

立法會
Legislative Council

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Panel on Economic Services

**Minutes of special meeting held on
Tuesday, 2 March 2004, at 8:30 am
in Conference Room A of the Legislative Council Building**

Members present : Hon James TIEN Pei-chun, GBS, JP (Chairman)
Dr Hon LUI Ming-wah, JP (Deputy Chairman)
Hon Kenneth TING Woo-shou, JP
Hon Fred LI Wah-ming, JP
Hon Mrs Selina CHOW LIANG Shuk-yee, GBS, JP
Hon CHEUNG Man-kwong
Hon HUI Cheung-ching, JP
Hon CHAN Kam-lam, JP
Hon SIN Chung-kai
Dr Hon Philip WONG Yu-hong, GBS
Hon Howard YOUNG, SBS, JP
Hon LAU Chin-shek, JP
Hon Miriam LAU Kin-yee, JP
Hon Abraham SHEK Lai-him, JP
Hon LI Fung-ying, JP
Hon Henry WU King-cheong, BBS, JP
Hon LEUNG Fu-wah, MH, JP

Non-Panel Member : Hon Emily LAU Wai-hing, JP
attending

Members absent : Dr Hon Eric LI Ka-cheung, GBS, JP
Dr Hon David LI Kwok-po, GBS, JP
Hon CHOY So-yuk

Public Officers attending : Mr Stephen IP
Secretary for Economic Development and Labour

Ms Sandra LEE
Permanent Secretary for Economic Development and Labour (Economic Development)

Mr Howard LEE
Principal Assistant Secretary for Economic Development and Labour (Economic Development)

Mr Martin GLASS
Deputy Secretary for Financial Services and the Treasury (Treasury)

Attendance by invitation : **UBS Investment Bank**

Ms Melanie GEE
Managing Director

Ms Mary LEUNG
Director

Clerk in attendance : Mr Andy LAU
Chief Council Secretary (1)2

Staff in attendance : Ms Debbie YAU
Senior Council Secretary (1)1

Miss Winnie CHENG
Legislative Assistant 5

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- I Privatization of the Airport Authority**
- (LC Paper No. CB(1)1154/03-04(01) - Information paper provided by the Administration
 - LC Paper No. CB(1)1017/03-04(05) - Information paper provided by the Administration
 - LC Paper No. CB(1)1153/03-04 - Background brief on "Privatization of the Airport Authority" prepared by the Secretariat)

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In response to members' questions raised at the meeting on 23 February 2004, members noted that the Administration had provided a written response vide LC Paper No. CB(1) 1154/03-04(01).

2. The Secretary for Economic Development and Labour (SEDL) briefed members that the Administration was mindful of the concerns over certain issues relating to the proposed privatization of Airport Authority (AA), and therefore had decided to take more time to further consult stakeholders before putting a privatization bill to the Legislative Council. In the meantime, the Administration intended to restructure the capital of AA in order to lower its overall costs of capital. The proposed capital restructuring did not in anyway affect the ownership or corporate structure of AA. It did not preempt the arrangements for privatization, and indeed the decision on whether and when AA should be privatized. AA as a statutory corporation would still benefit from a lowering of its overall cost of capital. The Administration proposed to restructure AA's capital as soon as possible so that AA could take advantage of the current low interest environment to raise debt financing.

Labour issues

3. Noting that the Administration and AA were exploring the introduction of a reward and penalty system to link the actual service standards of AA to the level of airport charges to encourage good performance, Ms LI Fung-ying sought details on how the system could help prevent AA from maximizing its own profits at the expense of the benefits of employees and service standards. She requested the Administration to undertake that the working conditions, remuneration and benefits of staff working on the airport island would be maintained after privatization.

4. Referring to the worries expressed by members and the staff side, Ms Emily LAU pointed out that the Administration and AA should conduct proper consultation before going ahead with the privatization of AA. She also enquired about the operation of the proposed reward and penalty system and how it could help maintaining benefits of employees at the airport whilst encouraging good performance.

5. Mr CHEUNG Man-kwong also expressed concern about the impact of the privatization on staff working on the airport island.

6. The Principal Assistant Secretary for Economic Development and Labour (Economic Development) (PAS/EDL(ED)) remarked that the Administration and AA would work out the performance levels required of AA, having regard to the need to ensure that AA would maintain a high standard of service after privatization. The introduction of a reward and penalty system to link the actual service standards of AA to the level of airport charges would therefore encourage AA to retain quality staff so as to maintain good performance.

