

LEGISLATIVE COUNCIL BRIEF

Airport Authority Ordinance
(Chapter 483)

Airport Authority (Amendment) Bill 2004

INTRODUCTION

At the meeting of the Executive Council on 16 March 2004, the Council ADVISED and the Chief Executive ORDERED that -

- (a) the Airport Authority (Amendment) Bill 2004 (the Bill), at Annex A, should be introduced into the Legislative Council to provide a mechanism for the reduction of AA's capital and the return of AA's equity capital to Government in cash or in kind; and
- (b) subject to the passage of the Bill by the Legislative Council, the proposed resolution (the Resolution), at Annex B, should be introduced into the Legislative Council to implement the restructuring of capital and the return of funds to the Government.

JUSTIFICATIONS

Need to Restructure AA's Capital

2. Upon reviewing the financial position of the AA in preparation for its proposed privatisation, Government's financial adviser has observed that the present debt to equity ratio of AA is relatively low when compared with utilities in Hong Kong and selected airports around the world¹. As the cost of debt is typically lower than the cost of equity, a higher level of debt relative to equity (provided that the interest charge does not affect a company's cash flow and hence its default risk) usually leads to a reduction

¹ Debt to equity ratio of those are listed at Annex C.

in a company's overall cost of capital². Government's financial adviser has advised that AA's cost of capital can be reduced through restructuring its capital base by way of raising funds in the debt market to pay down its equity.

3. Subject to the continuation of appropriate support from Government (e.g. a majority Government ownership), AA's financial strength and credit ratings should not be unduly affected by an additional borrowing of around \$6 billion to finance the reduction of its equity capital. After the restructuring, the percentage of debt will increase from around 20% at present to about 33%. The current low interest rate environment provides a good opportunity for AA to restructure its capital.

4. The reduction would be effected by a payment of \$6 billion to Government as AA's sole shareholder.

Benefits of Capital Restructuring

5. Optimising AA's capital structure would help to ensure that an optimal value is achievable upon privatisation. As an organisation operating on prudent commercial principles, AA should, as far as it could, invest in projects with projected returns above its cost of capital. Lowering AA's cost of capital would in turn expand the investment opportunities available to AA due to a potentially lower required minimum return.

6. The capital restructuring will also bring an additional one-off capital revenue of about \$6 billion to Government.

Need to Amend the Airport Authority Ordinance (Chapter 483)

7. The Airport Authority Ordinance (the Ordinance) does not currently provide for a reduction in the capital of AA or the return of capital to Government. Section 23(1) of the Ordinance stipulates that the capital of AA is \$36,648 million. Section 23(2) provides for the increase of the

² The cost of capital of a company is the weighted average cost of its cost of equity and cost of debt, commonly referred to as the Weighted Average Cost of Capital (WACC).

capital of AA. Pursuant to section 23(3), AA has issued 366,480 shares of \$100,000 each to the Government. Section 23(5) prohibits AA from issuing shares otherwise than to the Government.

Treatment of the Returned Capital on Government's Account

8. We propose to credit any cash payment received as a result of the capital restructuring to the Capital Investment Fund (CIF). Dividends received from AA will continue to be credited to the General Revenue. As any repayment of capital by the AA represents a return of our investment originally funded by CIF over the years, crediting the repayment amount back to CIF will distinguish it from the usual payment of dividends arising from AA's operation.

OTHER OPTIONS

9. The proposed capital restructuring cannot be achieved by any non-legislative route.

THE BILL

10. The purpose of the Bill is to amend the Ordinance to provide for a reduction of the capital of AA.

11. Clause (2) of the Bill provides for the reduction of AA's capital by means of a resolution of the Legislative Council made on the recommendation of the Financial Secretary after consulting AA. Such a resolution may also specify that the capital so reduced be returned to the Government, and that shares issued by AA to the value of the capital returned be cancelled.

