a person or body incorporate who as at the relevant date does not have the ability to do (a) or (b) above but subsequent to that date that person or body incorporate has the ability to do so by reason of transfer (or issue) of shares in the licence holder to that person or body incorporate who was a shareholder in the company immediately before the relevant date.

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

4. A licence holder should be required to submit to ATLA every year a business plan covering, at least, a period of 12 months, 2 months in advance of the period to which it relates to. The business plan should include the relevant information, including the following data –

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

5. If a licence holder is likely to become unable to meet its obligations to such an extent as to cause material adverse effect on its

operations, it should be required to forthwith report in writing all relevant facts, circumstances and information to ATLA.

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