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7. SEDL added that AA would continue to attach great importance to maintaining harmonious employee relations at the airport. With the introduction of a reward and penalty system to link the actual service standards of AA to the level of airport charges to encourage good performance, AA would have great incentive to retain their staff and continue to provide a high standard service to airport users.

8. Mr LAU Chin-shek echoed the concern raised by Ms LI Fung-ying that employees working on airport island were worried that their benefits would be unduly affected after privatization of AA. Mr LAU requested the Administration to consider appointing representatives of the staff side to the future AA Board. In deciding whether or not the proposed privatization of AA should go ahead, the views of the staff side should take precedence over other factors. Mr LAU also said that the Administration should consider introducing legislation to ensure that the rights and benefits of employees working on the airport island would not be unduly affected as a result of the privatization of AA.

9. Mr LEUNG Fu-wah said that the level of wages of staff working on the airport island was already very low, he was worried that the situation would worsen after privatization. Given that employees of the airport franchisees and contractors were suffering from low wages because AA used the bidding price as the determining factor in contracting out its services, he was also concerned that this would affect the operation of the airport as well as its overall quality and standards of service.

10. The Permanent Secretary for Economic Development and Labour (Economic Development) (PS/EDL(ED)) said that the Administration appreciated the anxiety of staff working at the airport. In fact, AA had briefed its employees and the airport community on its privatization through various channels. It would continue to maintain effective communication and a dialogue with its staff and stakeholders. SEDL added that the Administration was equally concerned about the welfare and benefits of employees working on the airport island. This explained why the Administration proposed to take more time to further consult stakeholders before putting a privatization bill to the Legislative Council. The Administration and AA would engage the staff side in taking forward the privatization exercise. In fact, after privatization, issues relating to employment of labour would continue to be governed by relevant legislation that safeguarded the interests of all employees.

11. Regarding the appointment of a representative of the staff side to the future AA Board, PAS/EDL(ED) said that the Administration would further study the matter when taking the privatization exercise forward.

12. Regarding employees of airport franchisees and contractors, Mr HUI Cheung-ching and Mr LEUNG Fu-wah enquired whether their employment and

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benefits would be affected by the proposed privatization of AA. PS/EDL(ED) replied that as a general principle, whenever AA sought bids from the market for provision of services at the airport, the bidders' experience and service quality were the determining factors instead of pricing alone. Airport franchisees and contractors determined the wages and staffing level to ensure that the prescribed service standards were met. This mode of operation would not change as a result of privatization. After all, AA was already operating under prudent commercial principles now and the Administration did not envisage any major changes upon privatization.

13. Mr LEUNG Fu-wah was not convinced of the Administration's reply. He highlighted the difficulties faced by the working force on the airport island, particularly the low income group whereby they needed to pay a higher transportation cost with longer travelling time and lower salary as compared to the past operating environment in urban Kai Tak. He asked the Administration to conduct a study on the level of wages at the airport before and after the relocation of the airport.

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14. With regard to the pay survey as suggested by Mr LEUNG, SEDL said that as it involved substantial resources, the Administration would examine what kind of information could be made available to the Panel.

15. The Chairman suggested that representatives from AA should be invited to brief members at a Panel meeting after it had consulted the employees working on airport island on issues relating to AA privatization.

Economic regulation

16. Mr. Abraham SHEK pointed out that upon privatization, AA would focus on maximizing return to its shareholders and operate purely on the basis of commercial principles which, in turn, might not always be in the best interest of the general public and Hong Kong as a whole. He remarked that a high landing fee would drive away airlines to the nearby airports and affect the economy of Hong Kong.

17. Mr Howard YOUNG said that airlines were concerned whether there were permissible return for AA and a set of regulated activities after privatization, as these parameters would determine the level of airport charges which, in turn, would affect the competitiveness of the airport and general economy of Hong Kong.

18. SEDL said that AA was already operating in accordance with prudent commercial principles. Indeed, Government's objective was to maintain the competitiveness of the Hong Kong International Airport and ensure that Hong Kong's status as a centre for international and regional aviation could be maintained. The Administration would not accept any unreasonable increase in airport charges purely for the sake of maximizing returns to AA's shareholders. The

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Administration was discussing with AA and airlines on the proposed regulatory arrangement for airport charges after privatization. The Administration would try to incorporate appropriate features in the price regulatory mechanism to help monitor the performance of the airport to ensure high service standards and efficiency. SEDL assured members that Hong Kong's overall interests would always be at the forefront when formulating the regulatory mechanism.