THE RESOLUTION

12. The purpose of the Resolution is to effect a reduction of \$6

billion in the capital of AA and to require AA to distribute an amount equivalent to the reduction to Government. Payment received by Government would be credited to the CIF. The Resolution will also effect the cancellation of shares in the AA held by the Government to an equivalent value. The Resolution will be suitably amended to tie-in with any changes to the Bill as approved by the Legislative Council.

LEGISLATIVE TIMETABLE

13. Subject to Members' approval of the introduction of the Bill into the Legislative Council, the legislative timetable will be –

Publication in the Gazette	19 March 2004
First Reading and commencement of Second Reading debate	24 March 2004
Resumption of Second Reading debate, committee stage and Third Reading	To be notified

14. The Resolution will be introduced into the Legislative Council after the Bill is enacted.

IMPLICATIONS OF THE PROPOSAL

15. The proposed capital restructuring is expected to bring in one-off capital revenue of \$6 billion in 2004-05. AA has yet to declare any dividend and the \$6 billion reduction in capital on its own will not affect Government's entitlement to future dividend.

16. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. It has no economic, environmental or sustainability implications. It also has no impact on the civil service system.

PUBLIC CONSULTATION

17. We have consulted the Legislative Council Panel on Economic Services on 23 February 2004 and 2 March 2004 on the present proposal and have received their general support.

PUBLICITY

18. We will issue a press release. A spokesman will also be available to answer any enquiries.

BACKGROUND

19. AA is a statutory corporation established under the Ordinance to provide, operate, develop and maintain an airport for civil aviation at and in the vicinity of Chek Lap Kok (known as Hong Kong International Airport), and also to carry out airport-related activities as permitted by the Chief Executive by order in the Gazette. The AA is currently wholly-owned by the Government with a share capital of \$36,648 million as at the end of the financial year on 31 March 2003.

20. The Financial Secretary announced on 6 August 2003 that we would commence work immediately in preparation for the proposed privatisation of AA. Government has indicated that its plan is to introduce the required legislation into the Legislative Council in the first half of 2004.

21. When preparing for the privatisation and after initial discussion with various stakeholders including the AA management, Government has come to the view that the issues involved merit more time to resolve and further consultation with the stakeholders are necessary. Our plan is to introduce the privatisation bill into the Legislative Council around the end of 2004. The privatisation will be implemented after enactment of the Bill.

22. Relevant financial data of AA are set out at Annex D.

OTHERS

23. In case of enquiries about this Brief, please contact Mr Tommy Yuen, Principal Assistant Secretary for Financial Services and the Treasury (Treasury) at 2810 3743.

**The Treasury Branch
Financial Services and the Treasury Bureau
March 2004**

A BILL

To

Amend the Airport Authority Ordinance to provide for a reduction of the capital of the Airport Authority established under that Ordinance, and for related matters.

Enacted by the Legislative Council.

1. Short title

This Ordinance may be cited as the Airport Authority (Amendment) Ordinance 2004.

2. Capital of Authority

(1) Section 23(1) of the Airport Authority Ordinance (Cap. 483) is amended by adding "initial authorized share" before "capital".

(2) Section 23 is amended by adding –

"(6) The Legislative Council may, on the recommendation of the Financial Secretary made after he has consulted the Authority, by resolution provide for a reduction of the capital of the Authority in any way to an amount specified in the resolution.

(7) A resolution made under subsection (6) may provide for matters ancillary to the matter specified in that subsection and, without limiting the generality of the foregoing, may provide –

(a) for the distribution to the Government of the amount by which the capital is so reduced, and for the form and manner in which that distribution shall be effected;

- (b) where a distribution mentioned in paragraph (a) is in the form of non-cash assets, for the substitution of the Government for the Authority in any contract relating to such assets;
- (c) for the manner in which any amount received by the Government by way of a distribution mentioned in paragraph (a) shall be accounted for in the books of the Government; and
- (d) for the cancellation of any shares issued under this section."

Explanatory Memorandum

The purpose of this Bill is to amend the Airport Authority Ordinance (Cap. 483) to enable the capital of the Airport Authority established under that Ordinance to be reduced.

