

**Report on
Public Consultation on
Partial Privatization of the Airport Authority**

Table of contents

Section 1: Introduction (para 1)

Section 2: Background (paras 2 – 3)

Section 3: Public Consultation Process (paras 4 – 6)

Section 4: Public Response (paras 7 – 8)

Section 5: Key Issues 1 – 6 (paras 9 – 37)

Section 6: Conclusion (paras 38 – 43)

Section 1: Introduction

1. This document reports on the outcome of the Government's public consultation on a proposal to partially privatize the Airport Authority (AA) conducted between November 2004 and May 2005.

Section 2: Background

2. On 6 August 2003, the Government announced its plan to commence work in preparation for the proposed privatization of AA. The Government's main objective in the proposed privatization is to help strengthen AA's market discipline in the running of the airport for greater efficiency and more commercial opportunities. The proposed privatization will also introduce an additional quality stock to our financial market and enable Hong Kong people to own shares in our successful airport. In addition, proceeds from sale of shares in AA would bring capital revenue to the Government in the medium term.

3. The Government commissioned an investment bank as its financial advisor to examine the privatization proposal. Having considered the financial advisor's recommendation and consulted stakeholders, the Government announced in February 2004 that it planned to proceed with the privatization exercise on the basis of an initial public offering (IPO) and that the community would be further consulted on the specific issues involved. As a first step, legislation was enacted to authorize AA's return of \$6 billion equity capital to the Government so as to optimize AA's capital structure and lower its weighted average cost of capital in preparation for its proposed partial privatization.

Section 3: Public Consultation Process

4. After completing the capital restructuring exercise, the Government released a Consultation Document on Partial Privatization of AA on 22 November 2004 to gauge the community's views on the regulatory and institutional framework pertinent to the proposed partial privatization. The closing date for public comments was originally 28 February 2005 but it was

extended subsequently to 31 May 2005 to allow more time for the community to consider the issues involved and offer their feedback.

5. During the consultation period, the Consultation Document was made available to the public in print and through the Internet. Over 4,500 copies of the Consultation Document and its summary were distributed through the 20 Public Enquiry Service Centres of the Home Affairs Department or mailed directly to organizations and members of the public who had requested the Consultation Document. The webpages of the Consultation Document and its summary recorded over 2,500 visits.

6. The consultation process was reported widely in the printed and electronic media. The Administration held consultation meetings with various groups including the Aviation Advisory Board, academics, labour unions and airline representatives. The Administration also attended two meetings of the Legislative Council Panel on Economic Services on 22 November 2004 and 31 January 2005 to brief Members on the Consultation Document and to listen to Members' views.

Section 4: Public Response

7. We have received a total of 69 written submissions from different sectors of the community, including political parties, airlines, trade and industry organizations, labour unions, commercial and financial institutions, academics and individuals. The submissions will be made public on the website of the Economic Development and Labour Bureau save for those which requested confidentiality.

8. A summary of the responses to each key issue is set out in the following section. This summary should be read in conjunction with the Consultation Document¹, which contains more detailed background information on the key issues.

¹ The Consultation Document is available at www.edlb.gov.hk/edb/eng/papers/cdoc/.

Section 5: Key issues

Key Issue 1: Justifications for Privatization

Background

In pursuing partial privatization of AA, the key objectives of the Government are to –

- strengthen market discipline in the running of the airport for greater efficiency and more commercial opportunities;
- enhance AA's access to the capital market;
- introduce an additional quality stock to add diversity to the local financial markets;
- offer an opportunity for Hong Kong people to participate in the success of a well-managed company with strong growth potential; and
- obtain some proceeds from the privatization which will help strengthen Government finance in the short to medium term.

Privatization is in line with the Government's philosophy of "big market, small government".

Summary

9. 91% of the respondents expressed views on this issue.

10. The opinions were divided. Strong views were expressed both in favour and against the proposed privatization.

11. About 30% of the respondents agreed that AA should be privatized because privatization –

- is a global trend;
- can introduce market discipline to AA;
- enhances AA's performance;
- enhances the airport's efficiency and competitiveness;

- enables AA to have better access to capital market;
- allows members of the public to benefit directly by becoming AA's shareholders; and
- will help ease Government's fiscal deficits.