19. In response to the Chairman, SEDL also said that one option that could be considered was for the Administration to set up an independent adjudication body should airlines and AA failed to agree on certain aeronautic charges.

Abuse of monopolistic power

20. Members noted that the airport island covered some 1 200 hectares and was granted to AA in 1995 before the airport opened. Whilst the Government had injected a total of about \$36 billion into the AA, the cost of land formation which was in the region of about \$10 billion was paid by AA. Mr Fred LI remarked that the cost of land formation did not reflect the true value of the land granted to AA, and hence, the interest of the general public might not be adequately protected if the land not already earmarked for airport operational and support facilities was kept by AA after privatization.

21. Although 90% of the 1 200 hectares of land owned by AA on the airport island had already been designated for the provision of airport operational facilities and airport support facilities, Mr Abraham SHEK was worried that AA might abuse its dominant position and engage in property development in the remaining land.

22. On land use at the airport, PAS/EDL(ED) said that the existing land grant to AA contained stringent controls over land use on the airport island. Only airport operational, airport support, and airport related developments were permitted. Although AA could develop airport related facilities in the remaining land, it had to satisfy the Director of Lands that the development was in full compliance with the Master Layout Plan for the airport and obtain his approval for the relevant building plans. The Administration intended to maintain the stringent controls under the land grant after privatization. These controls would ensure that AA would continue to focus on its core business of operating and developing the Hong Kong International Airport.

23. Mr Abraham SHEK was not convinced of the Administration's reply. As AA was not established for the purpose of property development, he opined that the Government should take back the land on the airport island not already earmarked for airport operational and support facilities before privatizing AA. Mr Fred LI echoed the view that the remaining land should be taken back for tender out. Mr CHEUNG Man-kwong shared similar view as he was worried that AA might abuse its dominant position to engage in other non airport-related activities, bearing in mind AA was a natural monopoly, and such monopolistic characteristics also

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extended to other related businesses such as logistics and transport, etc.

24. Dr LUI Ming-wah also said that as the core business of AA was not related to property development, he queried why the land on the airport island not already earmarked for airport operational and support facilities should be kept by AA after privatization.

25. The Chairman remarked that as property development on the airport island might give rise to a significant volume of private sector housing supply, there was a need for the Administration to address the issue.

26. SEDL responded that the Administration was aware of members' concerns. He however said that as the land was already granted to AA, it could not be easily taken back without sound justification. The Administration could consider defining clearly the scope of activities that could be undertaken by AA and revert back to the Panel.

Scope of AA's business and competition

27. Mr Fred LI and Mr CHEUNG Man-kwong were concerned about the scope of businesses which AA would be allowed to conduct both on and outside the airport island. Mr Fred LI pointed out that as AA was a natural monopoly, there was no competition at all in the airport sector. The situation was therefore quite different from the telecommunications and broadcasting industries where there was some albeit limited competition. In view of this difference, he asked what other legislation would the Administration make reference to in drawing up the competition-related provisions in the privatization bill apart from the Telecommunications Ordinance (Cap. 106) and Broadcasting Ordinance (Cap. 562). He also asked the Administration to provide information on the scope of intended regulated and non-regulated activities after privatization with detailed justifications for their classification.

28. The Chairman also said that as AA was a natural monopoly, there was concern that AA might make use of its dominant position to engage in other related businesses such as logistics and transport, etc.

29. PS/EDL(ED) said that the Administration intended to maintain the controls under the land grant after privatization. These controls would ensure that AA would continue to focus on its core business of operating and developing the Hong Kong International Airport. For other types of business activities such as logistics and transport, it had been the current practice of AA to engage other business partners to provide the related services. Regarding the scope of regulated and non-regulated activities, the Administration was still discussing with the stakeholders. The Administration would provide further information to the Panel when available.

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30. Expressing support for the introduction of a general competition law, Ms Emily LAU sought the Administration's stance on how to prevent AA from abusing its dominant position at the airport island. She also enquired whether there were any complaints against AA abusing its dominant position at the airport island.

31. PAS(EDL)/ED replied that he was not aware of any complaints related to AA engaging in anti-competitive activities or abusing its dominant position, although some airport operators had claimed that AA had applied very stringent rules in management of the apron. PS/EDL(ED) supplemented that the Competition Policy Advisory Group had never received complaint against AA for engaging in anti-competitive activities. Regarding competition law, SEDL replied that the Administration was in support of fair competition. However, the issue at stake was more on the mechanism to prohibit AA from engaging in anti-competitive activities and abuse of its dominant position. The Administration would consider introducing statutory prohibitions against anti-competitive activities and abuse of dominant position by AA to address potential public concerns. Meanwhile, the Administration would incorporate appropriate features in the price regulatory mechanism to help monitor the performance of the airport to ensure high service standards and efficiency at the airport.

