

2 December 2004

Ms Sandra Lee
Permanent Secretary for Economic Development
Government Secretariat
Central Government Offices
Lower Albert Road
Hong Kong

Dear Sandra

Response to Consultation Document on Partial Privatisation of the Airport Authority

Thank you for your letter of 15 November.

I attach my response to the Consultation Document.

Yours sincerely,

John

John E Strickland

cc Dr David Pang

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- (i) It is proposed that the legislative proposals should contain sufficient powers for the Government to exercise various regulatory functions, notwithstanding the Government's current intention to remain as a majority owner of the new Company in the foreseeable future. *Agreed*
- (ii) It is proposed that the Government should be empowered to appoint a minority number of additional members to the Board of the new Company to represent the Government or the public interests, on top of any rights the Government may have as a shareholder. *Agreed*
- (iii) It is proposed that more than half of the members of the new Company's Board, excluding the additional directors appointed by the Government, should be ordinarily resident in Hong Kong, and that the existing requirement for the AA Chairman to be a Hong Kong Permanent Resident should be retained. *Why exclude the directors appointed by the Government? Why exclude Mainland residents? Is this regulation really necessary?*
- (iv) It is 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. *33% would be better. AAHK, with tacit Government agreement, has sought to procure well over 10% of other airports outside Hong Kong. We should not have double standards.*
- (v) It is proposed that the exercise of voting rights in the aggregate by shareholders who are not ordinarily resident in Hong Kong should be limited to not more than 49% of votes cast at a general meeting of shareholders. *Is this really necessary? The other regulatory constraints below should be sufficient to exercise control if the Airport acts seriously contrary to Hong Kong's interests. If the Government sees this matter as important, then it should retain its majority holding.*
- (vi) It is proposed that the Government should be empowered to obtain information from the new Company for the purpose of enforcing relevant laws and regulations. *Agreed*
- (vii) It is proposed that the new Company would be required to submit capital investment plans to the Government as a regulator of the airport for information. *Agreed*
- (viii) It is proposed that the Government should be empowered to give directions to the new Company in the public interest, with compensation to it under specified circumstances. *Agreed*
- (ix) It is proposed that the Government should be empowered to take over the new Company's assets in case of the new Company's default or under emergency situation, with compensation to the new Company under specified circumstances. *Agreed*
- (x) It is proposed that the Government should be empowered to impose financial penalties on the new Company for breaches of relevant laws and licensing conditions; and should retain powers to suspend or revoke the aerodrome licence of the new Company in justifiable cases such as substantial breakdown of services at the airport. *Agreed*
- (xi) Do you consider it essential to preserve taxpayers' \$30.7 billion investment in AA in the privatization exercise; and if so, do you consider it reasonable and acceptable to increase airport charges over a period of three to five years in order to achieve this? *The value to be preserved should be the \$30.7bn less the value the land at Kai Tak freed up as a result of*

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the move to Chek Lap Kok plus the cost of environmental cleanup at Kai Tak. Credit could also be given for the benefit to Government finances of removing height limits for buildings on the Kowloon peninsula. These calculations would allow a lower IPO price and hence a reasonable return on investment without the necessity of increasing airport charges.

- (xii) Do you attach more importance to minimizing any increase in the airport charges in the next few years; and if so, do you consider it acceptable if taxpayers' investment in AA as measured by its valuation at IPO is diminished? *See (xi) above*
- (xiii) It is proposed that the regulatory framework should also subscribe to the user pays principle; allow the new Company a reasonable return on its investment; and provide incentives for enhancing efficiency and increasing capacity to cater for demand. *See (xiv) below. Regulation of return on investment need not be necessary.*
- (xiv) It is proposed that only airport charges (i.e. currently landing, parking and terminal building charges) paid by airlines should be regulated. *Agreed. However this does not preclude a "single till" approach. The airlines bring the passengers to the airport and can reasonably expect to share in revenues deriving from the spending of these captive customers while they are at the airport. The best way to regulate airport charges is to restrict increases to below the increase in a suitable (maybe blended) price index. There could then be an escape hatch of appeal to an impartial body where exceptional expenditure is needed at the airport but it can only be commercially justified if an exceptional increase in charges is permitted.*
- (xv) It is proposed that the level of the new Company's target return for aeronautical activities should commensurate with the risk of the aeronautical business, which may not necessarily be the same as the average cost of capital of the new Company as a whole. *See (xiv) above. Regulation of return on investment need not be necessary.*
- (xvi) It is proposed that the new Company should be allowed to negotiate on a commercial basis with airline representatives on the level of airport charges every three years or as a need arises, within a set of broad parameters set out in the Ordinance. *See (xiv) above. The Airport can balance the benefits of raising charges as permitted by the price index against the potential loss of competitiveness compared with other regional airports that might result. The airlines will doubtless put their case persuasively. There should be no need for rules or regulation other than to check that the price index increase is not exceeded.*
- (xvii) It is for consideration whether the Government or a Government appointed independent panel should be empowered to adjudicate on the reasonable level of airport charges. *See (xiv) above*
- (xviii) It is proposed that the new Company should be required to draw up a set of service standards, and on the basis of which a financial reward and penalty system should be devised to link the actual service standards to the level of airport charges. *Given the airport's natural monopoly, it would be desirable for such standards to be set and for there to be penalties if they are not met. It is not clear that rewards would be necessary, or that airport charges should be related to performance standards. The penalties can be fines such that it is cheaper for the airport to improve performance than it is to pay the fines. The challenge will be to set durable and effective standards that are not overly intrusive.*

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- (xix) It is proposed that the new Company should continue to hold and make use of the land on the airport island in order to retain flexibility in planning and developing necessary facilities in support of airport operations, and that the existing controls over land uses on the airport island, including limitation on AA to use the land only for airport-related purposes and the requirement for AA to obtain prior Government approval for its building plans should continue. *This is reasonable. The alternative would be to confine this restriction to "airside" and to require land premium to be paid for land developed "landside".*
- (xx) It is proposed that the existing restrictions on the range of airport-related activities that AA may conduct should be retained. It is for consideration whether such approval requirement should be replaced by a new provision empowering the Government to direct the new Company to divest an investment or desist from undertaking an activity if it is found to be outside the range of permitted activities. *Are not control of airport charges and performance standards and Directors appointed by Government already sufficient to ensure protection of the public interest?*
- (xxi) It is proposed that statutory provisions be made to prohibit the new Company from engaging in anti-competitive activities and abuse of its dominant position in relation to its land use and scope of business. *Agreed, but general legislation against anti-competitive behaviour would be better.*

J. E. Strickland

John E Strickland
Airport Authority of Hong Kong Board Member
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