AIRPORT AUTHORITY ORDINANCE

RESOLUTION OF THE LEGISLATIVE COUNCIL

Resolution made and passed by the Legislative Council under section 23(6) of the Airport Authority Ordinance (Cap. 483) on 2004.

RESOLVED that –

- (a) the authorized share capital of the Airport Authority referred to in section 23(1) of the Airport Authority Ordinance (Cap. 483) be reduced by an amount of \$6,000 million to \$30,648 million;
- (b) the Airport Authority shall distribute to the Government in cash an amount of \$6,000 million, such amount in the hands of the Government to be credited to the Capital Investment Fund established by resolution made and passed by the Legislative Council on 14 March 1990 under section 29 of the Public Finance Ordinance (Cap. 2); and
- (c) with effect from the date of receipt by the Government of the distribution referred to in paragraph (b), shares previously issued at par by the Airport Authority in accordance with section 23(3)(a) of the Airport Authority Ordinance (Cap. 483) and representing at the time of such issue a value of \$6,000 million in total be cancelled.

Clerk to the Legislative Council

2004

Explanatory Note

This Resolution provides for a reduction in the authorized share capital of the Airport Authority established under section 3(1) of the Airport Authority Ordinance (Cap. 483) by an amount of \$6,000 million, for the distribution of that amount to the Government of the Hong Kong Special Administrative Region, to be credited to the Capital Investment Fund, and for the cancellation of shares in the Airport Authority held by the Government to a similar value.

AIRPORT AUTHORITY ORDINANCE

RESOLUTION

(Under section 23(6) of the Airport Authority Ordinance (Cap. 483))

RESOLVED that –

- (a) the authorized share capital of the Airport Authority referred to in section 23(1) of the Airport Authority Ordinance (Cap. 483) be reduced by an amount of \$6,000 million to \$30,648 million;
- (b) the Airport Authority shall distribute to the Government in cash an amount of \$6,000 million, such amount in the hands of the Government to be credited to the Capital Investment Fund established by resolution made and passed by the Legislative Council on 14 March 1990 under section 29 of the Public Finance Ordinance (Cap. 2); and
- (c) with effect from the date of receipt by the Government of the distribution referred to in paragraph (b), shares previously issued at par by the Airport Authority in accordance with section 23(3)(a) of the Airport Authority Ordinance (Cap. 483) and representing at the time of such issue a value of \$6,000 million in total be cancelled.

Debt to Equity Ratio of Selected Airports

Airport / Airport Corporation	Debt to Equity Ratio
Auckland, New Zealand	106%
BAA, United Kingdom	40%
Copenhagen, Denmark	127%
Fraport, Germany	16%

Hong Kong market comparable

CLP Holdings Limited	24%
Hongkong Electric Holdings Limited	44%
MTR Corporation Limited	56%

Note:

Debt to equity ratios are derived from latest published year-end figures of respective organisations/ airports. For calculation purpose, debt is net of cash.

Annex D

Relevant Financial Data for 2001, 2002 and 2003

(\$, million)	2001	2002	2003
Authorised capital as prescribed in section 23 of Cap. 483 that is fully paid and allotted	36,648	36,648	36,648
Retained Losses as at 1 April (beginning of financial year)	(556)	(485)	(172) ²
Net Profit	71	236	502
Retained Earnings/ (Losses) as at 31 March (end of financial year)	(485)	(249)	330
Capital and Reserves ¹	36,163	36,399	36,978

Numbers in brackets are negative figures.

1. “Capital and Reserves” include share capital and reserves comprising retained earnings/ losses.
2. Restated due to change in accounting policy (against closing balance of “(249)” as at 31.3.2002.)

Net Profit / (Loss) since the Opening of the Hong Kong International Airport in 1998

(\$, million)	1999	2000	2001	2002	2003
Net Profit/ (Losses)	(388)	(168)	71	236	502

Source: AA Annual Reports