Air cargoes fees

32. In order to enhance the competitiveness of the airport, Mr Kenneth TING urged the Administration to introduce measures to lower the charges for freighter service. There was a need to increase the transparency in price setting. In order to capture the growing business out of Southern China, there was a need for the Administration to continue to work on initiatives to streamline the custom clearance procedures across the border.

33. PS/EDL(ED) replied that charges for freighter service was a matter for the private sector to decide. However, the Administration would encourage the trade to increase transparency in price setting. Regarding measures to develop a one-stop customs cargo clearance for air and land transport modes, the Administration would continue to work on it.

Justifications for privatizing AA

34. Dr LUI Ming-wah enquired about the justifications for privatizing AA. Unlike other airports in the world, the Hong Kong International Airport was already a very efficient airport. PAS/EDL(ED) said that the partial privatization of AA could offer an opportunity for Hong Kong people to participate in the success of a well-managed company with strong growth potential. Upon privatization, the AA Board could further strengthen its market discipline in the running of the airport for greater efficiency and more commercial opportunities.

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35. Regarding the conflicting interest between shareholders and the general public at large, SEDL said that AA would have to explain how it had taken into account some qualitative factors such as competitiveness of the airport or general economy of Hong Kong before implementing any adjustment to airport charges. A price cap mechanism would also be in place to ensure that the interests of all stakeholders would be taken into account.

36. On future monitoring, PS/EDL(ED) said that upon privatization, the Government would appoint a minority number of members to the Board of AA to represent Government's interests, on top of any rights Government might have as a shareholder. The Security Bureau and the Civil Aviation Department would continue to monitor the performance of AA to ensure the safety and security of the airport.

Options for privatization

37. Mr CHAN Kam-lam enquired about the pros and cons of different options for privatization.

38. The Deputy Secretary for Financial Services and the Treasury (Treasury) (DS/FST(T)) said that following the MTRC precedent, a logical arrangement for privatizing AA was through initial public offering (IPO) followed by a listing on the Hong Kong Stock Exchange. To ascertain whether this was the best choice for AA, the Government's financial advisors had analyzed several other options for privatizing AA, including sale to strategic investors, securitization, issue of exchangeable bond and sale to the Exchange Fund. Generally speaking, all of these options had the drawback of not conferring ownership of the airport on members of the public, hence did not build on the Government's privatization efforts.

39. Mr CHAN Kam-lam said that in order to offer an opportunity for Hong Kong people to participate in the success of a well-managed company, the Administration should increase the proportion of initial offer shares under the Hong Kong Public Offering vis-à-vis the International Public Offering.

40. On the question of amount of shares to be issued to small investors in Hong Kong and to international investors, DS/FST(T) referred to the case of MTRC where about 25% of its shares were held by people of Hong Kong at the time of IPO and it would broadly be the case of AA too. He explained that during the IPO of MTRC, the numbers of shares in international and domestic retail tranche were broadly level. According to the mechanism, in case there was a strong demand from the domestic retail side, some of the shares in the international tranche could be allocated to the domestic tranche to meet the demand. The privatization of AA would more or less follow this model.

41. Mr Henry WU requested the Administration to provide further information on the privatization experience elsewhere, including the contributing factors for

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growth in EBITDA (earnings before interest, tax, depreciation and amortization), land use arrangements, dividend rate, profit/earning ratio, operating profit after tax, and target investors at the time of initial public offer in respect of the relevant airports.

42. Mr LAU Chin-shek asked the Administration to provide further information on whether it was possible to remove the compensation clause in the Government's power to give directions to AA in the public interest.

43. Mr CHAN Kam-lam also asked about the detailed analysis on the pros and cons of various privatization options and capital restructuring proposals.

44. The Administration took note of members' concern and undertook to provide further information as appropriate.

45. Mr LEUNG Fu-wah suggested that the Panel should consider inviting the interested parties to give views on the proposed privatization of AA. Members agreed to defer the decision to a later meeting.

II Any other business

46. There being no other business, the meeting ended at 10:10 am.

Council Business Division 1
Legislative Council Secretariat
3 May 2004