12. Around 40% of responses categorically objected to privatization, mainly for the following reasons –

- there is no compelling case for privatizing AA;
- the privatized AA would become so profit-oriented that HKIA's competitiveness would be undermined;
- potential conflicts between interests of AA's shareholders and Hong Kong's public interests;
- immature business case of AA which could mean either a hike of airport charges or selling our crown jewel cheaply;
- concern over compliance with Basic Law provisions regarding management of airport;
- impact on airport workers; and
- land use on the airport island.

13. The rest of the responses either proposed a postponement of the proposed privatization until the AA's business case has become more mature, or did not clearly indicate whether they support or oppose privatizing AA.

Key Issue 2: Relationship between the Government and the Privatized AA

Background

HKIA is a strategic asset of Hong Kong. Its smooth and efficient operation has an important bearing on our economy. In taking forward the privatization exercise, we are mindful of the need to put in place appropriate mechanisms to ensure that a good balance can be struck between the shareholders' interest and the wider public interest whenever a conflict arises. Hence, we have proposed a package of measures in the Consultation Document, such as power for the Government to appoint additional board members to represent the Government or public interest, power for the Government to obtain information from the privatized AA, etc.

Summary

14. 35% of the respondents expressed their views on this issue.
15. Nearly all who commented on this issue agreed that the Government should have sufficient power to control over AA after its privatization in order to protect public interests. Many emphasized the need to strike a right balance between the interests of the shareholders and the public.
16. Some respondents expressed concern that after privatization, AA would become much more profit-oriented and might make decisions against the interest of the public.
17. A few respondents considered that it would be difficult for Government to regulate AA after privatization, while several respondents suggested that there should be a regulatory body overseeing the operation of the privatized AA.
18. The specific measures proposed in this section of the Consultation Document were generally endorsed by those respondents who commented on them.

Key Issue 3: AA's Business Case and Valuation

Background

Prior to IPO, AA is expected to demonstrate to potential investors that it would be able to achieve a commercial return within a reasonable period of time. Given the significant initial capital investment in the airport, its profitability was only very modest relative to Government's equity of over \$30.7 billion.

It is a choice between securing a better valuation at IPO by increasing airport charges in the next few years, or keeping airport charges more competitive at the risk of undermining the valuation at IPO, thereby diminishing taxpayers' investment in AA.

Summary

19. 44% of the respondents expressed their views on this issue.
20. While the vast majority emphasized the need to maintain the competitiveness of HKIA in view of fierce competition in the region, views were divided as to whether airport charges should be increased in order to achieve a better valuation at IPO.
21. Some respondents objected to any increase in airport charges, and a few even requested the lowering of airport charges.
22. Many agreed that a good valuation at IPO should be secured but some of them at the same time objected to any increase in airport charges.
23. Some considered that a reasonable increase in airport charges would not affect HKIA's competitiveness.
24. Many respondents commented that with the economic recovery, the airport should be able to demonstrate stronger traffic growth and hence a better financial case in the near future. They suggested that the privatization exercise should be postponed until AA had built up a good enough business case to support a valuation on par with the Government's equity without increasing airport charges.

Key Issue 4: Economic Regulation

Background

At present, AA has autonomy in setting its airport charges, subject to the Chief Executive in Council's prior approval for compliance with international obligations relating to civil aviation.

The Government considers it desirable to set out a more transparent regulatory framework for the determination of airport charges. However, in designing the regulatory framework, it is important to ensure that sufficient commercial

flexibility and incentive for enhanced efficiency be retained, and that the privatized AA be allowed to earn a reasonable return. A number of specific proposals were put forward in the Consultation Document regarding the design of such an economic regulatory framework.

Summary

25. 35% of the respondents expressed their views on this issue.
26. Most respondents agreed that an economic regulatory framework should be established, but a handful considered that it was not necessary to regulate airport charges because we should leave it to the market to determine the level of such charges.
27. The vast majority of respondents who commented on this issue concurred that any regulatory framework should be fair, predictable and transparent and subscribe to the user-pay principle.
28. There were divergent views on whether non-aeronautical activities of AA should be included in the regulatory framework. Generally speaking, airlines and related parties and some academics were in favour of a “single-till” approach, whereas airport-related bodies, and some academics, individuals and organizations preferred a “dual-till” arrangement. Some airlines suggested that “strategic value” and “national benefits” should be taken into account when calculating the rate of return and apportionment of assets and costs by the privatized AA.

