



31st May, 2005

Mr Stephen Ip
Economic Development and Labour Bureau
Central Government Offices
Lower Albert Road
Central
HONG KONG

Dear Stephen,

We write on behalf of the Board of Airline Representatives in Hong Kong (BAR) to offer our comments on the Consultation Document issued by EDLB in November 2004, on the subject of the partial privatisation of the Hong Kong Airport Authority (AA). BAR endorses and supports the separate submission presented by IATA, and the joint IATA/BAR/AA submission. We are therefore limiting our comments in this document to summarised points, but would be happy to discuss and expand on the rationale supporting these opinions at any time with EDLB, its advisers, the Legislative Council or any other branch of Government.

Our views are as follows:

1. The arguments set out in the consultation document for partial privatisation at this early stage of the airport's life are weak. It is not clear how privatisation will improve the management of what is already a well-run airport, nor can there be an urgent need for capital revenue to the Government at this time. The Chief Executive of AA is on public record as saying that AA has no current need to raise equity capital itself, and this is borne out by the fact that it has embarked upon a programme of extensive investments in Mainland airports.
2. There is no justification for increasing airport charges paid by airlines at Hong Kong International Airport (HKIA). Privatising the AA must not be used as such a justification since to raise charges will be contrary to the interests of the economy and people of Hong Kong, and to the development of HKIA as an international air transport hub. Contrary to the impression given in the Consultation Paper, the cost of HKIA to airlines is among the highest in the region.

3. If it is believed that the current revenues at HKIA do not justify a sufficiently high valuation of AA, then the privatisation exercise should be deferred. In due course, strong growth in traffic at HKIA will drive revenues and earnings up to levels which will comfortably satisfy investors' expectations in an initial public offering (IPO). Indeed, the financial results for AA in the 2004-05 Financial Year will already be significantly better than those for FY2002-03, cited in the Consultation Document (paragraph 10).
4. Following an IPO, the Government will no longer be in a position to manage the inherent conflict between the shareholders' desire to maximise profits, and the interests of the Hong Kong community in preserving a competitive airport. It is therefore essential that a strong regulatory regime be set up to control the AA's airline charges, overseen by an independent regulator.
5. BAR accepts that the matter of HKIA's ownership per se is an issue of public policy upon which airline views may not be accorded particular weight. However, the system of economic regulation to be implemented if an IPO of HKIA goes ahead is a matter of the greatest importance to BAR members. We have wide experience of airport regulatory regimes around the world, and strong views about the key features of any acceptable regulatory scheme. BAR urges EDLB to take careful consideration of these recommendations.
6. The most important point is that the regulatory process must include some recognition of the part the airlines play in driving the growth of non-aeronautical revenues and profits at HKIA. While it is not essential to have a pure "single till", the scope of the "regulated till" must be defined sufficiently widely to include some share of the non-aeronautical, but airline traffic-related, costs, revenues and profits. It is impossible to draw clear lines of separation between the various different sources of an airport's revenues and profits, or its various assets: the same point applies to most other modern service businesses. It follows that any attempt to define a narrow "aeronautical" regulated till will rely upon allocations of assets, costs and revenues which are essentially arbitrary. This can lead to unfairness, and will also risk damaging Hong Kong's competitiveness, with harmful economic effects not just to BAR members but to the wider community.

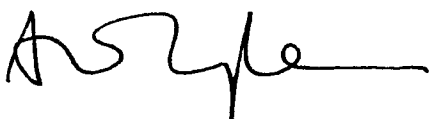
7. We support the principle of "user pays", and believe that this should be applied to the fees for passenger use of the terminal building at HKIA, as it is already for security services provided there.
8. We are concerned at the high proportion of AA's costs which are constituted by Government charges of various kinds. If AA is to be permitted simply to "pass through" these charges to the airlines there must be some form of regulatory control imposed upon them. At the very least, the airlines and AA must be given full disclosure of the components of the costs so that appropriate benchmarking can be done, and efficiency measured and improved.
9. AA's land formation costs should be excluded from the asset base of any regulated scope of activities. Thus, the airlines should not be charged for depreciation of these costs because the land will still exist following the depreciation period. Nor should the airlines have to generate a financial return on the land reclamation costs. First, recognition should be given to the fact that the airlines paid many times over the costs of the land at Kai Tak Airport, and account taken of the more than HK\$2.5 billion paid by airlines as "Traffic Revenue Multiplier" funds from 1990 to 1998. Secondly, the opening of HKIA has enabled Government to generate huge additional land premiums in the lifting of the height restrictions in Kowloon. Thirdly, the land upon which aircraft operations take place is part of the essential public infrastructure of Hong Kong in the same way as are roads and other public facilities. This infrastructure adds value to the general economy of Hong Kong, and should not in addition be used to generate financial returns for the private shareholders of the AA. The Government has demonstrated, in the approach taken towards the return on the land reclamation costs for the Disneyland project, that it is prepared to forgo a full economic return on land in certain circumstances. We suggest that such an approach be pursued in respect of the airport land reclamation costs.
10. We believe there should be no requirement to achieve a valuation of the outstanding AA equity amount of HK\$30.7 billion at an IPO. The Hong Kong taxpayer has benefited already from the release of land at Kai Tak and from the lifting of height restrictions. In addition, the value of the new towns in the area of the airport and developments along the airport highway should be taken into account. In any case, the HK\$30.7 billion figure is an arbitrary one which could be reduced by AA's issuing more debt (which is cheaper than equity) and returning cash to the Government by means of a special dividend.

BAR has participated fully in the discussions with AA and IATA over the appropriate regulatory mechanism for AA. We commend the representatives of AA for their openness, flexibility and co-operative attitude in these discussions. There remain, however, some very important differences between the parties.

BAR is ready and willing to continue to participate in further discussions on these matters. Our ambition and desire is to continue to support the development of Hong Kong as a major aviation hub, and to seek to ensure that this development is fair to all parties who participate in it. Our members make significant investments in order to operate to and at HKIA, and have as much entitlement as AA or any of its other business partners to make reasonable returns on these investments.

Yours sincerely,

BOARD OF AIRLINE REPRESENTATIVES HONG KONG

A handwritten signature in black ink, appearing to read 'A N Tyler', with a long horizontal flourish extending to the right.

A N Tyler
Chairman

ANT/ec

cc: Ms Sandra Lee
Mr Howard Lee
Mr Howard Eng
Mr Peter Bysouth
Mr Gilbert Chow
BAR Executive Committee