Key Issue 5: Land Use, Competition and Scope of Business

Background

Given the privatized AA’s monopolistic status with a vast amount of land under its control, some people are concerned about its unparalleled advantages in certain business activities and the risk of it engaging in anti-competitive practices.

In order to allow the privatized AA to retain flexibility in planning and developing necessary facilities in support of airport operations, the Government proposed in the Consultation Document that the privatized AA should continue to hold and make use of the land on the airport island subject to existing controls over land uses on the airport island.

The Government also proposed in the Consultation Document that statutory provisions be made to prohibit the privatized AA from engaging in anti-competitive activities or abusing its dominant position.

Summary

29. 35% of the respondents expressed their views on this issue.
30. Most who commented on this issue agreed that the Government should strike a balance between commercial flexibility and the need to prohibit anti-competitive activities of the privatized AA.
31. A few respondents urged the Government not to impose too much restriction on or interfere with the economic activities of the privatized AA.
32. Several respondents suggested that AA should return its land to the Government prior to privatization or that AA be required to pay a premium if it did not use the land for permitted purposes.

Key Issue 6: Impact on Companies and Workers at the Airport

Background

Some members of the airport community and labour organizations expressed concern about the potential adverse impact of the proposed privatization on their companies or the welfare of workers at the airport. They were worried that the privatized AA would become more profit oriented and would exploit the workforce.

At present, AA already has a very lean set-up with only about 900 staff. AA has confirmed that it has no plan to lay off any staff or reduce their benefits as a result of privatization.

As regards employees of airport franchisees and contractors, their employment and benefits should not be affected by the proposed privatization for the reasons stated in the Consultation Document.

Summary

33. 17% of the respondents expressed their views on this issue.

34. In general, the respondents believed that the welfare of the employees and workers at the airport would not be adversely affected due to AA privatization, as the AA was already operating under prudent commercial principles.

35. The labour unions, however, expressed concern that after privatization, the privatized AA would seek commercial benefits at the expense of the employees and workers at the airport. A union specifically requested that labour representative(s) be appointed to the board of directors of the privatized AA.

36. Some respondents emphasized that AA should be privatized only if the benefits and safety of employees and workers at the airport were adequately protected.

Other Comments

37. Apart from the responses to the key issues above, various other comments were received on subjects such as the different ways of privatization, the operation of AA, as well as ways to achieve greater efficiency and higher profits. The salient points raised included -

- the Government should consider other ways of privatizing AA such as sale or long lease of assets;
- to avoid possible legal challenge, the Government should take every step to ensure that the IPO is legally in order;
- the Government should sell more shares and most shares should be sold to Hong Kong citizens;
- the objectives of the privatized AA should include the promotion of Hong Kong's long term interests as an international airport and achieving higher safety and service standards;
- AA should actively look for new sources of income from activities such as slot allocation; and
- the AA should be re-organized to achieve greater efficiency.

Section 6: Conclusion

38. The Consultation Document stimulated varied views on the regulatory and institutional framework pertinent to the proposed partial privatization of AA. The 69 responses covered a broad spectrum of opinion from different sectors of the public.

39. On the key question of whether AA should be privatized, the Government's proposal has yet to obtain the support of the majority of respondents.

40. For those who opposed the proposal, while few were against the concept of privatization per se, a range of concerns and reservations were raised. These included maintaining the competitiveness of HKIA; avoiding a substantial increase in airport charges; safeguarding the welfare of workers at the airport; preventing unfair competition between the privatized AA and other companies, and reserving adequate powers for the Government to ensure that the privatized AA will take account of public interests in its operation.

41. As regards the supporters of privatization, their voices were also very strong. But there were also some concerns about the timing to proceed with the proposal which they believed would need to be carefully considered.

42. The Government agrees that the above are very valid concerns and they should be fully addressed before AA is privatized. Detailed proposals will be drawn up and stakeholders will be further consulted as the privatization exercise continues.

43. Last but not the least, we are grateful for the efforts that have been made by various organizations and individuals in preparing their comments and expressing their views on the Consultation Document.

**Economic Development and Labour Bureau
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